

SECURITIES & EXCHANGE COMMISSION EDGAR FILING

Rekor Systems, Inc.

Form: 10-Q

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-38338

Rekor Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation
or organization)

81-5266334
(I.R.S. Employer Identification No.)

14420 Albemarle Point Place, Suite 200
Chantilly, VA
(Address principal executive offices)

20151
(Zip Code)

(703) 953-3838
(Registrant's telephone number, including area code)

Novume Solutions, Inc.
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.0001 par value per share	REKR	The Nasdaq Stock Market

As of May 9, 2019, the Registrant had 19,367,619 shares of common stock, \$0.0001 par value per share outstanding.

SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (the "Quarterly Report") contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve substantial risks and uncertainties. All statements other than statements of historical facts contained in this Quarterly Report, including statements regarding our future results of operations and financial position, business strategy, prospective products and services, timing and likelihood of success, plans and objectives of management for future operations, and future results of current and anticipated products and services, are forward-looking statements. These statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expect," "plan," "anticipate," "could," "intend," "target," "project," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar expressions. These forward-looking statements speak only as of the date of this Quarterly Report and are subject to a number of risks, uncertainties and assumptions described under the sections in our Annual Report on Form 10-K for the year ended December 31, 2018 entitled "Risk Factors" and elsewhere in this Quarterly Report. Because forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified and some of which are beyond our control, you should not rely on these forward-looking statements as predictions of future events. We undertake no obligation to update any forward-looking statement as a result of new information, future events or otherwise.

Rekor Systems, Inc. and Subsidiaries
Form 10-Q
For the Quarterly Period Ended March 31, 2019

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Rekor Systems, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)

	March 31, 2019	December 31, 2018
Assets		
Current Assets		
Cash and cash equivalents	\$ 5,051,931	\$ 2,767,183
Accounts receivable, net	6,923,625	5,264,949
Inventory	120,191	72,702
Related party receivable from acquisition	254,340	-
Other current assets, net	549,709	425,530
Total current assets	<u>12,899,796</u>	<u>8,530,364</u>
Property and Equipment		
Capitalized software	1,108,157	913,455
Furniture and fixtures	302,243	302,243
Office equipment	549,732	544,533
Camera systems	682,906	553,758
Vehicles	36,020	36,020
Leasehold improvements	95,422	95,422
Total fixed assets	<u>2,774,480</u>	<u>2,445,431</u>
Less: accumulated depreciation	<u>(1,049,298)</u>	<u>(978,150)</u>
Net property and equipment	1,725,182	1,467,281
Right-of-use lease assets, net	857,624	-
Goodwill	3,092,616	3,092,616
Intangibles, net	16,309,652	4,834,503
Other Assets		
Deposits and other long-term assets	60,537	130,485
Total other assets	<u>60,537</u>	<u>130,485</u>
Total assets	<u>\$ 34,945,407</u>	<u>\$ 18,055,249</u>
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	\$ 1,930,959	\$ 1,593,726
Accrued expenses	3,030,296	2,643,027
Lines of credit	2,414,649	1,661,212
Notes payable, current portion	34,051	2,469,211
Lease liability, short term	201,918	-
Deferred revenue	505,902	207,059
Total current liabilities	<u>8,117,775</u>	<u>8,574,235</u>
Long-Term Liabilities		
Notes payable	19,424,951	964,733
Lease liability, long term	717,681	-
Deferred rent	1,906	8,475
Total long-term liabilities	<u>20,144,538</u>	<u>973,208</u>
Total liabilities	<u>28,262,313</u>	<u>9,547,443</u>
Series A Cumulative Convertible Redeemable Preferred stock, \$0.0001 par value, 505,000 shares authorized and 502,327 shares issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	<u>5,230,184</u>	<u>5,051,683</u>
Stockholders' Equity		
Common stock, \$0.0001 par value, 30,000,000 shares authorized, 19,367,619 and 18,767,619 shares issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	1,937	1,877
Preferred stock, \$0.0001 par value, 2,000,000 authorized, 505,000 shares designated as Series A and 240,861 shares designated as Series B as of March 31, 2019 and December 31, 2018, respectively	-	-
Series B Cumulative Convertible Preferred stock, \$0.0001 par value, 240,861 shares authorized, issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	24	24
Additional paid-in capital	16,504,847	15,518,013
Accumulated deficit	<u>(15,053,898)</u>	<u>(12,063,791)</u>
Total stockholders' equity	<u>1,452,910</u>	<u>3,456,123</u>
Total liabilities and stockholders' equity	<u>\$ 34,945,407</u>	<u>\$ 18,055,249</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Rekor Systems, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)

	For the Three Months Ended March 31,	
	2019	2018
Revenue	\$ 11,626,221	\$ 11,218,769
Cost of revenue	8,522,555	8,134,036
Gross profit	3,103,666	3,084,733
Operating expenses		
Selling, general, and administrative expenses	4,569,764	5,280,950
Loss from operations	(1,466,098)	(2,196,216)
Other expense		
Loss on extinguishment of debt	(1,112,609)	-
Interest expense	(287,772)	(92,950)
Other income (expense)	3,041	95,322
Total other expense	(1,397,340)	2,372
Loss before income taxes	(2,863,438)	(2,193,844)
(Provision) benefit from income taxes	(11,761)	-
Net loss	\$ (2,875,199)	\$ (2,193,844)
Loss per common share - basic	\$ (0.17)	\$ (0.17)
Loss per common share - diluted	\$ (0.17)	\$ (0.17)
Weighted average shares outstanding		
Basic	18,800,496	14,496,697
Diluted	18,800,496	14,496,697

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Rekor Systems, Inc. and Subsidiaries
Condensed Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

	Shares of Common Stock	Common Stock	Shares of Series B Preferred Stock	Series B Preferred Stock	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance as of December 31, 2017	14,463,364	\$ 1,447	240,861	\$ 24	\$12,342,527	\$ (5,833,660)	\$ 6,510,338
Adjustment to adopt new revenue recognition accounting guidance (1)	-	-	-	-	-	(67,000)	(67,000)
Balance as of January 1, 2018	14,463,364	1,447	240,861	24	12,342,527	(5,900,660)	6,443,338
Stock-based compensation	-	-	-	-	112,455	-	112,455
Issuance of warrants	-	-	-	-	123,472	-	123,472
Common stock issued in Secure Education Consultants acquisition	33,333	3	-	-	163,329	-	163,332
Preferred stock dividends	-	-	-	-	-	(114,908)	(114,908)
Accretion of Series A preferred stock	-	-	-	-	(155,343)	-	(155,343)
Net loss	-	-	-	-	-	(2,193,844)	(2,193,844)
Balance as of March 31, 2018	<u>14,496,697</u>	<u>\$ 1,450</u>	<u>240,861</u>	<u>\$ 24</u>	<u>\$12,586,440</u>	<u>\$ (8,209,412)</u>	<u>\$ 4,378,502</u>

(1) See Note 2 for additional information

	Shares of Common Stock	Common Stock	Shares of Series B Preferred Stock	Series B Preferred Stock	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance as of December 31, 2018	18,767,619	\$ 1,877	240,861	\$ 24	\$15,518,013	\$12,063,791)	\$ 3,456,123
Stock-based compensation	-	-	-	-	62,852	-	62,852
Issuance of warrants in conjunction with notes payable	-	-	-	-	705,943	-	705,943
Common stock issued in OpenALPR Technology acquisition	600,000	60	-	-	396,540	-	396,600
Preferred stock dividends	-	-	-	-	-	(114,908)	(114,908)
Accretion of Series A preferred stock	-	-	-	-	(178,501)	-	(178,501)
Net loss	-	-	-	-	-	(2,875,199)	(2,875,199)
Balance as of March 31, 2019	<u>19,367,619</u>	<u>\$ 1,937</u>	<u>240,861</u>	<u>\$ 24</u>	<u>\$16,504,847</u>	<u>\$15,053,898)</u>	<u>\$ 1,452,910</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Rekor Systems, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)

	For the Three Months Ended	
	March 31,	
	2019	2018
Cash Flows from Operating Activities		
Net loss	\$ (2,875,199)	\$ (2,193,844)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	71,148	82,039
Amortization of right-of-use lease asset	63,326	-
Share-based compensation	62,852	112,455
Amortization of financing costs	73,535	-
Amortization of warrant feature of note payable	18,374	-
Deferred rent	-	(1,889)
Change in fair value of derivative liability	-	(45,754)
Amortization of intangibles	369,924	255,294
Loss on extinguishment of debt	1,112,609	-
Changes in operating assets and liabilities:		
Accounts receivable	(1,008,254)	1,011,186
Inventory	(47,489)	11,357
Deposits	69,948	(23,600)
Other current assets	(110,755)	142,028
Accounts payable	337,233	616,278
Accrued expenses	(9,294)	516,510
Deferred revenue	(88,756)	(26,810)
Lease liability and deferred rent	(7,920)	-
Net cash (used in) provided by operating activities	<u>(1,968,718)</u>	<u>455,250</u>
Cash Flows from Investing Activities		
Proceeds from sale of note receivable	-	1,475,000
Capital expenditures	(308,107)	(66,003)
Net cash (used in) provided by investing activities	<u>(308,107)</u>	<u>1,408,997</u>
Cash Flows from Financing Activities		
Proceeds from short-term borrowings	753,437	-
Repayments of short-term borrowings	(30,266)	(1,522,162)
Net proceeds from notes payable	3,838,402	-
Payment of preferred dividends	-	(114,908)
Net cash provided by (used in) financing activities	<u>4,561,573</u>	<u>(1,637,070)</u>
Net increase in cash and cash equivalents	2,284,748	227,177
Cash and cash equivalents at beginning of period	2,767,183	1,957,212
Cash and cash equivalents at end of period	<u>\$ 5,051,931</u>	<u>\$ 2,184,389</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Rekor Systems, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND RECAPITALIZATION

Nature of Operations

Rekor Systems, Inc. (the “Company” or “Rekor”), (formerly Novume Solutions, Inc.) was formed in February 2017 to effectuate the mergers of, and become a holding company for KeyStone Solutions, Inc. (“KeyStone”) and Brekford Traffic Safety, Inc. (“Brekford”). For the purposes of this Quarterly Report any references to KeyStone are to KeyStone Solutions, Inc. prior to August 28, 2017 and to KeyStone Solutions, LLC on or after August 28, 2017. On April 26, 2019, the Company changed its name from Novume Solutions, Inc. to Rekor Systems, Inc. For narrative purposes, all references to the Company or Rekor are to Novume Solutions, Inc. prior to April 26, 2019 and to Rekor Systems, Inc. on and after April 26, 2019. On February 28, 2019, the Company changed the name of its wholly owned subsidiary, Brekford Traffic Safety, Inc. to Rekor Recognition Systems, Inc. (“Rekor Recognition”). For narrative purposes, all references to Rekor Recognition before February 28, 2019 are to Brekford Traffic Safety, Inc. and to Rekor Recognition Systems, Inc. on and after February 28, 2019.

In March 2019, Rekor acquired certain assets and certain liabilities of OpenALPR Technology, Inc. (“OpenALPR Technology”) through its subsidiary, OpenALPR Software Solutions, LLC (“OpenALPR”) (see Note 4).

Beginning with the first quarter of 2019, the Company has segmented its services into two operating and reporting groups: the Technology Group; and the Professional Services Group. The following wholly owned subsidiaries are within the Technology Group: Rekor Recognition and OpenALPR. The following wholly owned subsidiaries are within the Professional Services Group: AOC Key Solutions, Inc. (“AOC Key Solutions”); Global Technical Services, Inc. (“GTS”) and Global Contract Professionals, Inc. (“GCP”) (collectively referred to as “Global” or the “Global Entities”); and Firestorm Solutions, LLC and Firestorm Franchising, LLC (collectively referred to as “Firestorm” or “Firestorm Entities”).

For narrative purposes, references to the Company or Rekor include each of its wholly owned subsidiaries. The financial information in this Quarterly Report only includes OpenALPR in the results of operations beginning as of March 12, 2019 (see Note 4).

Technology Group

Rekor Recognition, headquartered in Hanover, Maryland, is a leading public safety technology service provider of fully-integrated artificial intelligence and machine-learning enabled automated license plate recognition (“ALPR”) systems, powered by OpenALPR software to improve the accuracy of license plate reads and to identify the make, model and color of vehicles. Rekor Recognition’s products can be used for law enforcement, security and surveillance, electronic toll collection, parking operations, banking and insurance, logistics, traffic management and customer loyalty. Its solutions include mobile and fixed license plate readers, “Move Over” law enforcement, school bus stop-arm enforcement, red light and speed enforcement, parking enforcement and citation management.

On March 12, 2019, the Company acquired certain assets and assumed certain liabilities of OpenALPR Technology (see Note 4), a software development company. The assets acquired are now held within OpenALPR, headquartered in Hanover, MD. OpenALPR software currently has the capability to analyze video images produced by almost any Internet Protocol camera and to identify vehicle license plates from over 70 countries while also providing the vehicle’s make, model and color.

Professional Services Group

AOC Key Solutions is based in Chantilly, Virginia and provides consulting and technical support services to assist clients seeking U.S. federal government contracts in the technology, telecommunications, defense, and aerospace industries.

Global is headquartered in Fort Worth, Texas, and provides the defense and the aerospace industry with experienced maintenance and modification specialists. Global provides specialized contract personnel, temp-to-hire professionals, direct hires, and temporary or seasonal hires to a diverse group of companies.

Firestorm provides services related to crisis management, crisis communications, emergency response, and business continuity and other emergency, crisis and disaster preparedness initiatives. Its BC Management division is an executive search firm for business continuity, disaster recovery, crisis management and risk management professionals and a provider of business continuity research with annual studies covering compensation assessments, program maturity effectiveness, event impact management reviews, IT resiliency and critical supply analyses. Its Secure Education division is comprised of an expert team of highly trained, former U.S. Secret Service Agents and assists clients by designing customized plans, conducting security assessments, delivering training, and responding to critical incidents.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Rekor, the parent company, and its wholly owned subsidiaries: Rekor Recognition, OpenALPR, AOC Key Solutions, Global and Firestorm. The financial results of OpenALPR are included in the results of operations beginning as of March 12, 2019 (see Note 4).

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and in accordance with the accounting rules under Regulation S-X, as promulgated by the Securities and Exchange Commission (“SEC”). All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

In the opinion of management, all adjustments necessary for a fair presentation for the periods presented have been reflected as required by Regulation S-X, Rule 10-01. All necessary adjustments are of a normal, recurring nature.

Going Concern Assessment

For all annual and interim periods, management will assess going concern uncertainty in the Company's consolidated financial statements to determine whether there is sufficient cash on hand and working capital, including available borrowings on loans and external bank lines of credit, to operate for a period of at least one year from the date the consolidated financial statements are issued or available to be issued, which is referred to as the “look-forward period”, as defined in GAAP. As part of this assessment, based on conditions that are known and reasonably knowable to management, management will consider various scenarios, forecasts, projections, estimates and will make certain key assumptions, including the timing and nature of projected cash expenditures or programs, its ability to delay or curtail expenditures or programs and its ability to raise additional capital, if necessary, among other factors. Based on this assessment, as necessary or applicable, management makes certain assumptions around implementing curtailments or delays in the nature and timing of programs and expenditures to the extent it deems probable those implementations can be achieved and management has the proper authority to execute them within the look-forward period.

The Company has generated losses since its inception in August 2017 and has relied on cash on hand, external bank lines of credit, the sale of a note, debt financing and a public offering of its common stock to support cashflow from operations. The Company attributes losses to merger costs, public company corporate overhead and investments made by some of its subsidiary operations. As of, and for the three months ended March 31, 2019, the Company had working capital of approximately \$4.8 million and a net loss of approximately \$2.9 million. The Company's net cash position was increased by approximately \$4 million in March 2019 by the issuance of \$20 million senior secured notes, of which \$5 million was non-cash, offset by \$7 million of cash paid for the acquisition of OpenALPR Technology, and approximately \$4 million related to the extinguishment of debt and associated fees (see Notes 4 and 8).

Management believes that based on relevant conditions and events that are known and reasonably knowable, its current forecasts and projections, for one year from the date of the filing of the consolidated financial statements in this Quarterly Report on Form 10-Q, indicate the Company's ability to continue operations as a going concern for that one-year period. The Company is actively monitoring its operations, cash on hand and working capital. The Company has contingency plans to reduce or defer expenses and cash outlays should operations weaken in the look-forward period or additional financing, if needed, is not available.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with the maturity of three months or less to be cash equivalents.

Rekor Recognition makes collections on behalf of certain client jurisdictions. Cash balances designated for these client jurisdictions as of March 31, 2019 and December 31, 2018 were \$577,408 and \$608,557, respectively, and correspond to equal amounts of related accounts payable.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are customer obligations due under normal trade terms. The Company performs continuing credit evaluations of its clients' financial condition, and the Company generally does not require collateral.

Management reviews accounts receivable to determine if any receivables will potentially be uncollectible. Factors considered in the determination include, among other factors, number of days an invoice is past due, client historical trends, available credit ratings information, other financial data and the overall economic environment. Collection agencies may also be utilized if management so determines.

The Company records an allowance for doubtful accounts based on specifically identified amounts that are believed to be uncollectible. The Company also considers recording as an additional allowance a certain percentage of aged accounts receivable, based on historical experience and the Company's assessment of the general financial conditions affecting its customer base. If actual collection experience changes, revisions to the allowance may be required. After all reasonable attempts to collect an account receivable have failed, the amount of the receivable is written off against the allowance. Based on the information available, the Company determined that an allowance for loss of \$45,560 and \$24,405 was required as of March 31, 2019 and December 31, 2018, respectively.

Accounts receivable as of March 31, 2019 and December 31, 2018 included \$1,672,178 and \$1,124,705 in unbilled contracts, respectively, related to work performed in the period in which the receivable was recorded. The amounts were billed in the subsequent period.

Inventory

Inventory principally consists of parts held temporarily until installed for service. Inventory is valued at the lower of cost or market value. The cost is determined by the lower of first-in, first-out ("FIFO") method, while market value is determined by replacement cost for components and replacement parts.

Other Current Assets, Net

Other assets are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts, as necessary. Other assets includes a balance due of \$134,818 incurred in connection with a prior financing activity. The balance due remains outstanding as of March 31, 2019 and the Company continues to carry a valuation allowance of \$134,818 as of March 31, 2019.

Property and Equipment

The cost of furniture and fixtures and equipment is depreciated over the useful lives of the related assets. Leasehold improvements are amortized over the shorter of their estimated useful lives or the terms of the lease. Depreciation and amortization is recorded on the straight-line basis.

The range of estimated useful lives used for computing depreciation are as follows:

Furniture and fixtures	2 - 10 years
Office equipment	2 - 5 years
Leasehold improvements	3 - 15 years
Internally-developed software	3 - 5 years
Automobiles	3 - 5 years
Camera systems	3 years

The Company capitalizes eligible costs related to internally-developed software which were incurred during the application development stage, in accordance with ASC 985-20. In accordance with ASC 985-20, capitalized internally-developed software costs, net, not yet placed in service were \$1,108,157 and \$913,455 as of March 31, 2019 and December 31, 2018, respectively. The Company anticipates placing this internally-developed software into service in the second quarter of 2019.

Repairs and maintenance are expensed as incurred. Expenditures for additions, improvements and replacements are capitalized. Depreciation and amortization expense for the three months ended March 31, 2019 and 2018 was \$71,148 and \$82,039, respectively.

Business Combination

Management conducts a valuation analysis on the tangible and intangible assets acquired and liabilities assumed at the acquisition date thereof. During the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the fair value of these tangible and intangible assets acquired and liabilities assumed, with the corresponding offset to goodwill. In addition, uncertain tax positions and tax-related valuation allowances are initially established in connection with a business combination as of the acquisition date. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company's consolidated statements of operations.

Amounts paid for acquisitions are allocated to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The Company allocates a portion of the purchase price to the fair value of identifiable intangible assets. The fair value of identifiable intangible assets is based on detailed valuations that use information and assumptions provided by management. The Company allocates any excess purchase price over the fair value of the net tangible and intangible assets acquired to goodwill.

The Company recorded intangible assets for the acquisitions that occurred in 2018 and 2019. The Secure Education Consultants, Inc. ("Secure Education") and OpenALPR Technology acquisitions were business combinations, which created both book and tax bases in non-goodwill intangible assets. Secure Education's acquisition resulted in \$0.4 million of non-goodwill intangible assets. The acquisition of OpenALPR Technology resulted in \$11.8 million of technology-based intangibles.

Goodwill and Other Intangibles

In applying the acquisition method of accounting, amounts assigned to identifiable assets and liabilities acquired were based on estimated fair values as of the date of acquisition, with the remainder recorded as goodwill. Identifiable intangible assets are initially valued at fair value using generally accepted valuation methods appropriate for the type of intangible asset. Identifiable intangible assets with definite lives are amortized over their estimated useful lives and are reviewed for impairment, if indicators of impairment arise. Intangible assets with indefinite lives are tested for impairment within one year of acquisitions or annually as of October 1, and whenever indicators of impairment exist. The fair value of intangible assets is compared with their carrying values, and an impairment loss would be recognized for the amount by which a carrying amount exceeds its fair value. No impairments have been recorded through March 31, 2019.

Acquired identifiable intangible assets are amortized over the following periods:

Acquired intangible Asset	Amortization Basis	Expected Life (years)
Customer-Related	Straight-line basis	5-15
Marketing-Related	Straight-line basis	4
Technology-Based	In line with underlying cash flows or straight-line basis	3-5

Revenue Recognition

The Company recognizes revenues for the provision of services when persuasive evidence of an arrangement exists, services have been rendered or delivery has occurred, the fee is fixed or determinable and the collectability of the related revenue is reasonably assured. The Company principally derives revenues from fees for services generated on a project-by-project basis. Revenues for time-and-materials contracts are recognized based on the number of hours worked by the employees or consultants at an agreed-upon rate per hour set forth in the Company's contracts or purchase orders. Revenues related to firm-fixed-price contracts are primarily recognized upon completion of the project as these projects are typically short-term in nature. Revenue from the sale of individual franchises is recognized when the contract is signed and collectability is assured, unless the franchisee is required to perform certain training before operations commence. The franchisor has no obligation to the franchisee relating to store development and the franchisee is considered operational at the time the franchise agreement is signed or when required training is completed, if applicable. Royalties from individual franchises are earned based upon the terms in the franchising agreement, which are generally the greater of \$1,000 or 8% of the franchisee's monthly gross sales.

For automated traffic safety enforcement revenue, the Company recognizes revenue when the required collection efforts, from citizens, are completed and posted to the municipality's account. The respective municipality is then billed depending on the terms of the respective contract, typically 15 days after the preceding month while collections are reconciled. For contracts where the Company receives a percentage of collected fines, revenue is calculated based upon the posted payments from citizens multiplied by the Company's contractual percentage. For contracts where the Company receives a specific, fixed monthly fee, regardless of citations issued or collected, revenue is recorded once the amount collected from citizens exceeds the monthly fee per camera. Rekor Recognition's fixed-fee contracts typically have a revenue neutral provision whereby the municipality's payment to Rekor Recognition cannot exceed amounts collected from citizens within a given month. OpenALPR generates revenue through a variety of services and products. Software license revenue is recognized at the time of delivery, while related maintenance service revenue is recognized over the period of performance. Cloud service software license revenue is offered as a fixed quantity over a specified term, for which revenue is recognized ratably.

Advertising

The Company expenses all non-direct-response advertising costs as incurred. Such costs were not material for the three months ended March 31, 2019 and 2018.

Use of Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual amounts may differ from these estimates. On an on-going basis, the Company evaluates its estimates, including those related to collectability of accounts receivable, fair value of debt and equity instruments, and income taxes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not apparent from other sources. Actual results may differ from those estimates under different assumptions or conditions.

Income Taxes

Income tax expense consists of U.S. federal and state income taxes. The Company is required to pay income taxes in certain state jurisdictions. Historically, AOC Key Solutions and GCP initially elected to be taxed under the provisions of Subchapter S of the Internal Revenue Code. Under those provisions, neither AOC Key Solutions nor GCP paid federal corporate income tax, and in most instances state income tax, on its taxable income. AOC Key Solutions revoked its S Corporation election upon the March 15, 2016 merger with KeyStone and GCP revoked its S Corporation election upon the acquisition by the Company, and are therefore, subject to corporate income taxes. Firestorm is a single-member LLC with KeyStone as the sole member.

The Company uses the liability method of accounting for income taxes as set forth in the authoritative guidance for accounting for income taxes. This method requires an asset and liability approach for the recognition of deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Management has evaluated the recoverability of the net deferred income tax assets and the level of the valuation allowance required with respect to such net deferred income tax assets. After considering all available facts, the Company fully reserved for its net deferred tax assets, except for the any deferred tax liability associated with indefinite-lived goodwill or non-goodwill intangibles, because management believes that it is more-likely-than-not that their benefits will not be realized in future periods. The Company will continue to evaluate its net deferred tax assets to determine whether any changes in circumstances could affect the realization of their future benefit. If it is determined in future periods that portions of the Company's net deferred income tax assets satisfy the realization standard, the valuation allowance will be reduced accordingly.

The tax effects of uncertain tax positions are recognized in the consolidated financial statements only if the position is more-likely-than-not to be sustained on audit, based on the technical merits of the position. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the consolidated financial statements is the largest benefit that has a greater than 50% likelihood of being realized. It is the Company's accounting policy to account for ASC 740-10-related penalties and interest as a component of the income tax provision in the consolidated statements of operations and comprehensive loss.

As of March 31, 2019 and December 31, 2018, the Company's evaluation revealed no uncertain tax positions that would have a material impact on the financial statements. The 2016 through 2018 tax years remain subject to examination by the IRS, as of March 31, 2019. Management does not believe that any reasonably possible changes will occur within the next twelve months that will have a material impact on the financial statements.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "2017 Act") was enacted, which changes U.S. tax law and includes various provisions that impact the Company. The 2017 Act effects the Company by changing U.S. tax rates, increasing the Company's ability to use accumulated net operating losses generated after December 31, 2017, and limiting the Company's ability to deduct interest.

Equity-Based Compensation

The Company recognizes equity-based compensation based on the grant-date fair value of the award on a straight-line basis over the requisite service period, net of estimated forfeitures. Total equity-based compensation expense included in selling, general and administrative expenses in the accompanying consolidated statements of operations for the three months ended March 31, 2019 and 2018 was \$62,852 and \$112,455, respectively.

The Company estimates the fair value of stock options using the Black-Scholes option-pricing model. The use of the Black-Scholes option-pricing model requires the use of subjective assumptions, including the fair value and projected volatility of the underlying common stock and the expected term of the award.

The fair value of each option granted has been estimated as of the date of the grant using the Black-Scholes option pricing model with the following assumptions during the three months ended March 31, 2019:

	For the Three Months Ended March 31, 2019
Risk-free interest rate	2.18%
Expected term	2.5 - 6.0 years
Volatility	83.80%
Dividend yield	0%
Estimated annual forfeiture rate at time of grant	0 - 30%

Risk-Free Interest Rate – The yield on actively traded non-inflation indexed U.S. Treasury notes with the same maturity as the expected term of the underlying grants was used as the average risk-free interest rate.

Expected Term – The expected term of options granted was determined based on management's expectations of the options granted which are expected to remain outstanding.

Expected Volatility – Because the Company's common stock has only been publicly traded since late August 2017, there is not a substantive share price history to calculate volatility and, as such, the Company has elected to use the calculated value method.

Dividend Yield – The Black-Scholes option pricing model requires an expected dividend yield as an input. The Company has not issued common stock dividends in the past nor does the Company expect to issue common stock dividends in the future.

Forfeiture Rate – This is the estimated percentage of equity grants that are expected to be forfeited or cancelled on an annual basis before becoming fully vested. The Company estimates the forfeiture rate based on past turnover data, level of employee receiving the equity grant, and vesting terms, and revises the rate if subsequent information indicates that the actual number of instruments that will vest is likely to differ from the estimate. The cumulative effect on current and prior periods of a change in the estimated number of awards likely to vest is recognized in compensation cost in the period of the change.

Fair Value of Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable and accounts payable approximate fair value as of March 31, 2019 and December 31, 2018 because of the relatively short-term maturity of these financial instruments. The carrying amount reported for long-term debt approximates fair value as of March 31, 2019 and December 31, 2018, given management's evaluation of the instrument's current rate compared to market rates of interest and other factors.

The determination of fair value is based upon the fair value framework established by Accounting Standards Codification (“ASC”) Topic 820, *Fair Value Measurements and Disclosures* (“ASC 820”). Fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. ASC 820 also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the factors market participants would use in valuing the asset or liability. The guidance establishes three levels of inputs that may be used to measure fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurements. Changes in the observability of valuation inputs may result in a reclassification of levels for certain securities within the fair value hierarchy.

The Company’s goodwill and other intangible assets are measured at fair value on a recurring and non-recurring basis, respectively, using Level 2 and Level 3 inputs.

The Company has concluded that its Series A Preferred Stock is a Level 3 financial instrument and that the fair value approximates the carrying value, which includes the accretion of the discounted interest component through March 31, 2019. There were no changes in levels during the three months ended March 31, 2019 and 2018.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, and accounts receivable. Concentrations of credit risk with respect to accounts receivable are minimal due to the collection history and due to the nature of the Company’s client base. The Company limits its credit risk with respect to cash by maintaining cash balances with high-quality financial institutions. At times, the Company’s cash may exceed U.S. federally-insured limits, and as of March 31, 2019 and December 31, 2018, the Company had \$4,500,382 and \$2,176,907, respectively, of cash and cash equivalents on deposit that exceeded the federally-insured limit.

Earnings per Share

Basic earnings per share, or EPS, is computed using the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the weighted average number of common and potentially dilutive securities outstanding during the period, except for periods of net loss for which no potentially dilutive securities are included because their effect would be anti-dilutive. Potentially dilutive securities consist of common stock issuable upon exercise of stock options or warrants using the treasury stock method. Potentially dilutive securities issuable upon conversion of the Series A and Series B Preferred Stock (see Note 10) are calculated using the if-converted method.

The Company calculates basic and diluted earnings per common share using the two-class method. Under the two-class method, net earnings are allocated to each class of common stock and participating security as if all of the net earnings for the period had been distributed. Participating securities consist of preferred stock that contain a nonforfeitable right to receive dividends and therefore are considered to participate in undistributed earnings with common stockholders.

Segment Reporting

The Financial Accounting Standards Board ("FASB") ASC Topic 280, *Segment Reporting*, requires that an enterprise report selected information about reportable segments in its financial reports issued to its stockholders. Beginning with the first quarter of 2019, the Company changed its operating and reportable segments from one segment to two segments: the Technology Group and the Professional Services Group. The two segments reflect the Company's separate focus on technology products and services versus professional services.

The Company's Technology Group includes the wholly owned subsidiaries Rekor Recognition and OpenALPR. The Professional Services Group includes wholly owned subsidiaries AOC Key Solutions, Global and Firestorm. See Note 3 for further details on the Company's reportable segments.

New Accounting Pronouncements

Recently Issued Accounting Pronouncements

Not Yet Adopted

In August 2018, the FASB issued Accounting Standards Update ("ASU") No. 2018-13, *Fair Value Measurement (Topic 820), Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement* ("ASU 2018-13"), which modifies the disclosure requirements for fair value measurements by removing, modifying or adding certain disclosures. ASU 2018-13 is effective for annual periods beginning after December 15, 2019 and interim periods within those annual periods, with early adoption permitted. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. The Company is currently evaluating the effect that ASU 2018-13 will have on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment* ("ASU 2017-04"). To simplify the subsequent measurement of goodwill, ASU 2017-04 requires only a single-step quantitative test to identify and measure impairment based on the excess of a reporting unit's carrying amount over its fair value. A qualitative assessment may still be completed first for an entity to determine if a quantitative impairment test is necessary. ASU 2017-04 is effective for fiscal year 2021 and is to be adopted on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company will test goodwill for impairment within one year of the acquisition or annually as of October 1, and whenever indicators of impairment exist. The Company is currently evaluating the effect that ASU 2017-04 will have on its financial statements and related disclosures.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"), which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. ASU 2016-13 replaces the existing incurred loss impairment model with an expected loss methodology, which will result in more timely recognition of credit losses. ASU 2016-13 is effective for annual reporting periods, and interim periods within those years beginning after December 15, 2019. The Company is currently in the process of evaluating the impact of adopting ASU 2016-13 on its consolidated financial statements.

There are currently no other accounting standards that have been issued, but not yet adopted, that will have a significant impact on the Company's consolidated financial position, results of operations or cash flows upon adoption.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize lease assets and lease liabilities on the balance sheet and requires expanded disclosures about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 and interim periods in fiscal years beginning after December 15, 2018, with early adoption permitted. In July 2018, the FASB issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements* ("ASU 2018-11"). ASU 2018-11 provides entities another option for transition, allowing entities to not apply the new standard in the comparative periods they present in their financial statements in the year of adoption. Effective January 1, 2019, the Company adopted ASU 2016-02, as amended, which requires lessees to recognize a right-of-use ("ROU") lease assets and lease liability on the balance sheet for most lease arrangements and expands disclosures about leasing arrangements for both lessees and lessors, among other items. The Company adopted ASU 2016-02 using the optional transition method whereby the Company applied the new lease requirements under ASU 2016-02 through a cumulative-effect adjustment, which after completing our implementation analysis, resulted in no adjustment to its January 1, 2019 beginning retained earnings balance. On January 1, 2019, the Company recognized \$920,950 of ROU operating lease assets and \$950,927 of operating lease liabilities, including noncurrent operating lease liabilities of \$727,513, as a result of adopting this standard. The difference between ROU operating lease assets and operating lease liabilities was primarily due to previously accrued rent expense relating to periods prior to January 1, 2019. As part of its adoption, the Company elected the following practical expedients: the Company has not reassessed whether any expired or existing contracts are or contain leases, the Company has not reassessed lease classification for any expired or existing leases; the Company has not reassessed initial direct costs for any existing leases; and the Company has not separated lease and non-lease components. The adoption of the standard did not have a material impact on the Company's consolidated financial statements and related disclosures. The comparative periods have not been restated for the adoption of ASU 2016-02.

In June 2018, the FASB issued ASU No. 2018-07, *Compensation – Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting* ("ASU 2018-07"), which is intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share-based compensation. ASU 2018-07 is effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods, with early adoption permitted but no earlier than an entity's adoption date of Topic 606. The Company adopted the provisions of ASU 2018-07 effective January 1, 2019. Adopting ASU 2018-07 had no impact on the Company's consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"), which was further amended in 2015 and 2016 (Topic 606). ASU 2014-09 provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes previous revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the previous revenue guidance. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented (full retrospective method), or apply the requirements in the year of adoption, through a cumulative adjustment (modified retrospective method). The Company adopted Topic 606 effective January 1, 2018 using the modified retrospective method. The adoption of Topic 606 resulted in the following changes: 1) a change to franchisee agreements recorded prior to 2017; and 2) the timing of certain contractual agreements which the Company deemed as immaterial. Revenue recognition related to the Company's other revenue streams remained substantially unchanged following the adoption of Topic 606 and therefore did not have a material impact on its revenues. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

Practical Expedients Election – Costs to Obtain and Fulfill a Contract – The Company's incremental costs of obtaining a contract consist of sales commissions. As part of adopting Topic 606, the Company elected to use the practical expedient to expense costs to obtain a contract as incurred when the amortization period would have been one year or less. As of March 31, 2019, costs incurred to fulfill contracts in excess of one year have been immaterial to date.

Revenue Recognition – The Company generates substantially all revenues from providing technology products and services and professional services to clients. A single contract could include one or multiple performance obligations. For those contracts that have multiple performance obligations, the Company allocates the total transaction price to each performance obligation based on its relative standalone selling price, which is determined based on our overall pricing objectives, taking into consideration market conditions and other factors.

Revenue is recognized when control of the goods and services provided are transferred to our customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods and services using the following steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, performance obligations are satisfied

The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Disaggregated Revenue – The Company disaggregates revenue from contracts with customers by contract type, as it believes it best depicts how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

The Company's revenue by contract type is as follows:

	For the Three Months Ended March 31,	
	2019	2018
Revenues		
Time and materials	\$ 10,799,306	\$ 10,321,152
Fixed price	817,265	874,202
Franchising	9,650	23,415
Total revenue	<u>\$ 11,626,221</u>	<u>\$ 11,218,769</u>

Performance Obligations – Performance obligations for three different types of services are discussed below:

- *Time and Material Services* – Revenues for time and material contracts are recognized as a single promise to provide hourly support or staff augmentation. Revenue is based on the number of hours worked by the employees or consultants at an agreed-upon rate per hour set forth in standard rate sheets or as written from time to time in contracts or purchase orders.
- *Firm-Fixed-Price Services* – Revenues related to firm-fixed-price contracts are primarily a single promise to provide a specific service, such as a site assessment or report. Revenues related to firm-fixed-price contracts are recognized in two ways, either as services are provided for longer term contracts or upon completion of the project for short-term contracts.
- *Franchising Services* – Revenue from the sale of individual franchises represents a single promise to provide a distinctive system that offers critical decision support, planning and consulting to individuals, corporate entities and government agencies. As no additional services are provided under the franchising sale, revenue is recognized when the contract is signed and collectability is assured, unless the franchisee is required to perform certain training before operations commence. Royalty and advertising and promotion services are provided over the term of the franchise and therefore revenue from these services are recognized over time based on the monthly fee per the contract terms.

Accounts Receivable, Net – Accounts receivable, net, are amounts due from customers where there is an unconditional right to consideration. Unbilled receivables of \$1,672,178 and \$1,124,705 are included in this balance as of March 31, 2019 and December 31, 2018, respectively. The payment of consideration related to these unbilled receivables is subject only to the passage of time.

The Company reviews accounts receivable on a periodic basis to determine if any receivables will potentially be uncollectible. Estimates are used to determine the amount of the allowance for doubtful accounts necessary to reduce accounts receivable to its estimated net realizable value. The estimates are based on an analysis of past due receivables, historical bad debt trends, current economic conditions, and customer specific information. After the Company has exhausted all collection efforts, the outstanding receivable balance relating to services provided is written off against the allowance. Additions to the provision for bad debt are charged to expense.

The Company determined that an allowance for loss of \$45,560 and \$24,405 was required as of March 31, 2019 and December 31, 2018, respectively.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation - Stock Compensation: Scope of Modification Accounting* ("ASU 2017-09"), which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity will account for the effects of a modification unless the fair value of the modified award is the same as the original award, the vesting conditions of the modified award are the same as the original award and the classification of the modified award as an equity instrument or liability instrument is the same as the original award. ASU 2017-09 is effective for fiscal year 2019. The update is to be adopted prospectively to an award modified on or after the adoption date. Early adoption is permitted. The Company adopted ASU 2017-09 in 2018 and the impact of the adoption was not material to its consolidated financial statements and related disclosures.

NOTE 3 – INFORMATION ON BUSINESS SEGMENTS

FASB ASC Topic 280, *Segment Reporting*, requires that an enterprise report selected information about reportable segments in its financial reports issued to its stockholders. Beginning with the first quarter of 2019, the Company changed its operating and reportable segments from one segment to two segments: the Technology Group and the Professional Services Group. The two segments reflect the Company's separate focus on technology products and services versus professional services.

The Company's Technology Group includes wholly owned subsidiaries Rekor Recognition and OpenALPR. The financial results of OpenALPR are included beginning as of March 12, 2019 (see Note 4). The Professional Services Group includes wholly owned subsidiaries AOC Key Solutions, Global, and Firestorm. The Company provides general corporate services to its segments, however, these services are not considered when making operating decisions and assessing segment performance. These services are reported as "Corporate Services" below and these include costs associated with executive management, financing activities and public company compliance.

Summarized financial information concerning the Company's reportable segments is presented below:

	For the Three Months Ended March 31,	
	2019	2018
Revenue:		
Technology group	\$ 1,009,843	\$ 874,202
Professional services group	10,616,378	10,344,567
Total revenue	<u>\$ 11,626,221</u>	<u>\$ 11,218,769</u>
Cost of revenue:		
Technology group	\$ 490,110	\$ 327,796
Professional services group	8,032,445	7,806,240
Total cost of revenue	<u>\$ 8,522,555</u>	<u>\$ 8,134,036</u>
Gross profit:		
Technology group	\$ 519,734	\$ 546,406
Professional services group	2,583,933	2,538,327
Total gross profit	<u>\$ 3,103,666</u>	<u>\$ 3,084,733</u>
Selling, general and administrative expenses:		
Technology group	\$ 718,473	\$ 804,421
Professional services group	2,863,950	2,913,655
Corporate expenses	987,341	1,562,874
Total operating expenses	<u>\$ 4,569,764</u>	<u>\$ 5,280,950</u>
Loss from operations:		
Technology group	\$ (198,739)	\$ (258,015)
Professional services group	(280,018)	(375,327)
Corporate expenses	(987,341)	(1,562,874)
Total loss from operations	<u>\$ (1,466,098)</u>	<u>\$ (2,196,216)</u>

NOTE 4 – ACQUISITIONS

Secure Education Consultants Acquisition

On January 1, 2018, the Company completed its acquisition of certain assets of Secure Education through Firestorm. Consideration paid as part of this acquisition included: \$99,197 in cash; 33,333 shares of Rekor common stock valued at \$163,332; warrants to purchase 33,333 shares of Rekor common stock, exercisable over a period of five years, at an exercise price of \$5.44 per share, valued at \$65,988; and warrants to purchase 33,333 of Rekor common stock, exercisable over a period of five years, at an exercise price of \$6.53 per share, valued at \$57,484.

The Company has completed its analysis of the purchase price allocation. The Company recorded \$386,001 of customer relationships as intangibles. The table below shows the final breakdown related to the Secure Education acquisition:

Cash paid	\$ 99,197
Common stock issued	163,332
Warrants issued, at \$5.44	65,988
Warrants issued, at \$6.53	57,484
Total consideration	<u>386,001</u>
Less intangible and intellectual property	(386,001)
Net goodwill recorded	<u>\$ -</u>

OpenALPR Acquisition

On November 14, 2018, the Company entered into an Asset Purchase Agreement (the "OpenALPR Purchase Agreement") by and among the Company, OpenALPR Technology and Matthew Hill pursuant to which the Company agreed to purchase all of the assets of OpenALPR Technology and its subsidiaries, except for certain excluded assets, and assumed certain liabilities as provided for in the OpenALPR Purchase Agreement. The Company agreed to pay \$15,000,000, subject to certain adjustments, provided that OpenALPR Technology could elect to receive up to 1,000,000 shares of the Company's common stock, par value, \$0.0001 per share, in lieu of up to \$5,000,000 in cash valued at a price per share of \$5.

On February 15, 2019, the Company entered into Amendment No. 1 to the OpenALPR Purchase Agreement, pursuant to which the parties agreed to amend the Base Purchase Price to \$7,000,000, subject to adjustment after closing, issue a promissory note in the amount of \$5,000,000, and issue 600,000 shares of Rekor common stock as consideration for the acquisition of OpenALPR Technology's assets.

On March 8, 2019, the Company entered into Amendment No. 2 to the OpenALPR Asset Purchase Agreement which eliminated the working capital adjustment set forth in the OpenALPR Asset Purchase Agreement, as amended, and replaced it with an adjustment for prepaid maintenance contracts.

On March 12, 2019, the Company completed the acquisition of certain assets of OpenALPR Technology and assumed certain liabilities. (the "OpenALPR Acquisition"). Consideration paid as part of the OpenALPR Acquisition was: \$7,000,000 in cash, subject to adjustment after closing; 600,000 shares of Rekor common stock, valued at \$396,600; and \$5,000,000 of the 2019 Promissory Notes (see Note 8) principal amount, together with an accompanying warrant to purchase 625,000 shares of Rekor common stock, exercisable over a period of five years, at an exercise price of \$0.74 per share, valued at \$208,125 ("March 2019 Warrants" see Note 8). As the OpenALPR Technology acquisition has recently been completed, the Company is currently in the process of completing the purchase price allocation treating the OpenALPR Technology acquisition as a business combination.

The purchase price has been preliminarily allocated to the assets acquired and liabilities assumed based on fair values as of the acquisition date. Since the acquisition of OpenALPR Technology occurred on March 12, 2019, the results of operations for OpenALPR Technology from the date of acquisition have been included in the Company's consolidated statement of operations for the three months ended March 31, 2019. The table below shows the breakdown related to the preliminary purchase price allocation for the OpenALPR Technology acquisition:

Assets acquired	\$ 939,127
Liabilities acquired	(387,599)
Net assets acquired	551,527
Less intangible assets	11,845,073
Consideration paid (see below)	(12,396,600)
Net goodwill recorded	\$ -
Cash consideration	\$ 7,000,000
Note payable	5,000,000
Common stock consideration	396,600
Total acquisition consideration	\$ 12,396,600

Hill Employment Agreement

On November 14, 2018, concurrent with the execution of the OpenALPR Purchase Agreement, the Company entered into an employment agreement with Matthew Hill (the "Hill Employment Agreement") which became effective as of March 12, 2019, the closing date of the OpenALPR Purchase Agreement. Pursuant to the Hill Employment Agreement, Mr. Hill began serving as the Company's Chief Science Officer. The Hill Employment Agreement provides for a term of three years, unless earlier terminated pursuant to the terms thereof, which term renews for additional one-year terms until terminated upon 90-days advance notice. Mr. Hill will earn an annual base salary of \$165,000.

Either party may terminate the Hill Employment Agreement with or without cause with notice as contemplated by the Hill Employment Agreement, provided however, if Mr. Hill resigns, he shall provide the Company with at least six months prior written notice. The Hill Employment Agreement provides for the payment of severance under certain circumstances as outlined therein.

Operations of Combined Entities

The following unaudited pro forma combined financial information gives effect to the acquisition of Secure Education and OpenALPR Technology as if they were consummated as of January 1, 2018. This unaudited pro forma financial information is presented for information purposes only and is not intended to present actual results that would have been attained had the acquisition been completed as of January 1, 2018 (the beginning of the earliest period presented) or to project potential operating results as of any future date or for any future periods.

	Three Months Ended March 31,	
	2019	2018
Revenues	\$ 12,595,218	\$ 11,421,765
Net income (loss)	\$ (2,067,077)	\$ (2,104,936)
Basic earnings (loss) per share	\$ (0.12)	\$ (0.16)
Diluted earnings (loss) per share	\$ (0.12)	\$ (0.16)
Basic Number of Shares	19,367,619	15,130,030
Diluted Number of Shares	19,367,619	15,130,030

NOTE 5 – INVESTMENT AT COST AND NOTES RECEIVABLE

The Company owns a minority interest of 19.1% of Global Public Safety, LLC ("Global Public Safety"). The Company is accounting for this as an investment at cost. The Company recorded an impairment of \$262,140 related to the investment in Global Public Safety for the year end December 31, 2018.

In February 2018, the Company sold a \$2,000,000 promissory note that it had acquired in connection with the acquisition of Rekor Recognition. The current portion of notes receivable was \$0 as of March 31, 2019 and December 31, 2018. In connection with the sale, the Company indemnified the unrelated third-party buyer for any amount of principal and interest not paid by LB&B Associates, Inc.

NOTE 6 – IDENTIFIABLE INTANGIBLE ASSETS

The following provides a breakdown of identifiable intangible assets as of March 31, 2019:

	Customer Relationships	Marketing Related	Technology Based	Total
Identifiable intangible assets, gross	\$ 5,588,677	\$ 730,000	\$ 11,928,485	\$ 18,247,162
Accumulated amortization	(1,542,535)	(280,345)	(114,630)	(1,937,510)
Identifiable intangible assets, net	<u>\$ 4,046,142</u>	<u>\$ 449,655</u>	<u>\$ 11,813,855</u>	<u>\$ 16,309,652</u>

With the acquisition of Secure Education, the Company identified customer relationships and marketing-related intangibles of \$386,801. With the acquisition of OpenALPR Technology, the Company identified technology-based intangibles of \$11,845,073 in its preliminary purchase price allocation. These assets are being amortized on a straight-line basis over their weighted average estimated useful life of 5.7 years and amortization expense amounted to \$369,924 and \$255,294 for the three months ended March 31, 2019 and 2018, respectively.

As of March 31, 2019, the estimated annual amortization expense for each of the next five fiscal years and thereafter is as follows:

2019	\$ 2,563,497
2020	3,417,996
2021	3,365,794
2022	2,614,122
2023	2,523,612
Thereafter	1,824,631
Total	<u><u>\$ 16,309,652</u></u>

NOTE 7 – SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Supplemental disclosures of cash flow information for the three months ended March 31, 2019 and 2018 were as follows:

	For the Three Months Ended March 31,	
	2019	2018
Cash paid for interest	\$ 266,601	\$ 59,857
Cash paid for taxes	\$ -	\$ -
Business Combinations:		
Current assets	\$ 939,127	\$ -
Intangible assets	\$ 11,845,073	\$ 386,001
Acquisition of OpenALPR Technology	\$ (12,000,000)	\$ -
Deferred revenue	\$ (387,599)	\$ -
Issuance of common stock	\$ (396,600)	\$ (163,332)
Issuance of common stock warrants	\$ -	\$ (123,472)
Financing:		
Notes payable	\$ 21,000,000	\$ -
Debt discount financing costs	\$ (2,599,193)	\$ -
Extinguishment of debt	\$ (1,112,609)	\$ -
Repayment of notes payable and interest expense, net of debt discount	\$ (2,515,739)	\$ -
Investment in OpenALPR Technology	\$ (12,000,000)	\$ -
Issuance of warrants in conjunction with notes payable	\$ 705,943	\$ -
Accounts Payable	\$ 360,000	\$ -
Adoption of ASC-842 Lease Accounting:		
Right-of-use lease asset	\$ 920,950	\$ -
Deferred rent	\$ 29,976	\$ -
Lease liability	\$ (950,926)	\$ -

On January 5, 2018, April 6, 2018 and July 9, 2018, the Company paid cash dividends of \$87,907 to shareholders of record of Series A Preferred Stock as of the end of the previous month. On September 30, 2018, December 31, 2018 and March 31, 2019, the Company accrued dividends of \$87,907 to these Preferred Stock shareholders and did not pay dividends in cash. Accrued dividends payable to Series A Preferred Stock shareholders were \$263,722 and \$175,814 as of March 31, 2019 and December 31, 2018, respectively.

On January 5, 2018, April 6, 2018 and July 9, 2018, the Company paid cash dividends of \$27,001 to shareholders of record of Series B Preferred Stock as of the end of the previous month. On September 30, 2018, December 31, 2018 and March 31, 2019, the Company accrued dividends of \$27,001 to these Preferred Stock shareholders and did not pay dividends in cash. Accrued dividends payable to Series B Preferred Stock shareholders were \$81,003 and \$54,002 as of March 31, 2019 and December 31, 2018, respectively.

NOTE 8 – DEBT

Line of Credit

Global has revolving lines of credit with Wells Fargo Bank National Association (“WFB”) (“Wells Fargo Credit Facilities”). WFB agreed to advance to Global, 90% of all eligible accounts with a maximum facility amount of \$5,000,000. Interest is payable under the Wells Fargo Credit Facilities at a monthly rate equal to the Three-Month LIBOR, (as such term is defined under the Wells Fargo Credit Facilities), in effect from time to time plus 3%, plus an additional margin of 3%. Payment of the revolving lines of credit is secured by the accounts receivable of Global. The current term of the Wells Fargo Credit Facilities run through December 31, 2019, with automatic renewal terms of 12 months. WFB or Global may terminate the Wells Fargo Credit Facilities upon at least 60 days’ written notice prior to the last day of the current term. The principal balance as of March 31, 2019 and December 31, 2018 was \$2,046,043 and \$1,094,766, respectively. As part of the agreements for the Wells Fargo Credit Facilities, Global must maintain certain financial covenants. Global met all such financial covenant requirements for the three months ended March 31, 2019.

On November 12, 2017, AOC Key Solutions entered into an Account Purchase Agreement and related agreements (the "AOC Wells Agreement") with WFB. Pursuant to the AOC Wells Agreement, AOC Key Solutions agreed to sell and assign to WFB all of its Accounts (as such term is defined in Article 9 of the Uniform Commercial Code), constituting accounts arising out of sales of Goods (as such term is defined in Article 9 of the Uniform Commercial Code) or rendition of services that WFB deems to be eligible for borrowing under the AOC Wells Agreement. WFB agreed to advance to AOC Key Solutions, 90% of all eligible accounts with a maximum facility amount of \$3,000,000. Interest is payable under the AOC Wells Agreement at a monthly rate equal to the Daily One Month LIBOR, (as such term is defined under the AOC Wells Agreement), in effect from time to time plus 5%. The AOC Wells Agreement also provides for a deficit interest rate equal to the then applicable interest rate plus 50% and a default interest rate equal to the then applicable interest rate or deficit interest rate, plus 50%. The initial term of the AOC Wells Agreement runs through December 31, 2018 (the "Initial Term"), with automatic renewal terms of 12 months (the "Renewal Term"), commencing on the first day after the last day of the Initial Term. The current term of the AOC Wells Agreement runs through December 31, 2019. AOC Key Solutions may terminate the AOC Wells Agreement upon at least 60 days' prior written notice, but no more than 120 days' written notice, prior to and effective as of the last day of the Initial Term or the Renewal Term, as the case may be. WFB may terminate the AOC Wells Agreement at any time and for any reason upon 30 days' written notice or without notice upon the occurrence of an Event of Default (as such term is defined in the AOC Wells Agreement) after the expiration of any grace or cure period. The principal balance as of March 31, 2019 and December 31, 2018 was \$368,606 and \$566,447, respectively. As part of the AOC Wells Agreement, AOC Key Solutions must maintain certain financial covenants. AOC Key Solutions met all such financial covenant requirements for the three months ended March 31, 2019.

Long-Term Debt

On March 16, 2016, the Company entered into a Subordinated Note and Warrant Purchase Agreement (the "Avon Road Note Purchase Agreement") pursuant to which \$500,000 in subordinated debt (the "Avon Road Note") was issued by the Company to Avon Road Partners, L.P. ("Avon Road"), an affiliate of Robert Berman, the Company's President and CEO and a member of the Company's Board of Directors. The Avon Road Subordinated Note Warrants had an expiration date of March 16, 2019.

On March 12, 2019, the \$500,000 balance due on the Avon Road Note was retired in its entirety from the proceeds of the 2019 Promissory Notes (see below).

On January 25, 2017, pursuant to the terms of its acquisition of Firestorm, the Company issued \$1,000,000 in the aggregate of unsecured, subordinated promissory notes with interest payable over five years \$500,000 of the notes are payable at an interest rate of 2% and the remaining note is payable at an interest rate of 7%. The notes mature on January 25, 2022. The balance of these notes payable was \$947,531 and \$938,272, net of unamortized interest, as of March 31, 2019 and December 31 2018, respectively, to reflect the amortized fair value of the notes issued due to the difference in interest rates of \$52,469 and \$61,728, respectively.

On April 3, 2018, the Company and Rekor Recognition entered into a transaction pursuant to which an institutional investor (the "2018 Lender") loaned \$2,000,000 to the Company and Rekor Recognition (the "2018 Promissory Note"). The loan was originally due and payable on May 1, 2019 and bears interest at 15% per annum, with a minimum of 15% interest payable if the loan is repaid prior to May 1, 2019. In addition, the Company issued 35,000 shares of common stock to the 2018 Lender, which shares contain piggy-back registration rights. If the shares are not registered on the next selling shareholder registration statement, the Company will be obligated to issue an additional 15,000 shares to the 2018 Lender. Upon the sale of Rekor Recognition or its assets, the 2018 Lender was entitled to receive 7% of any proceeds received by the Company or Rekor Recognition in excess of \$5 million (the "Lender's Participation"). In addition, commencing January 1, 2020, the 2018 Lender shall be paid 7% of Rekor Recognition's earnings before interest, taxes, depreciation and amortization, less any capital expenditures, which amount would be credited for any payments that might ultimately be paid to the 2018 Lender as its Lender's Participation, if any. At April 3, 2018, the fair value of shares issued was \$126,000. On October 24, 2018, the Company and Rekor Recognition entered into a note amendment with the 2018 Lender by which the maturity date of the note was extended to May 1, 2020 (the "2018 Promissory Note Amendment"). The 2018 Promissory Note Amendment further provided for payment of interest through May 1, 2019, if the principal was repaid before May 1, 2019. At October 24, 2018, an additional \$62,500 fee was paid as consideration for extending the maturity date to May 1, 2020 and designated as financing costs related to the 2018 Promissory Note Amendment. Amortized financing cost for the three months ended March 31, 2019 and 2018 was determined to be \$31,425 and \$96,378, respectively, is included in interest expense. The 2018 Promissory Note has an effective interest rate of 19.5%. On March 12, 2019, the \$2,000,000 balance due on the 2018 Promissory Note was retired in its entirety and Rekor paid to the 2018 Lender \$1,050,000 of consideration for the Lender's Participation and \$75,000 of interest due through May 1, 2019. All amounts paid were obtained from the proceeds of the 2019 Promissory Notes (see below). The 2018 Lender consideration of \$1,050,000 for the Lender's Participation and unamortized financing costs of \$62,609 are recorded as extinguishment of debt of \$1,112,609 for the three months ended March 31, 2019.

2019 Promissory Notes

On March 12, 2019, Rekor entered into a note purchase agreement pursuant to which investors, including OpenALPR Technology (see Note 4), (the "2019 Lenders") loaned \$20,000,000 to Rekor (the "2019 Promissory Notes") and the Company issued to the 2019 Lenders warrants to purchase 2,500,000 shares of Rekor common stock (the "March 2019 Warrants"). The loan is due and payable on March 11, 2021 and bears interest at 16% per annum, of which at least 10% per annum shall be paid in cash. The full remaining portion of all interest, if any, shall accrue and be paid-in-kind. The notes also require a premium, if paid before the maturity date, a \$1,000,000 exit fee due at maturity, and compliance with affirmative, negative and financial covenants, including a fixed charge ratio, minimum liquidity and maximum capital expenditures, as defined. Transaction costs were approximately \$403,250 for a work fee payable over 10 months, \$290,000 in legal fees and a \$200,000 closing fee. The loan is secured by a security interest in substantially all of the assets of Rekor. The March 2019 Warrants are exercisable over a period of five years, at an exercise price of \$0.74 per share, and are valued at \$705,943. The warrants are exercisable commencing March 12, 2019 and expire on March 12, 2024. The 2019 Promissory Notes has an effective interest rate of 24.87%.

The principal amounts due for long-term notes payable described above and a minor equipment note payable are shown below as of March 31, 2019:

	<u>Short-term</u>	<u>Long-term</u>	<u>Total</u>
2019	\$ 34,051	\$ -	\$ 34,051
2020	-	4,665	4,665
2021	-	21,004,959	21,004,959
2022	-	1,005,273	1,005,273
2023	-	10,491	10,491
Total	<u>34,051</u>	<u>22,025,388</u>	<u>22,059,439</u>
Less unamortized interest	-	(52,469)	(52,469)
Less unamortized financing costs	-	(2,547,968)	(2,547,968)
	<u>34,051</u>	<u>19,424,951</u>	<u>19,459,002</u>
Current portion of long-term debt	<u>(34,051)</u>	<u>-</u>	<u>(34,051)</u>
Long-term debt	<u>\$ -</u>	<u>\$ 19,424,951</u>	<u>\$ 19,424,951</u>

NOTE 9 – INCOME TAXES

The Company accounts for income taxes in accordance with ASC Topic 740. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized. In determining the need for a valuation allowance, management reviews both positive and negative evidence pursuant to the requirements of ASC Topic 740, including current and historical results of operations, future income projections and the overall prospects of the Company's business.

The 2017 Act changes U.S. tax law and includes various provisions that impact our company. The 2017 Act effects our company by changing U.S. tax rates, increasing the Company's ability to utilize accumulated net operating losses generated after December 31, 2017, and impacts the estimates of our deferred tax assets and liabilities.

The Company's income tax provision for the three months ended March 31, 2019 and 2018 was \$11,761 and \$0, respectively. The increase in the tax expense is primarily related to state minimum taxes and the state of Texas gross receipts tax. The Company established a valuation allowance against deferred tax assets during 2017 and has continued to maintain a full valuation allowance through the three months ended March 31, 2019.

The Company files income tax returns in the United States and in various state and foreign jurisdictions. No U.S. Federal, state or foreign income tax audits were in process as of March 31, 2019.

Management has evaluated the recoverability of the net deferred income tax assets and the level of the valuation allowance required with respect to such net deferred income tax assets. After considering all available facts, the Company fully reserved for its net deferred tax assets because management believes that it is more-likely-than-not that their benefits will not be realized in future periods. The Company will continue to evaluate its deferred tax assets to determine whether any changes in circumstances could affect the realization of their future benefit. If it is determined in future periods that portions of the Company's net deferred income tax assets satisfy the realization standard, the valuation allowance will be reduced accordingly.

For the three months ended March 31, 2019 the Company did not record any interest or penalties related to unrecognized tax benefits. It is the Company's policy to record interest and penalties related to unrecognized tax benefits as part of income tax expense. The 2015 through 2018 tax years remain subject to examination by the IRS.

NOTE 10 – STOCKHOLDERS' EQUITY

Common Stock

The Company is authorized to issue 30,000,000 shares of common stock, \$0.0001 par value. As of March 31, 2019 and December 31, 2018, the issued and outstanding common shares of Rekor were 19,367,619 and 18,767,619, respectively.

In January 2018, the Company issued 33,333 shares of Rekor common stock as consideration as part of its acquisition of Secure Education.

In April 2018, the Company issued 35,000 shares of Rekor common stock as additional consideration to the 2018 Lender in connection with the 2018 Promissory Note.

As part of its acquisition of Brekford on August 29, 2017, the Company assumed warrants to purchase 56,000 shares of Rekor common stock (the "Brekford Warrants") (see Note 11). Effective October 16, 2018, the Company entered into exchange agreements with holders of the Brekford Warrants pursuant to which the Company issued to the holders an aggregate of 96,924 shares of common stock in exchange for the return of the warrants to the Company for cancellation.

On November 1, 2018, the Company issued 4,125,000 shares of common stock through an underwritten public offering at a public offering price of \$0.80 per share. Net proceeds to the Company was approximately \$2.8 million. In addition, the Company granted underwriters a 45-day option to purchase up to 618,750 additional shares of common stock to cover over-allotment, if any. The underwriters did not exercise this option and the options were cancelled. As part of the consideration to the underwriters, the Company issued to the underwriters warrants to purchase an aggregate of 206,250 shares of common stock, exercisable over a period of five years, at an exercise price of \$1.00 per share. The underwriter warrants have a value of approximately \$0.2 million and are exercisable commencing April 27, 2019 and expire on October 29, 2023.

On December 13, 2018, the Company received a letter from the Nasdaq indicating that the Company is required to maintain a minimum bid price of \$1 per share of its common stock. The Company's closing bid price of its common stock had been less than \$1 for the previous 30 consecutive business days. As such, the Company was not compliant with the minimum bid price requirements under Nasdaq Listing Rule 5550(a)(2). The letter from Nasdaq provided the Company with a compliance period of 180 calendar days, or until June 11, 2019, to regain compliance with the minimum bid price requirement. If at any time during this 180-day compliance period the closing bid price of the Company's common stock is at least \$1 for a minimum of 10 consecutive business days, then Nasdaq will provide the Company with written confirmation of compliance and the matter will be closed.

In the event the Company's common stock were to be delisted from the Nasdaq, management expects that it would be traded on the OTCQB or OTCQX, which are unorganized, inter-dealer, over-the-counter markets which provides significantly less liquidity than the Nasdaq or other national securities exchanges.

For the year ended December 31, 2018, the Company issued 13,998 shares of Rekor common stock related to the exercise of common stock options.

On February 15, 2019, the Company entered into Amendment No. 1 to the OpenALPR Purchase Agreement, pursuant to which the Company agreed to issue 600,000 shares of Rekor common stock as partial consideration for the acquisition of the assets of OpenALPR Technology. On March 12, 2019, the Company issued 600,000 shares of Rekor common stock pursuant to the acquisition of OpenALPR Technology.

For the three months ended March 31, 2019 and 2018, the Company issued 600,000 and 33,333 shares of Rekor common stock, respectively. For the three months ended March 31, 2019 and 2018, no options were exercised related to common stock.

Preferred Stock

The Company is authorized to issue up to 2,000,000 shares of preferred stock, \$0.0001 par value. The Company's preferred stock may be entitled to preference over the common stock with respect to the distribution of assets of the Company in the event of liquidation, dissolution or winding-up of the Company, whether voluntarily or involuntarily, or in the event of any other distribution of assets of the Company among its shareholders for the purpose of the winding-up of its affairs. The authorized but unissued shares of the preferred stock may be divided into, and issued in, designated series from time to time by one or more resolutions adopted by the Board of Directors of the Company. The Board of Directors of the Company, in its sole discretion, has the power to determine the relative powers, preferences and rights of each series of preferred stock.

Series A Cumulative Convertible Redeemable Preferred Stock

Of the 2,000,000 authorized shares of preferred stock, 505,000 shares are designated as \$0.0001 par value Series A Cumulative Convertible Redeemable Preferred Stock (the "Series A Preferred Stock"). The holders of Series A Preferred Stock are entitled to quarterly dividends of 7.0% per annum per share. The holders of Series A Preferred Stock have a put right to convert each share into common stock at an initial conversion price and a specified price which increases annually based on the passage of time beginning in November 2019. The holders of Series A Preferred Stock also have a put right after 60 months from the issuance date to redeem any or all of the Series A Preferred Stock at a redemption price of \$15.00 per share plus any accrued but unpaid dividends. The Company has a call right after 36 months from the issuance date to redeem all of the Series A Preferred Stock at a redemption price which increases annually based on the passage of time beginning in November 2019. The Series A Preferred Stock contains an automatic conversion feature based on a qualified initial public offering in excess of \$30,000,000 or a written agreement by at least two-thirds of the holders of Series A Preferred Stock at an initial conversion price and a specified price which increases annually based on the passage of time beginning in November 2016. Based on the terms of the Series A Preferred Stock, the Company concluded that the Series A Preferred Stock should be classified as temporary equity in the accompanying consolidated balance sheets as of March 31, 2019 and December 31, 2018.

The Company adjusts the value of the Series A Preferred Stock to redemption value at the end of each reporting period. The adjustment to the redemption value is recorded through additional-paid-in-capital of \$178,501 and \$155,343 for the three months ended March 31, 2019 and March 31, 2018, respectively.

As of March 31, 2019 and December 31, 2018, 502,327 shares of Series A Preferred Stock were issued and outstanding.

The holders of Series A Preferred Stock are entitled to quarterly cash dividends of \$0.175 (7% per annum) per share. Dividends accrue quarterly and dividend payments for declared dividends are due within five business days following the end of a quarter. On January 5, 2018, April 6, 2018 and July 9, 2018, the Company paid cash dividends of \$87,907 to shareholders of record of Series A Preferred Stock as of the end of the previous month. On September 30, 2018, December 31, 2018 and March 31, 2019, the Company accrued dividends of \$87,907 to Series A Preferred Stock shareholders of record. Accrued dividends payable to Series A Preferred Stock shareholders were \$263,722 and \$175,814 as of March 31, 2019 and December 31, 2018, respectively, and are included in accrued expenses on the accompanying condensed consolidated balance sheets.

On February 15, 2019, the Company's Series A Preferred Stock, which had been designated as securities trading on the OTC Markets OTCQX exchange, was transferred to being designated as trading on the OTC Markets OTCQB exchange.

Series B Cumulative Convertible Preferred Stock

Of the 2,000,000 authorized shares of preferred stock, 240,861 shares are designated as \$0.0001 par value Rekor Series B Cumulative Convertible Preferred Stock (the "Series B Preferred Stock"). The Series B Preferred Stock has a conversion price of \$5.00 per share. Each Series B Preferred Stock has an automatic conversion feature based on the share price of the Company. The holders of Series B Preferred Stock are entitled to quarterly cash dividends of 1.121% (4.484% per annum) per share. Dividends accrue quarterly and dividend payments for declared dividends are due within five business days following the end of a quarter. On January 5, 2018, April 6, 2018 and July 9, 2018, the Company paid cash dividends of \$27,001 to shareholders of record of Series B Preferred Stock as of the end of the previous month. On September 30, 2018, December 31, 2018 and March 31, 2019, the Company accrued dividends of \$27,001 to Series B Preferred Stock shareholders of record. Accrued dividends payable to Series B Preferred Stock shareholders were \$81,003 and \$54,002 as of March 31, 2019 and December 31, 2018, respectively, and are included in accrued expenses on the accompanying condensed consolidated balance sheets.

Warrants

The Company has a total of 3,973,163 and 1,473,163 warrants issued and outstanding as of March 31, 2019 and December 31, 2018, respectively. These warrants are exercisable and convertible for a total of 3,714,491 and 1,214,491 shares of Rekor common stock as of March 31, 2019 and December 31, 2018, respectively. On February 15, 2019, the Company's Unit Warrants (see Note 10) which had been designated as securities trading on the OTC Markets OTCQX exchange were transferred to the OTC Markets OTCQB exchange.

As part of its acquisition of Brekford on August 29, 2017, the Company assumed Brekford's obligations with respect to the Brekford Warrants. The exercise price for the Brekford Warrants was \$7.50 and they expired on March 31, 2020. Effective October 16, 2018, the Company entered into exchange agreements with holders of the Brekford Warrants pursuant to which the Company issued to the holders an aggregate of 96,924 shares of common stock in exchange for the return of the warrants to the Company for cancellation. As of March 31, 2019 and December 31, 2018, no Brekford Warrants were outstanding. (See Note 11).

As part of a Regulation A Offering in fiscal year 2016 and 2017, the Company issued 502,327 Unit Warrants to the holders of Series A Preferred Stock. The exercise price for these Unit Warrants is \$1.03 and they are convertible into a total of 243,655 shares of Rekor common stock. The Unit Warrants expire on November 23, 2023. As of March 31, 2019, and December 31, 2018, there are 502,327 Unit Warrants outstanding.

On March 16, 2016, the Company entered into the Avon Road Note Purchase Agreement, as more fully described in Note 8 above, pursuant to which the Company issued warrants to purchase 121,247 shares of its common stock to Avon Road, an affiliate of Robert Berman, Rekor's President and CEO and a member of the Company's Board of Directors. These warrants were exercised on December 11, 2017 for proceeds of \$125,006 and there were no Avon Road Subordinated Note Warrants outstanding as of March 31, 2019 and December 31, 2018.

As part of the acquisition of Firestorm on January 24, 2017, the Company issued: warrants to purchase 315,627 shares of its common stock, exercisable over a period of five years, at an exercise price of \$2.5744 per share; and warrants to purchase 315,627 shares of its common stock, exercisable over a period of five years, at an exercise price of \$3.6083 per share (the "Firestorm Warrants"). The expiration date of the Firestorm Warrants is January 24, 2022. As of March 31, 2019 and December 31, 2018, there were 631,254 Firestorm Warrants outstanding.

Pursuant to its acquisition of BC Management on December 31, 2017, the Company issued: warrants to purchase 33,333 shares of its common stock, exercisable over a period of five years, at an exercise price of \$5.44 per share; and warrants to purchase 33,333 shares of its common stock, exercisable over a period of five years, at an exercise price of \$6.53 per share (the "BC Management Warrants"). The expiration date of the BC Management Warrants is December 31, 2022. As of March 31, 2019 and December 31, 2018, there were 66,666 BC Management Warrants outstanding.

Pursuant to its acquisition of Secure Education on January 1, 2018, the Company issued: warrants to purchase 33,333 shares of its common stock, exercisable over a period of five years, at an exercise price of \$5.44 per share; and warrants to purchase 33,333 shares of its common stock, exercisable over a period of five years, at an exercise price of \$6.53 per share (the "Secure Education Warrants"). The expiration date of the Secure Education Warrants is January 1, 2023. As of March 31, 2019 and December 31, 2018, there were 66,666 Secure Education Warrants outstanding.

On November 1, 2018, in connection with an underwritten public offering of its common stock, the Company issued to the underwriters warrants to purchase 206,250 shares of its common stock, exercisable over a period of five years, at an exercise price of \$1.00 per share. These warrants have a value of approximately \$0.2 million and are exercisable commencing April 27, 2019 and expire on October 29, 2023. As of March 31, 2019 and December 31, 2018, all 206,250 warrants related to the 2018 underwritten public offering remain outstanding.

On March 12, 2019, in connection with the 2019 Promissory Notes, the Company issued warrants to purchase 2,500,000 shares of its common stock, which are immediately exercisable at an exercise price of \$0.74 per share, to certain individuals and entities (see Note 8). Of the 2,500,000 warrants, 625,000 were issued as partial consideration for its acquisition of certain assets of OpenALPR Technology (see Note 4).

NOTE 11 – WARRANT DERIVATIVE LIABILITY

As part of its acquisition of Rekor Recognition on August 29, 2017, the Company assumed the Brekford Warrants to purchase 56,000 shares of its common stock (see Note 10). The Brekford Warrants permit the holder to purchase 56,000 shares of the Company's common stock with an exercise price of \$7.50 per share.

The Brekford Warrants exercise price is subject to anti-dilution adjustments that allow for its reduction in the event the Company subsequently issues equity securities, including shares of common stock or any security convertible or exchangeable for shares of common stock, for no consideration or for consideration less than \$7.50 a share. The Company accounted for the conversion option of the Brekford Warrants in accordance with ASC Topic 815. Accordingly, the conversion option is not considered to be solely indexed to the Company's own stock and, as such, was recorded as a liability.

Effective October 16, 2018, the Company entered into exchange agreements with holders of the Brekford Warrants pursuant to which the Company issued to the holders an aggregate of 96,924 shares of common stock in exchange for the return of the warrants to the Company for cancellation and extinguishment of the warrant liability.

NOTE 12 – COMMON STOCK OPTION AGREEMENT

On March 16, 2016, two stockholders of the Company entered into an option agreement with Avon Road (collectively, the "Avon Road Parties"). Under the terms of this agreement Avon Road paid the stockholders \$10,000 each (a total of \$20,000) for the right to purchase, on a simultaneous and pro-rata basis, up to 4,318,856 shares of Rekor's common stock owned by those two shareholders at \$0.52 per share, which was determined to be the fair value. The option agreement had a two-year term which would have expired on March 16, 2018. On September 7, 2017, the Avon Road Parties entered into an amended and restated option agreement which extended the right to exercise the option up to and including March 21, 2019 (the "Amended and Restated Option Agreement"). Pursuant to the Amended and Restated Option Agreement, Avon Road exercised the option to purchase 4,318,856 shares of Rekor's common stock.

NOTE 13 – OPERATING LEASES

The Company leases facilities for office space in various locations throughout the United States. The office leases have remaining lease terms of one to five years, some of which include options to terminate within one year.

Effective January 1, 2019, the Company adopted Topic 842, as amended, which requires lessees to recognize a ROU asset and lease liability on the balance sheet for most lease arrangements and expands disclosures about leasing arrangements for both lessees and lessors, among other items. The Company adopted ASU 2016-02 using the optional transition method whereby the Company applied the new lease requirements under ASU 2016-02 through a cumulative-effect adjustment, which after completing its implementation analysis, resulted in no adjustment to the Company's January 1, 2019 beginning retained earnings balance. On January 1, 2019, the Company recognized \$920,950 of ROU operating lease assets and \$950,927 of operating lease liabilities, including noncurrent operating lease liabilities of \$727,513 as a result of adopting this standard. The difference between ROU operating lease assets and operating lease liabilities was primarily due to previously accrued rent expense relating to periods prior to January 1, 2019. As part of adopting ASU 2016-02, the Company elected several practical expedients as discussed in Note 2. The comparative periods have not been restated for the adoption of ASU 2016-02.

Operating lease expense for the three months ended March 31, 2019 and 2018 was \$139,721 and \$192,964, respectively, and is included in selling, general and administrative expenses.

Cash paid for amounts included in the measurement of operating lease liabilities was \$38,735 for the three months ended March 31, 2019.

There were no right-of-use lease assets obtained in exchange for lease obligations for the three months ended March 31, 2019.

Supplemental balance sheet information related to leases was as follows:

	March 31, 2019
Operating lease right-of-use lease assets	\$ 857,624
Lease liability, short term	\$ 201,918
Lease liability, long term	717,681
Total operating lease liabilities	<u>\$ 919,599</u>
Weighted Average Remaining Lease Term - operating leases	4.5
Weighted Average Discount Rate - operating leases	9%

Maturities of lease liabilities were as follows:

	For the Years Ended December 31,
2019 (April to December)	\$ 187,826
2020	302,954
2021	217,272
2022	158,113
2023	159,288
2024	81,558
Total lease payments	1,107,012
Less imputed interest	187,413
Maturities of lease liabilities	<u>\$ 919,599</u>

NOTE 14 – COMMITMENTS AND CONTINGENCIES

NeoSystems

The Company planned to acquire NeoSystems LLC (“NeoSystems”) under an agreement entered into on November 16, 2017. The consummation of the merger was subject to, among other things, the completion of the Qualifying Offering by February 28, 2018. On March 7, 2018, the Company received notice of termination of the Agreement and Plan of Merger (the “NeoSystems Merger Agreement”). The stated basis of termination by NeoSystems was due to the Company’s failure to complete a Qualifying Offering, as defined in the NeoSystems Merger Agreement, by February 28, 2018. The terms of the NeoSystems Merger Agreement provided that upon termination, the Company was required to pay certain fees and expenses of legal counsel, financial advisors, investment bankers and accountants. On November 29, 2018, the Company paid NeoSystems \$225,000 to cover such fees and expenses, which were recorded as a selling, general and administrative expense.

OpenALPR Asset Purchase Agreement

On November 14, 2018, the Company entered into the OpenALPR Purchase Agreement. As consideration for the OpenALPR Acquisition, the Company agreed to pay \$15,000,000, subject to certain adjustments, provided that OpenALPR Technology could elect to receive up to 1,000,000 shares of the Company’s common stock, par value, \$0.0001 per share, in lieu of up to \$5,000,000 in cash valued at a price per share of \$5. The OpenALPR Purchase Agreement was subsequently amended and on March 12, 2019, the Company completed the acquisition of certain assets of OpenALPR Technology and assumed certain liabilities as described in Note 4.

NOTE 15 – EQUITY INCENTIVE PLAN

In August 2017, the Company approved and adopted the 2017 Equity Award Plan (the “2017 Plan”) which replaced the 2016 Equity Award Plan (the “2016 Plan”). The 2017 Plan permits the granting of stock options, stock appreciation rights, restricted and unrestricted stock awards, phantom stock, performance awards and other stock-based awards for the purpose of attracting and retaining quality employees, directors and consultants. Maximum awards available under the 2017 Plan were initially set at 3,000,000 shares.

Stock Options

Stock options granted under the 2017 Plan may be either incentive stock options (“ISOs”) or non-qualified stock options (“NSOs”). ISOs may be granted to employees and NSOs may be granted to employees, directors, or consultants. Stock options are granted at exercise prices as determined by the Board of Directors. The vesting period is generally three to four years with a contractual term of 10 years.

The 2017 Plan is administered by the Administrator, which is currently the Board of Directors of the Company. The Administrator has the exclusive authority, subject to the terms and conditions set forth in the 2017 Plan, to determine all matters relating to awards under the 2017 Plan, including the selection of individuals to be granted an award, the type of award, the number of shares of Rekor common stock subject to an award, and all terms, conditions, restrictions and limitations, if any, including, without limitation, vesting, acceleration of vesting, exercisability, termination, substitution, cancellation, forfeiture, or repurchase of an award and the terms of any instrument that evidences the award.

The Company has also designed the 2017 Plan to include a number of provisions that Rekor's management believes promote best practices by reinforcing the alignment of equity compensation arrangements for nonemployee directors, officers, employees, consultants and stockholders' interests. These provisions include, but are not limited to, the following:

No Discounted Awards. Awards that have an exercise price cannot be granted with an exercise price less than the fair market value on the grant date.

No Repricing Without Stockholder Approval. The Company cannot, without stockholder approval, reduce the exercise price of an award (except for adjustments in connection with a Rekor recapitalization), and at any time when the exercise price of an award is above the market value of Rekor common stock, the Company cannot, without stockholder approval, cancel and re-grant or exchange such award for cash, other awards or a new award at a lower (or no) exercise price.

No Evergreen Provision. There is no evergreen feature under which the shares of common stock authorized for issuance under the 2017 Plan can be automatically replenished.

No Automatic Grants. The 2017 Plan does not provide for "reload" or other automatic grants to recipients.

No Transferability. Awards generally may not be transferred, except by will or the laws of descent and distribution or pursuant to a qualified domestic relations order, unless approved by the Administrator.

No Tax Gross-Ups. The 2017 Plan does not provide for any tax gross-ups.

No Liberal Change-in-Control Definition. The change-in-control definition contained in the 2017 Plan is not a "liberal" definition that would be activated on mere stockholder approval of a transaction.

"Double-trigger" Change in Control Vesting. If awards granted under the 2017 Plan are assumed by a successor in connection with a change in control of the Company, such awards will not automatically vest and pay out solely as a result of the change in control, unless otherwise expressly set forth in an award agreement.

No Dividends on Unearned Performance Awards. The 2017 Plan prohibits the current payment of dividends or dividend equivalent rights on unearned performance-based awards.

Limitation on Amendments. No amendments to the 2017 Plan may be made without stockholder approval if any such amendment would materially increase the number of shares reserved or the per-participant award limitations under the 2017 Plan, diminish the prohibitions on repricing stock options or stock appreciation rights, or otherwise constitute a material change requiring stockholder approval under applicable laws, policies or regulations or the applicable listing or other requirements of the principal exchange on which Rekor's shares are traded.

Clawbacks. Awards based on the satisfaction of financial metrics that are subsequently reversed, due to a financial statement restatement or reclassification, are subject to forfeiture.

When making an award under the 2017 Plan, the Administrator may designate the award as "qualified performance-based compensation," which means that performance criteria must be satisfied in order for an employee to be paid the award. Qualified performance-based compensation may be made in the form of restricted common stock, restricted stock units, common stock options, performance shares, performance units or other stock equivalents. The 2017 Plan includes the performance criteria the Administrator has adopted, subject to stockholder approval, for a "qualified performance-based compensation" award.

A summary of stock option activity under the Company's 2017 Plan for the three months ended March 31, 2019 is as follows:

	Number of Shares Subject to Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding Balance at January 1, 2018	1,695,375	\$ 2.19	9.26	
Granted	48,499	0.73	9.85	
Exercised	(13,998)	1.68	9.50	
Forfeited	(450,633)	1.82	8.71	
Expired	(51,686)	1.36	8.53	
Outstanding Balance at December 31, 2018	<u>1,227,557</u>	<u>\$ 2.13</u>	<u>8.39</u>	<u>\$ -</u>
Granted	130,000	0.68	9.99	
Exercised	-	-	-	
Forfeited	-	-	-	
Expired	(212,100)	1.55	8.08	
Outstanding Balance at March 31, 2019	<u>1,145,457</u>	<u>\$ 2.08</u>	<u>8.41</u>	<u>\$ 2,600</u>
Exercisable at March 31, 2019	<u>732,364</u>	<u>\$ 1.87</u>	<u>8.21</u>	<u>\$ 800</u>
Vested and expected to vest at March 31, 2019	<u>1,021,529</u>	<u>\$ 2.03</u>	<u>8.37</u>	<u>\$ 2,600</u>

Stock compensation expense for the three months ended March 2019 and 2018 was \$62,852 and \$112,455, respectively, and is included in selling, general and administrative expenses in the accompanying consolidated statements of operations. The weighted average grant date fair value of options granted for the three months ended March 31, 2019 and 2018 was \$0.68 and \$2.21, respectively. The intrinsic value of the stock options granted during the three months ended March 31, 2019 was \$2,600. The total fair value of shares that became vested after grant during the three months ended March 31, 2019 and 2018 was \$512,657 and \$1,325,929, respectively.

As of March 31, 2019, there was \$422,097 of unrecognized stock compensation expense related to unvested stock options granted under the 2017 Plan that will be recognized over a weighted average period of 1.56 years.

NOTE 16 – EMPLOYEE BENEFIT PLAN

AOC Key Solutions has a defined contribution savings plan under Section 401(k) of the Internal Revenue Code (the "Code") (the "AOC 401(k) Plan") which was amended on January 1, 2013, as required by the Code. Pursuant to the amended AOC 401(k) Plan, AOC Key Solutions will make nondiscretionary "safe harbor" matching contributions for all participants of 100% of the participant's salary deferrals up to 3%, and 50% of deferrals up to the next 2%, of the participant's compensation.

Rekor Recognition has a defined contribution savings plan under Section 401(k) of the Code (the "Rekor Recognition 401(k) Plan"). The Rekor Recognition 401(k) Plan is a defined contribution plan, which covers substantially all U.S.-based employees who have completed three months of service. The Rekor Recognition 401(k) Plan provides that Rekor Recognition will match 50% of the participant salary deferrals up to 3% of a participant's compensation for all participants.

GCP also maintains a 401(k) plan (the "GCP 401(k) Plan"), which was amended September 15, 2014. However, GCP has not historically made matching contributions to the GCP 401(k) Plan.

On January 1, 2019, the Company established the Novume Solutions, Inc. 401(k) Plan (the "Novume 401(k) Plan"), a Qualified Automatic Contribution Arrangement (QACA) safe harbor plan, and the AOC 401(k) Plan, the Rekor Recognition 401(k) Plan, and the GCP 401(k) Plan were amended and merged into the Novume 401(k) Plan. Employees that satisfied the eligibility requirements became participants in the Novume 401(k) Plan. The Company contributes an amount equal to the sum of 100% of a participant's elective deferrals that do not exceed 1% of participant's compensation, plus 50% of the participant's elective deferrals that exceed 1% of the participants compensation, but do not exceed 6% of the participant's compensation. Employee contributions are fully vested and matching contributions are subject to a two-year service vesting schedule.

The amount of contributions recorded by the Company under these plans during the three months ended March 31, 2019 and 2018 was \$88,571 and \$45,531, respectively.

NOTE 17 – INVENTORY

As of March 31, 2019 and December 31, 2018, inventory consisted entirely of parts of \$120,191 and \$72,702, respectively.

NOTE 18 – EARNINGS (LOSS) PER SHARE

The following table provides information relating to the calculation of earnings (loss) per common share:

	Three Months Ended March 31,	
	2019	2018
Basic and diluted (loss) earnings per share		
Net (loss) earnings from continuing operations	\$ (2,875,199)	\$ (2,193,844)
Less: preferred stock accretion	(178,501)	(155,343)
Less: preferred stock dividends	(114,908)	(114,908)
Net (loss) attributable to shareholders	(3,168,608)	(2,464,095)
Weighted average common shares outstanding - basic	18,800,496	14,496,697
Basic (loss) earnings per share	\$ (0.17)	\$ (0.17)
Weighted average common shares outstanding - diluted	18,800,496	14,496,697
Diluted (loss) earnings per share	\$ (0.17)	\$ (0.17)
Common stock equivalents excluded due to anti-dilutive effect	6,316,157	3,913,995

As the Company had a net loss for the three months ended March 31, 2019, the following 6,316,157 potentially dilutive securities were excluded from diluted loss per share: 3,714,491 for outstanding warrants, 974,487 related to the Series A Preferred Stock, 481,722 related to the Series B Preferred Stock and 1,145,457 related to outstanding options.

As the Company had a net loss for the three months ended March 31, 2018, the following potentially 3,913,995 dilutive securities were excluded from diluted loss per share: 917,950 for outstanding warrants, 974,487 related to the Series A Preferred Stock, 481,722 related to the Series B Preferred Stock and 1,539,836 related to outstanding options.

(Loss) Earnings Per Share under Two – Class Method

The Series A Preferred Stock and Series B Preferred Stock have the non-forfeitable right to participate on an as converted basis at the conversion rate then in effect in any common stock dividends declared and, as such, is considered a participating security. The Series A Preferred Stock and Series B Preferred Stock are included in the computation of basic and diluted loss per share pursuant to the two-class method. Holders of the Series A Preferred Stock and Series B Preferred Stock do not participate in undistributed net losses because they are not contractually obligated to do so.

The computation of diluted (loss) earnings per share attributable to common stockholders reflects the potential dilution that could occur if securities or other contracts to issue shares of common stock that are dilutive were exercised or converted into shares of common stock (or resulted in the issuance of shares of common stock) and would then share in our earnings. During the periods in which the Company records a loss attributable to common stockholders, securities would not be dilutive to net loss per share and conversion into shares of common stock is assumed not to occur.

The following table provides a reconciliation of net (loss) to preferred shareholders and common stockholders for purposes of computing net (loss) per share for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,	
	2019	2018
Numerator:		
Net (loss) earnings from continuing operations	\$ (2,875,199)	\$ (2,193,844)
Less: preferred stock accretion	(178,501)	(155,343)
Less: preferred stock dividends	(114,908)	(114,908)
Net (loss) attributable to shareholders	<u>\$ (3,168,608)</u>	<u>\$ (2,464,095)</u>
Denominator (basic):		
Weighted average common shares outstanding	18,800,496	14,496,697
Participating securities - Series A preferred stock	974,487	974,487
Participating securities - Series B preferred stock	481,722	481,722
Weighted average shares outstanding	<u>20,256,705</u>	<u>15,952,906</u>
Loss per common share - basic under two-class method	<u>\$ (0.16)</u>	<u>\$ (0.15)</u>
Denominator (diluted):		
Weighted average common shares outstanding	18,800,496	14,496,697
Participating securities - Series A preferred stock	974,487	974,487
Participating securities - Series B preferred stock	481,722	481,722
Weighted average shares outstanding	<u>20,256,705</u>	<u>15,952,906</u>
Loss per common share - basic under two-class method	<u>\$ (0.16)</u>	<u>\$ (0.15)</u>

NOTE 19 – SUBSEQUENT EVENTS

Renaming of Novume Solutions, Inc. to Rekor Systems, Inc. and Amendment to Articles of Incorporation or Bylaws

As previously reported by the Company in its Current Report on Form 8-K filed with the SEC on April 30, 2019, on April 26, 2019, Novume Solutions, Inc. changed its legal name (the “Name Change”) to Rekor Systems, Inc. by filing with the Secretary of State of the State of Delaware an amendment (the “Certificate of Amendment”) to its Amended and Restated Certificate of Incorporation (the “Certificate of Incorporation”). The Board of Directors of the Company (the “Board”) approved the Name Change pursuant to Section 242 of the General Corporation Law of the State of Delaware, under which stockholder approval is not required to effect a corporate name change. The Board also adopted the Amended and Restated Bylaws of the Company (the “Amended Bylaws”) to amend and restate the Company’s existing Amended and Restated Bylaws (the “Bylaws”) to reflect the Name Change, effective upon the filing of the Certificate of Amendment with the Secretary of State of the State of Delaware. The Name Change does not affect the rights of the Company’s stockholders, and except for the Name Change, there were no changes to the Certificate of Incorporation or By-Laws.

In connection with the Name Change, the Company changed: the ticker symbol for its common stock on the Nasdaq Stock Market to “REKR” and the CUSIP number for the common stock to 759419 104; the ticker symbol for its Series A Preferred Stock on the OTC Markets OTCQB exchange to “REKRP” and the CUSIP number for the Series A Preferred Stock to 759419 203; and the ticker symbol for Unit Warrants on the OTC Markets OTCQB exchange to “REKRW” and the CUSIP number for the Unit Warrants to 759419 112.

The Company also changed its website address to www.rekorsystems.com and updated its committee charters and corporate policies to reflect the Name Change.

Columbia, Maryland Lease

On May 9, 2019, the Company entered into a sublease agreement (the “Sublease”) with Cardinal Health 121, LLC (the “Sublandlord”) pursuant to which the Company will lease approximately 8,738 rentable square feet located at 7172 Columbia Gateway Driveway, Columbia, Maryland 21046. The term of the Sublease shall commence on the date Sublandlord tenders possession of the premises to the Company and shall expire August 31, 2021 (the “Termination Date”), unless sooner terminated as provided in the Sublease.

The base rent will be \$12,014.75 per month in the first year of the lease, \$12,495.34 per month during the second year of the lease, and \$12,997.78 per month in the third year of the lease through the Termination Date. The base rent includes the Company's proportionate share of operating expense increases, real estate taxes and utility charges. The Sublease contains customary default and indemnification provisions. The Company is required under the terms of the Sublease to maintain customary insurance policies and to deposit security with Sublandlord.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Historical results may not indicate future performance. Certain statements in this Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis ("MD&A"), are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These include estimates, projections, and statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based. These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Our forward-looking statements reflect our current views about future events. They are based on assumptions and subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those contemplated by these statements. Factors that may cause differences between actual results and those contemplated by forward-looking statements include, but are not limited to, those discussed in "Risk Factors" in Item 1A of the Annual Report on Form 10-K filed with the SEC on April 11, 2019. We undertake no obligation to publicly update or revise any forward-looking statements, including any changes that might result from any facts, events or circumstances after the date hereof that may bear upon forward-looking statements. Furthermore, we cannot guarantee future results, events, levels of activity, performance or achievements.

This MD&A is intended to assist in understanding and assessing the trends and significant changes in our results of operations and financial condition. As used in this MD&A, the words, "we," "our" and "us" refer to Rekor Systems Inc., formerly named Novume Solutions, Inc., and its consolidated subsidiaries. This MD&A should be read in conjunction with our condensed consolidated financial statements and related notes included in this report, as well as the consolidated financial statements and MD&A of our Annual Report.

Executive Summary

Our Company

Rekor Systems, Inc. ("Rekor") provides services and products to both government and private sector clients, with an emphasis on public safety, risk management and workforce solutions. Currently, as a leading provider of support services to the government contracting market, our primary clients are companies that serve the government. We provide professional services that offer scalable and compliant outsourced support to these companies. We help these clients capture business by winning government contracts and perform their contract requirements. We also provide specialized staffing services primarily in the aerospace and aviation industries to help clients manage risk by giving them the tools to be prepared for, and respond to, disruptive events and creating secure environments.

A small but growing part of our business provides products and systems for the public safety, security, transportation and logistics areas. As part of this business, we have been working since 2017 to develop and field-test a line of mobile products and related services for use by law enforcement and other public safety entities. These operations are conducted by our Rekor Recognition Systems, Inc. subsidiary, which was formerly named Brekford Traffic Safety, Inc. and is herein referred to as "Rekor Recognition." In connection with this effort, in March 2019 we acquired substantially all of the assets of OpenALPR Technology, Inc. ("OpenALPR Technology"). These assets, consisting principally of vehicle recognition technology are now held in our new subsidiary, OpenALPR Software Solutions, LLC ("OpenALPR"). The technology we acquired currently has the capability to analyze images produced by almost any Internet Protocol camera and identify license plates from over 70 countries, as well as the make, model and color of the vehicle. Our new line of mobile public safety equipment employs this technology and ownership of the rights to the technology allows us to protect what we believe are significant competitive advantages for this new line of products. In addition, due to the advantages we see in the accuracy and speed of this technology, as well as its ability to be used with many widely available camera systems, we also believe that this technology can be used more broadly in the global vehicle recognition system market and serve other large markets in the transportation, security and logistics areas.

Beginning with the first quarter of 2019, we changed our operating and reportable segments from one segment to two segments: the Technology Group; and the Professional Services Group. The two segments reflect our separate focus on technology products and services versus professional services.

The Technology Group includes Rekor Recognition and OpenALPR and will be responsible for our activities in developing technology and distributing and licensing products and services for the public safety and vehicle recognition markets. The Professional Services Group includes AOC Key Solutions, Inc. ("AOC Key Solutions"); Global Technical Services, Inc. ("GTS"); Global Contract Professionals, Inc. ("GCP," and together with GTS, "Global"); and Firestorm Solutions, LLC and Firestorm Franchising, LLC (together, "Firestorm") and will be responsible for our businesses that provide professional services for the government contracting market, staffing services for the aerospace and aviation markets, and crisis and risk services. In connection with this internal reorganization, we also expect to evaluate the possibility of reconfiguring, selling or discontinuing various business assets or entities.

General

The information provided in this discussion and analysis of Rekor's financial condition and results of operations covers the three months ended March 31, 2019 and 2018. The statements of operations and other information provided in this discussion and analysis of the financial condition and results of operations of Rekor should be read in conjunction with the audited consolidated financial statements and the historical financial statements and the related notes thereto.

Recent Acquisitions

Secure Education Consultants Acquisition

On January 1, 2018, we completed our acquisition of certain assets of Secure Education Consultants, Inc. ("Secure Education"). Secure Education's security and safety experts provide customized emergency protocols and critical incident response training for schools and child care organizations and will further augment the risk mitigation and crisis management services we provide to our clients through Firestorm. Consideration paid as part of this acquisition included: \$99,197 in cash, 33,333 shares of Rekor common stock valued at \$163,332; warrants to purchase 33,333 shares of Rekor common stock, exercisable over a period of five years, at an exercise price of \$5.44 per share valued at \$65,988; and warrants to purchase 33,333 shares of Rekor common stock, exercisable over a period of five years at an exercise price of \$6.53 per share valued at \$57,484. The final purchase price allocation for Secure Education is included in our consolidated financial statements for the year ended December 31, 2018. Of these warrants, 66,666 remain outstanding as of March 31, 2019.

OpenALPR Technology Acquisition

On March 12, 2019, we completed our acquisition of certain assets of OpenALPR Technology and assumed certain liabilities. Consideration paid as part of this acquisition was: \$7,000,000 in cash, subject to adjustment after closing; 600,000 shares of Rekor common stock, valued at \$396,600; and \$5,000,000 in principal amount of the 2019 Promissory Notes (described below), together with an accompanying warrant to purchase 625,000 shares of Rekor common stock, exercisable over a period of five years, at an exercise price of \$0.74 per share, valued at \$208,125 (as part of the March 2019 Warrants). Of these warrants, 625,000 remain outstanding as of March 31, 2019.

The preliminary purchase price has been allocated to the assets acquired and liabilities assumed based on fair values as of the acquisition date. Since the acquisition of OpenALPR Technology occurred on March 12, 2019, the results of operations for OpenALPR from the date of acquisition are included in our consolidated statement of operations for the three months ended March 31, 2019.

Key Trends, Developments and Challenges

U.S. Government Spending and the Government Contractor Industry Generally

In March 2018, the Consolidated Appropriations Act of 2018 was signed into law and provided \$1.3 trillion in funding for the U.S. government through September 2018. The Act also appropriated \$500 billion in new federal outlays for defense and domestic programs to be spent over a two-year period. Prior to the beginning of the 2019 U.S. government fiscal year, Congress enacted some of its appropriations bills and provided for continuing resolutions into December 2018 for other appropriations bills. Upon the expiration of the continuing resolutions, those departments and agencies funded by the continuing resolution shut down from December 22, 2018 to January 25, 2019, a period of 34 days and the longest U.S. government shutdown in history. In February 2019, the remaining appropriations bills were enacted to fund the U.S. government through September 2019. The continuing resolutions in 2018 and related government shutdown reduced the number of RFPs issued by the government and thus diminished revenue opportunities for AOC Key Solutions.

While we had anticipated an increasing demand for our services based upon an expected increase in the volume of federal government spending and as our clients elect to outsource their bid and proposal activities, it is still not clear how government spending will be impacted beyond 2019. The administration does have some discretion to delay spending on programs previously authorized.

NeoSystems Merger

We filed a Registration Statement on Form S-1 with the SEC on January 25, 2018. A significant portion of the proceeds from the proposed offering were to be used for the planned acquisition of NeoSystems LLC ("NeoSystems") under an agreement and plan of merger entered into on November 16, 2017 (the "NeoSystems Merger Agreement"). On March 7, 2018, we received notice of termination of the NeoSystems Merger Agreement. Pursuant to the NeoSystems Merger Agreement, we paid NeoSystems \$225,000, which was recorded as a selling, general and administrative expense in the year ended December 31, 2018. No securities were sold in connection with the offering contemplated by the Registration Statement on Form S-1 and it was withdrawn on November 26, 2018.

Sale of Note

On February 13, 2018, Rekor Recognition sold a note receivable from Global Public Safety, LLC ("Global Public Safety"), which it had received as part of the purchase price consideration in connection with the sale of its legacy upfitting business prior to its merger with KeyStone Solutions, Inc. in 2017. On December 31, 2017, based on the decision to sell the note receivable to an unrelated third-party, we reclassified the note receivable balance to a current asset and wrote down \$450,000 as other expense, thus reducing the balance to \$1,475,000. Rekor Recognition continues to retain a 19.9% interest in Global Public Safety.

Promissory Notes

2018 Promissory Note

On April 3, 2018, Rekor and Rekor Recognition entered into a transaction pursuant to which an institutional investor (the "2018 Lender") loaned \$2,000,000 to Rekor and Rekor Recognition (the "2018 Promissory Note"). The 2018 Promissory Note is discussed in further detail in this Management's Discussion and Analysis of Financial Conditions and Results of Operations under the heading "Liquidity and Capital Resources."

2019 Promissory Notes

On March 12, 2019, Rekor entered into a note purchase agreement with investors (the "2019 Lenders") for \$20,000,000 in promissory notes (the "2019 Promissory Notes") and Rekor issued to the 2019 Lenders warrants to purchase 2,500,000 shares of Rekor common stock (the "March 2019 Warrants"). The 2019 Promissory Notes and the March 2019 Warrants amount include the note and warrant issued in the OpenALPR Acquisitions. The 2019 Promissory Notes and March 2019 Warrants are discussed in further detail this in Management's Discussion and Analysis of Financial Conditions and Results of Operations under "Liquidity and Capital Resources."

Other than as discussed above and elsewhere in this Quarterly Report on Form 10-Q, we are not aware of any trends, events or uncertainties that are likely to have a material effect on our financial condition.

Public Offering

On November 1, 2018, we issued 4,125,000 shares of common stock through an underwritten public offering at a public offering price of \$0.80 per share. Net proceeds to Rekor was approximately \$2.8 million. In addition, we granted underwriters a 45-day option to purchase up to 618,750 additional shares of common stock to cover over-allotment, if any. As part of this transaction, we issued to the underwriters warrants to purchase an aggregate of 206,250 shares of common stock, exercisable over a period of five years, at an exercise price of \$1.00 per share. The warrants are exercisable commencing April 27, 2019 and expire on October 29, 2023.

Results of Operations – Comparison of the three months ended March 31, 2019 and 2018

	For the Three Months Ended March 31,	
	2019	2018
Revenue	\$ 11,626,221	\$ 11,218,769
Cost of revenue	8,522,555	8,134,036
Gross profit	3,103,666	3,084,733
Operating expense		
Selling, general, and administrative expenses	4,569,764	5,280,950
Loss from operations	(1,466,098)	(2,196,216)
Other expense		
Loss on extinguishment of debt	(1,112,609)	-
Interest expense	(287,772)	(92,950)
Other income (expense)	3,041	95,322
Total other expense	(1,397,340)	2,372
Loss before taxes	(2,863,438)	(2,193,845)
Income tax (expense) benefit	(11,761)	-
Net loss	\$ (2,875,199)	\$ (2,193,845)

Consolidated operating results for the three months ended March 31, 2019 include operating results for OpenALPR beginning as of March 12, 2019. We also incur general corporate costs which are reported as "Corporate services" and these include costs associated with executive management, financing activities and public company compliance.

	For the Three Months Ended March 31,	
	2019	2018
Revenue:		
Technology group	\$ 1,009,843	\$ 874,202
Professional services group	10,616,378	10,344,567
Total revenue	<u>\$ 11,626,221</u>	<u>\$ 11,218,769</u>
Cost of revenue:		
Technology group	\$ 490,110	\$ 327,796
Professional services group	8,032,445	7,806,240
Total cost of revenue	<u>\$ 8,522,555</u>	<u>\$ 8,134,036</u>
Gross profit:		
Technology group	\$ 519,734	\$ 546,406
Professional services group	2,583,933	2,538,327
Total gross profit	<u>\$ 3,103,666</u>	<u>\$ 3,084,733</u>
Selling, general and administrative expenses:		
Technology group	\$ 718,473	\$ 804,421
Professional services group	2,863,950	2,913,655
Corporate services	987,341	1,562,874
Total operating expenses	<u>\$ 4,569,764</u>	<u>\$ 5,280,950</u>
Loss from operations:		
Technology group	\$ (198,739)	\$ (258,015)
Professional services group	(280,018)	(375,327)
Corporate services	(987,341)	(1,562,874)
Total loss from operations	<u>\$ (1,466,098)</u>	<u>\$ (2,196,216)</u>

Revenue

	For the Three Months Ended March 31,	
	2019	2018
Revenue:		
Technology group	\$ 1,009,843	\$ 874,202
Professional services group	10,616,378	10,344,567
Total revenue	<u>\$ 11,626,221</u>	<u>\$ 11,218,769</u>

Total revenue increased by \$407,452, or 4%, during the three months ended March 31, 2019 compared to the same period in 2018. The increase in total revenue for the Technology Group was primarily due to the inclusion of OpenALPR since its acquisition on March 12, 2019. The increase in total revenue for the Profession Services Group is primarily due to an increase in staffing services and placements offset by a decrease in proposal services as a result of the federal government furlough.

Cost of Revenue

	For the Three Months Ended March 31,	
	2019	2018
Cost of revenue:		
Technology group	\$ 490,110	\$ 327,796
Professional services group	8,032,445	7,806,240
Total cost of revenue	<u>\$ 8,522,555</u>	<u>\$ 8,134,036</u>

Total cost of revenue increased by \$388,519, or 5%, during the three months ended March 31, 2019 compared to the same period in 2018. The increase in cost of revenue for the Technology Group was primarily due to the inclusion of OpenALPR since its acquisition on March 12, 2019. The increase in total cost of revenue for the Professional Services Group is primarily due to an increase in direct billable labor costs supporting the increase in staffing services and crisis and risk services offset by a decrease in direct billable labor as a result of the federal government furlough.

Gross Profit

	For the Three Months Ended March 31,	
	2019	2018
Gross profit:		
Technology group	\$ 519,734	\$ 546,406
Professional services group	2,583,933	2,538,327
Total gross profit	<u>\$ 3,103,666</u>	<u>\$ 3,084,733</u>

Gross profit increased by \$18,933, or 1%, during the three months ended March 31, 2019 compared to the same period in 2018. The increase in gross profit for the Technology Group was primarily due to the inclusion of OpenALPR since its acquisition on March 12, 2019. The decrease in gross profit for the Professional Services Group is primarily due to an increase in direct billable labor costs supporting the increase in staffing services at lower profit margins.

Selling, General and Administrative Expenses

	For the Three Months Ended March 31,	
	2019	2018
Selling, general and administrative expenses:		
Technology group	\$ 718,473	\$ 804,421
Professional services group	2,863,950	2,913,655
Corporate services	987,341	1,562,874
Total operating expenses	<u>\$ 4,569,764</u>	<u>\$ 5,280,950</u>

Selling, general and administrative expenses ("SG&A") decreased by \$711,186, or 13% during the three months ended March 31, 2019 compared to the same period in 2018. The decrease in SG&A for the Technology Group was primarily due to lower labor costs offset by the inclusion of OpenALPR since its acquisition on March 12, 2019. The decrease in SG&A for the Professional Services Group was primarily due to lower labor costs. The decrease in SG&A for Corporate Services was primarily due to lower costs associated with acquisitions and professional services.

Loss from Operations

	For the Three Months Ended March 31,	
	2019	2018
Loss from operations:		
Technology group	\$ (198,739)	\$ (258,015)
Professional services group	(280,018)	(375,327)
Corporate services	(987,341)	(1,562,874)
Total loss from operations	<u>\$ (1,466,098)</u>	<u>\$ (2,196,216)</u>

Loss from operations decreased by \$730,119, or 33%, during the three months ended March 31, 2019 compared to the same period in 2018. The decrease in loss from operations for the three months ended March 31, 2019 compared to the prior year period was attributable to the factors described above.

Other Expense

Other expenses increased by \$1,397,340 during the three months ended March 31, 2019 compared to the same period in 2018. The increase in other expenses for Corporate Services was primarily due to fees associated with the extinguishment of debt of \$1,112,609, which includes lender participation buyout of \$1,050,000 and unamortized financing costs of \$62,609, and an increase in interest expense on outstanding debt.

Income Tax Expense

The income tax expense for the three months ended March 31, 2019, was \$11,761 and is due primarily to the state income taxes and the state of Texas gross receipts tax as compared to an income tax expense of \$0 for the quarter ended March 31, 2018. We established a valuation allowance against deferred tax assets in the fourth quarter of 2017 and have continued to maintain a full valuation allowance through the three months ended March 31, 2019. The \$11,761 income tax expense represents a provision for state income taxes for 2019.

Cash Flow

We believe our existing cash and net cash flow will fund our operations over the next twelve months.

The net cash flows from operating, investing and financing activities for the periods below were as follows:

	For the Three Months Ended March 31,	
	2019	2018
Net cash provided by (used in):		
Operating activities	\$ (1,968,718)	\$ 455,250
Investing activities	(308,107)	1,408,997
Financing activities	4,561,573	(1,637,070)
Net increase (decrease) in cash and cash equivalents:	<u>\$ 2,284,748</u>	<u>\$ 227,177</u>

Cash Used in Operating Activities

For the three months ended March 31, 2019, net cash used in operating activities was \$1,968,718. Cash was used primarily to fund our loss from operations of \$2,875,199 and was affected by the increase in current liabilities of \$239,183, and by an decrease in current assets of \$1,096,550. Rekor also incurred non-cash expenses of \$659,159 including depreciation and amortization, share-based compensation, amortization of right-of-use lease asset, warrant expense, and amortization of financing related costs and intangibles.

For the three months ended March 31, 2018, net cash provided by operating activities was \$455,250. Cash was used primarily to fund our loss from operations of \$2,193,844 and was affected by the increase in current liabilities of \$1,105,978, offset by a decrease in current assets of \$1,140,971. We also incurred non-cash expenses of \$402,145, including depreciation and amortization, share-based compensation, warrant expense and financing related costs.

Cash Provided by and Used in Investing Activities

For the three months ended March 31, 2019, net cash used in investing activities of \$308,107 was primarily related to the development of new products including the capitalization of software development costs and the purchase of computer hardware and equipment.

For the three months ended March 31, 2018, net cash provided by investing activities of \$1,408,997 was primarily as a result of \$1,475,000 of proceeds from the sale of a note receivable.

Cash Provided by Financing Activities

For the three months ended March 31, 2019, net cash provided by financing activities of \$4,561,573 primarily related to the net proceeds from notes payable of \$3,838,402, along with proceeds from short-term borrowings of \$753,437.

For the three months ended March 31, 2018, net cash used in financing activities of \$1,637,070 related to the repayment of short-term borrowings and the payment of Series A and Series B Preferred Stock dividends.

Non-Cash Financing Activities

The 2019 Promissory Notes resulting in the following detailed transaction:

	2019 Promissory Notes
Financing (non-cash):	
Notes payable, includes exit fee	\$ 21,000,000
Debt discount financing costs	(2,599,193)
Extinguishment of debt	(1,112,609)
Repayment of notes payable and interest expense, net of debt discount	(2,515,739)
Investment in OpenALPR Technology, includes \$7,000,000 cash paid and \$5,000,000 note assumed by seller	(12,000,000)
Issuance of warrants in conjunction with notes payable	705,943
Accounts Payable	360,000
Net cash proceeds from notes payable	<u>\$ 3,838,402</u>

In March 2019, we acquired certain assets of OpenALPR Technology. The non-cash consideration for this acquisition included the issuance of 600,000 shares of our common stock valued at \$396,600 and the issuance of warrants to purchase 625,000 shares of Rekor common stock valued at \$176,486.

In January 2018, we acquired the assets of Secure Education. The non-cash consideration for this acquisition included the issuance of 33,333 shares of our common stock valued at \$163,332 and the issuance of warrants to purchase 66,666 shares of Rekor common stock valued at \$123,472.

Lease Obligations

During 2017 and 2018, we leased office space in Chantilly, Virginia under the terms of a ten-year lease expiring October 31, 2019. The lease contained one five-year renewal option. The lease terms included an annual increase in base rent and expenses of 2.75%, which have been amortized ratably over the lease term.

During this same period, we subleased office space in Chantilly, Virginia with an initial term of two years, with eight one-year options for the subtenant to renew the lease through October 31, 2019. This sublease provided for annual increases in base rent and expenses of 2.90%. The initial term ended October 31, 2011 and the subtenant exercised the renewal options through 2014. On April 7, 2015, the sublease was amended to sublease more space to the subtenant and change the rental calculation. The sublease provided for an offset of \$0 and \$45,634 to rent expense for the three months ended March 31, 2019 and 2018, respectively.

Effective December 31, 2018, we terminated the original lease agreement for the Chantilly, Virginia space, and on January 1, 2019, we entered into a new agreement as sublessor for a portion of the original space occupied in this location. This sublease includes annual increases in base rent and expenses of 2.75% and expires on June 30, 2024, with a right to renew subject to the sublessor renewing its lease.

We also lease office space in: New Orleans, Louisiana on a month-to-month basis; Roswell, Georgia under a lease expiring in January 2022; and Fort Worth, Texas under a lease expiring in March 2021. In addition, we lease office space from Global Public Safety on a month-to-month basis and we also lease separate space under an operating lease expiring on June 30, 2019. Furthermore, we leased office space in Grand Rapids, Michigan under a lease which expired on April 30, 2019.

On May 9, 2019, we entered into a sublease agreement to lease office space in Columbia, Maryland commencing on the date we take possession of the premises and expiring on August 31, 2021.

Rent expense, net, for the three months ended March 31, 2019 and 2018 was \$139,721 and \$192,964, respectively, and is included in selling, general and administrative expenses.

Effective January 1, 2019, we adopted Accounting Standards Update "ASU" 2016-02, Leases (Topic 842), as amended, which requires lessees to recognize a right-of-use ("ROU") lease assets, and lease liability on the balance sheet for most lease arrangements and expands disclosures about leasing arrangements for both lessees and lessors, among other items. We adopted ASU 2016-02 using the optional transition method whereby we applied the new lease requirements under ASU 2016-02 through a cumulative-effect adjustment, which after completing our implementation analysis, resulted in no adjustment to our January 1, 2019 beginning retained earnings balance. On January 1, 2019, we recognized \$920,950 of ROU operating lease assets and \$950,927 of operating lease liabilities, including noncurrent operating lease liabilities of \$727,513 as a result of adopting this standard. The difference between ROU operating lease assets and operating lease liabilities was primarily due to previously accrued rent expense relating to periods prior to January 1, 2019. As part of our adoption, we elected the following practical expedients: we have not reassessed whether any expired or existing contracts are or contain leases, we have not reassessed lease classification for any expired or existing leases; we have not reassessed initial direct costs for any existing leases; and we have not separated lease and nonlease components. The adoption of the standard did not have a material impact on our operating results or cash flows. The comparative periods have not been restated for the adoption of ASU 2016-02.

Cash paid for amounts included in the measurement of operating lease liabilities was \$38,735 for the three months ended March 31, 2019.

There were no right-of-use lease assets obtained in exchange for lease obligations for the three months ended March 31, 2019.

Supplemental balance sheet information related to leases was as follows:

	March 31, 2019
Operating lease right-of-use lease assets	\$ 857,624
Lease liability, short term	\$ 201,918
Lease liability, long term	717,681
Total operating lease liabilities	<u>\$ 919,599</u>
Weighted Average Remaining Lease Term - operating leases	4.5
Weighted Average Discount Rate - operating leases	9%

Maturities of lease liabilities were as follows:

	For the Years Ended December 31,
2019 (April to December)	\$ 187,826
2020	302,954
2021	217,272
2022	158,113
2023	159,288
2024	81,558
Total lease payments	1,107,012
Less imputed interest	187,413
Maturities of lease liabilities	<u>\$ 919,599</u>

Liquidity and Capital Resources

During 2019 and 2018, we funded our operations primarily through cash from operating activities from our subsidiaries, revolving lines of credit, issuance of debt, sale of notes and the sale of equity. As of March 31, 2019, we had unrestricted cash and cash equivalents of \$5,051,931 and working capital of \$4,782,021, as compared to unrestricted cash and cash equivalents of \$2,767,183 and working capital deficit of \$43,871 as of December 31, 2018.

The holders of Rekor Series A Preferred Stock are entitled to quarterly dividends in the amount of \$0.175 (7% per annum) per share. Dividends accrue quarterly and dividend payments for declared dividends are due within five business days following the end of a quarter.

On January 5, 2018, April 6, 2018 and July 9, 2018, we paid cash dividends of \$87,907 to shareholders of record of Series A Preferred Stock as of the end of the previous month. On each of September 30, 2018, December 31, 2018 and March 31, 2019, no cash dividend was declared and we accrued dividends of \$87,907 to Series A Preferred Stock shareholders of record. Accrued dividends payable to Series A Preferred Stock shareholders were \$263,722 and \$175,814 as of March 31, 2019 and December 31, 2018, respectively.

As part of the acquisition of Global, we issued 240,861 shares of \$0.0001 par value Series B Preferred Stock. All Series B Preferred Stock was issued at a price of \$10.00 per share with a conversion price of \$5.00 per share. Each Series B Preferred Stock has an automatic conversion feature based on the share price of Rekor. The Series B Preferred Stock is entitled to quarterly cash dividends of 1.121% (4.484% per annum) per share. Dividends accrue quarterly and dividend payments for declared dividends are due within five business days following the end of a quarter. On January 5, 2018, April 6, 2018 and July 9, 2018, we paid cash dividends of \$27,001 to shareholders of record of Series B Preferred Stock as of the end of the previous month. On each of September 30, 2018, December 31, 2018 and March 31, 2019, no cash dividend was declared and we accrued dividends of \$27,001 to Series B Preferred Stock shareholders of record. Accrued dividends payable to Series B Preferred Stock shareholders were \$81,003 and \$54,002 as of March 31, 2019 and December 31, 2018, respectively.

Operating assets and liabilities consist primarily of receivables from billed and unbilled services, accounts payable, accrued expenses, current portion of long-term debt and lines of credit, and accrued payroll and related benefits. The volume of billings and timing of collections and payments affect these account balances.

Global has revolving lines of credit with Wells Fargo Bank National Association ("WFB") ("Wells Fargo Credit Facilities"). WFB agreed to advance to Global, 90% of all eligible accounts with a maximum facility amount of \$5,000,000. Interest is payable under the Wells Fargo Credit Facilities at a monthly rate equal to the Three-Month LIBOR, (as such term is defined under the Wells Fargo Credit Facilities), in effect from time to time plus 3%, plus an additional margin of 3%. Payment of the revolving lines of credit is secured by the accounts receivable of Global. The current term of the Wells Fargo Credit Facilities run through December 31, 2019, with automatic renewal terms of 12 months. WFB or Global may terminate the Wells Fargo Credit Facilities upon at least 60 days' written notice prior to the last day of the current term. The principal balance as of March 31, 2019 and December 31, 2018 was \$2,046,043 and \$1,094,766, respectively. As part of the Wells Fargo Credit Facilities, Global must maintain certain financial covenants. Global met all such financial covenant requirements for the three months ended March 31, 2019.

On November 12, 2017, AOC Key Solutions entered into an Account Purchase Agreement and related agreements (the "AOC Wells Agreement") with WFB. Pursuant to the AOC Wells Agreement, AOC Key Solutions agreed to sell and assign to WFB all of its Accounts (as such term is defined in Article 9 of the Uniform Commercial Code), constituting accounts arising out of sales of Goods (as such term is defined in Article 9 of the Uniform Commercial Code) or rendition of services that WFB deems to be eligible for borrowing under the AOC Wells Agreement. WFB agreed to advance to AOC Key Solutions, 90% of all eligible accounts with a maximum facility amount of \$3,000,000. Interest is payable under the AOC Wells Agreement at a monthly rate equal to the Daily One Month LIBOR (as such term is defined in the AOC Wells Agreement), in effect from time to time plus 5%. The AOC Wells Agreement also provides for a deficit interest rate equal to the then applicable interest rate plus 50% and a default interest rate equal to the then applicable interest rate or deficit interest rate, plus 50%. The initial term of the AOC Wells Agreement runs through December 31, 2018 (the "Initial Term"), with automatic renewal terms of 12 months (the "Renewal Term"), commencing on the first day after the last day of the Initial Term. AOC Key Solutions may terminate the AOC Wells Agreement upon at least 60 days' prior written notice, but no more than 120 days' written notice, prior to and effective as of the last day of the Initial Term or the Renewal Term, as the case may be. WFB may terminate the AOC Wells Agreement at any time and for any reason upon 30 days' written notice or without notice upon the occurrence of an Event of Default (as such term is defined in the AOC Wells Agreement) after the expiration of any grace or cure period. The principal balance as of March 31, 2018 and December 31, 2018 was \$386,606 and \$566,447, respectively. As part of the AOC Wells Agreement, AOC Key Solutions must maintain certain financial covenants. AOC Key Solutions met all such financial covenant requirements for the three months ended March 31, 2019.

On April 3, 2018, Rekor and Rekor Recognition entered into a transaction pursuant to which the 2018 Lender loaned \$2,000,000 to Rekor and Rekor Recognition (the "2018 Promissory Note"). The loan was originally due and payable on May 1, 2019 and bears interest at 15% per annum, with a minimum of 15% interest payable if the loan is repaid prior to May 1, 2019. On October 24, 2018, Rekor and Rekor Recognition entered into a note amendment with the 2018 Lender by which the maturity date of the note was extended to May 1, 2020 (the "2018 Promissory Note Amendment"). In consideration for the agreement of the 2018 Lender to extend the maturity date, Rekor agreed to pay the 2018 Lender \$62,500. The 2018 Promissory Note Amendment further provides for payment of interest through May 1, 2019, if the principal is repaid before May 1, 2019, and for the payment of interest through May 1, 2020, if the principal is repaid after May 1, 2019 and before May 1, 2020. The loan is secured by a security interest in all of the assets of Rekor Recognition. In addition, Rekor issued 35,000 shares of common stock to the 2018 Lender, which shares contain piggy-back registration rights. If the shares are not so registered on the next selling shareholder registration statement, Rekor shall be obligated to issue an additional 15,000 shares to the 2018 Lender. Upon any sale of Rekor Recognition or its assets, the 2018 Lender will be entitled to receive 7% of any proceeds received by Rekor or Rekor Recognition in excess of \$5 million (the "Lender's Participation"). In addition, commencing January 1, 2020, the 2018 Lender shall be paid 7% of Rekor Recognition's earnings before interest, taxes, depreciation and amortization, less any capital expenditures, which amount would be credited for any payments that might ultimately be paid to the 2018 Lender as its Lender's Participation, if any. At April 3, 2018, the fair value of shares issued was \$126,000. At October 24, 2018, an additional \$65,000 fee was paid and designated as financing costs related to the 2018 Promissory Note Amendment. Amortized financing cost for the three months ended March 31, 2019 was determined to be \$31,425 and is included in interest expense. The 2018 Promissory Note has an effective interest rate of 19.5%. On March 12, 2019, the \$2,000,000 balance due on the 2018 Promissory Note was retired in its entirety and Rekor paid to the 2018 Lender \$1,050,000 of consideration for the Lender's Participation and \$75,000 of interest due through May 1, 2019. All of the amounts paid were obtained from the proceeds of the 2019 Promissory Notes.

On November 1, 2018, we issued 4,125,000 shares of common stock through an underwritten public offering at a public offering price of \$0.80 per share. Net proceeds to Rekor was approximately \$2.8 million. In addition, we granted underwriters a 45-day option to purchase up to 618,750 additional shares of common stock to cover over-allotment, if any. The underwriters did not exercise this option and the options were cancelled. As part of this transaction, Rekor also issued to the underwriter warrants to purchase an aggregate of 206,250 shares of common stock, exercisable over a period of five years, at an exercise price of \$1.00 per share. The underwriter warrants have a value of approximately \$0.2 million and are exercisable commencing April 27, 2019 and expire on October 29, 2023.

On March 12, 2019, Rekor issued the 2019 Promissory Notes and the March 2019 Warrants. The loan is due and payable on March 11, 2021 and bears interest at 16% per annum, of which at least 10% per annum shall be paid in cash. The full remaining portion of all interest, if any, shall accrue and be paid-in-kind. The notes also require a premium, if paid before the maturity date, a \$1,000,000 exit fee due at maturity, and compliance with affirmative, negative and financial covenants. Transaction costs were approximately \$403,250 for a work fee payable over 10 months, \$290,000 in legal fees and a \$200,000 closing fee. The loan is secured by a security interest in substantially all of the assets of Rekor. The March 2019 Warrants are exercisable over a period of five years, at an exercise price of \$0.74 per share, and are valued at \$705,943. The warrants are exercisable commencing March 12, 2019 and expire on March 12, 2024. The 2019 Promissory Notes have an effective interest rate of 24.87%.

On March 12, 2019, Rekor retired the entire \$500,000 balance due on a promissory note issued under a March 16, 2016 Subordinated Note and Warrant Purchase Agreement with Avon Road Partners, L.P. ("Avon Road"), an affiliate of Robert Berman, Rekor's President and CEO and a member of our Board of Directors. Under this agreement, we also issued to Avon Road, warrants to purchase 121,247 shares of our common stock. These warrants were exercised on December 11, 2017 for proceeds of \$125,006 and none of these warrants were outstanding as of March 31, 2019 and December 31, 2018. The promissory note to Avon Road was extinguished on March 12, 2019 from proceeds of the 2019 Promissory Notes.

Rekor has generated losses since its inception in August 2017 and has relied on cash on hand, external bank lines of credit, issuance of debt, the sale of a note and the sale of common stock to provide cash for operations. We attribute losses to merger costs, financing costs, public company corporate overhead, lower than expected revenue and lower gross profit of some of our subsidiaries. As of and for the three months ended March 31, 2019, Rekor incurred a net loss from continuing operations of approximately \$2.9 million and used approximately \$2.0 million in net cash from operating activities from continuing operations. Rekor had total cash and cash equivalents of approximately \$5.1 million as of March 31, 2019 and a net working capital of \$4.8 million.

No additional sources of capital have been obtained or committed through the date these consolidated financial statements were available to be issued. There are currently no anticipated changes in the mix and relative cost of capital resources. Although certain of our subsidiaries are profitable, due to the operating costs associated with being a public company and expenses related to product development and commercialization costs at other subsidiaries, we anticipate that we may operate at a loss in the near-term, however, we anticipate this trend reversing for the year ending December 31, 2019.

As of December 31, 2018, Rekor did not have any material commitments for capital expenditures.

Recent Events

Increased Focus on Technology Products and Services, and Name and Symbol Change

On March 29, 2019, we announced that our Board of Directors approved changing the Company's name to Rekor Systems, Inc. (the "Name Change"). The Name Change is a result of our recent acquisition of assets of OpenALPR Technology and increased focus on technology products and services, and aligns with the renaming of Brekford Traffic Safety, Inc. to Rekor Recognition Systems, Inc. In connection with the Name Change, we changed: the ticker symbol for its common stock on the Nasdaq Stock Market to "REKR" and the CUSIP number for the Common Stock to 759419 104; the ticker symbol for its Series A Preferred Stock on the OTC Markets OTCQB exchange to "REKRP" and the CUSIP number for the Series A Preferred Stock to 759419 203; and the ticker symbol for Unit Warrants on the OTC Markets OTCQB exchange to "REKRW" and the CUSIP number for the Unit Warrants to 759419 112.

Off-Balance Sheet Arrangements, Contractual Obligations and Commitments

As of the date of this Quarterly Report on Form 10-Q, we did not have any off-balance sheet arrangements that have had or are reasonably likely to have a material effect on our financial condition, revenues or expenses, results of operations, liquidity, capital resources or capital expenditures.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon Rekor's consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these consolidated financial statements requires the management of Rekor to make estimates and judgments that affect the reported amounts in our consolidated financial statements.

We believe the application of accounting policies, and the estimates inherently required therein, are reasonable. These accounting policies and estimates are periodically reevaluated, and adjustments are made when facts and circumstances dictate a change. Rekor bases its estimates on historical experience and on various other assumptions that management of Rekor believes to be reasonable under the circumstances, the results of which form management's basis for making judgments about the carrying values of assets and liabilities that may not be readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, or if management made different judgments or utilized different estimates.

Rekor's accounting policies are further described in its historical audited consolidated financial statements included in the Form 10-K for the year ended December 31, 2018 filed on April 11, 2019 and the accompanying notes included elsewhere in this Form 10-Q. Rekor has identified the following critical accounting policies:

Revenue Recognition

We recognize revenues for the provision of services when persuasive evidence of an arrangement exists, services have been rendered or delivery has occurred, the fee is fixed or determinable, and the collectability of the related revenue is reasonably assured. Rekor principally derives revenues from fees for services generated on a project by project basis. Revenues for time-and-materials contracts are recognized based on the number of hours worked by our employees or consultants at an agreed upon rate per hour set forth in our standard rate sheet or as written from time to time in our contracts or purchase orders. These costs are recognized in the period in which services are performed.

Revenues related to firm-fixed-price contracts are recognized upon completion of the project as these projects are typically short-term in nature.

The agreements entered into in connection with a project, whether on a time-and-materials basis or firm-fixed-price basis, typically allow our clients to terminate early due to breach or for convenience with 30-days' notice. In the event of termination, the client is contractually required to pay for all time, materials and expenses incurred by us through the effective date of the termination.

For automated traffic safety enforcement revenue, we recognize the revenue when the required collection efforts, from citizens, are completed and posted to the municipality's account. The respective municipality is then billed depending on the terms of the respective contract, typically 15 days after the preceding month while collections are reconciled. For contracts where we receive a percentage of collected fines, revenue is calculated based upon the posted payments from citizens multiplied by our contractual percentage. For contracts where we receive a specific fixed monthly fee regardless of citations issued or collected, revenue is recorded once the amount collected from citizens exceeds the monthly fee per camera. Our fixed fee contracts typically have a revenue neutral provision whereby the municipality's payment to us cannot exceed amounts collected from citizens within a given month. Our software license revenue is recognized at the time of delivery while software and maintenance services revenue are recognized over the period of performance. Our cloud service software license revenue is offered as a fixed quantity over a specified term, for which revenue is recognized ratably.

Accounts Receivable

Accounts receivable are customer obligations due under normal trade terms. We perform continuing credit evaluations of its clients' financial condition, and we generally do not require collateral.

Management reviews accounts receivable to determine if any receivables will potentially be uncollectible. Factors considered in the determination include, among other factors, number of days an invoice is past due, client historical trends, available credit ratings information, other financial data and the overall economic environment. Collection agencies may also be utilized if management so determines.

We record an allowance for doubtful accounts based on specifically identified amounts that are believed to be uncollectible. We also record as an additional allowance a certain percentage of aged accounts receivable, based on historical experience and our assessment of the general financial conditions affecting its customer base. If actual collection experience changes, revisions to the allowance may be required. After all reasonable attempts to collect an account receivable have failed, the amount of the receivable is written off against the allowance. The balance in the allowance for doubtful accounts was \$21,560 and \$24,405 as of March 31, 2019 and December 31, 2018, respectively.

Income Taxes

We use the liability method of accounting for income taxes as set forth in the authoritative guidance for accounting for income taxes. This method requires an asset and liability approach for the recognition of deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Management has evaluated the recoverability of the net deferred income tax assets and the level of the valuation allowance required with respect to such net deferred income tax assets. After considering all available facts, we fully reserved for net deferred tax assets because management believes that it is more-likely-than-not that their benefits will not be realized in future periods. We will continue to evaluate net deferred tax assets to determine whether any changes in circumstances could affect the realization of their future benefit. If it is determined in future periods that portions of our net deferred income tax assets satisfy the realization standard, the valuation allowance will be reduced accordingly.

The tax effects of uncertain tax positions are recognized in the consolidated financial statements only if the position is more-likely-than-not to be sustained on audit, based on the technical merits of the position. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the consolidated financial statements is the largest benefit that has a greater than 50% likelihood of being realized. It is our accounting policy to account for ASC 740-10-25-related penalties and interest as a component of the income tax provision in the consolidated statements of operations and comprehensive loss.

As of March 31, 2019, our evaluation revealed no uncertain tax positions that would have a material impact on the financial statements. The 2015 through 2018 tax years remain subject to examination by the IRS, as of March 31, 2019. Our management does not believe that any reasonably possible changes will occur within the next twelve months that will have a material impact on the financial statements.

Going Concern and Management's Plan

For all annual and interim periods, management will assess going concern uncertainty in our consolidated financial statements to determine whether there is sufficient cash on hand and working capital, including available borrowings on loans and external bank lines of credit, to operate for a period of at least one year from the date the consolidated financial statements are issued or available to be issued, which is referred to as the "look-forward period", as defined in GAAP. As part of this assessment, based on conditions that are known and reasonably knowable to management, management will consider various scenarios, forecasts, projections, estimates and will make certain key assumptions, including the timing and nature of projected cash expenditures or programs, its ability to delay or curtail expenditures or programs and its ability to raise additional capital, if necessary, among other factors. Based on this assessment, as necessary or applicable, management makes certain assumptions around implementing curtailments or delays in the nature and timing of programs and expenditures to the extent it deems probable those implementations can be achieved and management has the proper authority to execute them within the look-forward period.

Rekor has generated losses since its inception in August 2017 and has relied on cash on hand, external bank lines of credit, the sale of a note, debt financing and a public offering of its common stock to support cashflow from operations. We attribute losses to merger costs, public company corporate overhead and development expenses and investments made by some of our subsidiary operations. As of and for the three months ended March 31, 2019, Rekor had a net loss of approximately \$2.9 million and working capital of approximately \$4.8 million. Rekor's net cash position was increased by approximately \$4 million in March 2019 by the issuance of \$20 million senior secured notes, of which \$5 million was non-cash, offset by \$7 million of cash paid for the acquisition of OpenALPR Technology, and approximately \$4 million related to the extinguishment of debt and associated fees.

Management believes that based on relevant conditions and events that are known and reasonably knowable, that its current forecasts and projections, for one year from the date of the filing of the consolidated financial statements in this Quarterly Report on Form 10-Q, indicate Rekor's ability to continue operations as a going concern for that one-year period. We are actively monitoring our operations, cash on hand and working capital. We have contingency plans to reduce or defer expenses and cash outlays should operations weaken in the look-forward period or additional financing is not available.

New Accounting Pronouncements

Recently Issued Accounting Pronouncements

Not Yet Adopted

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-13, *Fair Value Measurement (Topic 820), Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement* ("ASU 2018-13"). This ASU modifies the disclosure requirements for fair value measurements by removing, modifying or adding certain disclosures. ASU 2018-13 is effective for annual periods beginning after December 15, 2019 and interim periods within those annual periods, with early adoption permitted. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. We are currently evaluating the effect that ASU 2018-13 will have on our consolidated financial statements and related disclosures.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815)* ("ASU 2017-12"), which provides guidance related to accounting for hedging activities. ASU 2017-12 expands strategies that qualify for hedge accounting, changes how many hedging relationships are presented in the financial statements, and simplifies the application of hedge accounting in certain situations. ASU 2017-12 will be effective for us beginning July 1, 2019, with early adoption permitted for any interim or annual period before the effective date. Adoption of ASU 2017-12 will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of ASU 2017-12 on our consolidated financial statements, including accounting policies, processes, and systems.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment* ("ASU 2017-04"). To simplify the subsequent measurement of goodwill, ASU 2017-04 requires only a single-step quantitative test to identify and measure impairment based on the excess of a reporting unit's carrying amount over its fair value. A qualitative assessment may still be completed first for an entity to determine if a quantitative impairment test is necessary. ASU 2017-04 is effective for fiscal year 2021 and is to be adopted on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating the effect that this update will have on its financial statements and related disclosures.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"), which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. ASU 2016-13 replaces the existing incurred loss impairment model with an expected loss methodology, which will result in more timely recognition of credit losses. ASU 2016-13 is effective for annual reporting periods, and interim periods within those years beginning after December 15, 2019. We are currently in the process of evaluating the impact of adopting ASU 2016-13 on our consolidated financial statements.

There are currently no other accounting standards that have been issued but not yet adopted that will have a significant impact on our consolidated financial position, results of operations or cash flows upon adoption.

Recently Adopted

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize lease assets and lease liabilities on the balance sheet and requires expanded disclosures about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 and interim periods in fiscal years beginning after December 15, 2018, with early adoption permitted. In July 2018, the FASB issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements* ("ASU 2018-11"). ASU 2018-11 provides entities another option for transition, allowing entities to not apply the new standard in the comparative periods they present in their financial statements in the year of adoption. Effective January 1, 2019, we adopted ASU 2016-02, *Leases (Topic 842)*, as amended, which requires lessees to recognize a ROU lease assets and lease liability on the balance sheet for most lease arrangements and expands disclosures about leasing arrangements for both lessees and lessors, among other items. We adopted ASU 2016-02 using the optional transition method whereby we applied the new lease requirements under ASU 2016-02 through a cumulative-effect adjustment, which after completing our implementation analysis, resulted in no adjustment to our January 1, 2019 beginning retained earnings balance. On January 1, 2019, we recognized approximately \$920,950 of ROU operating lease assets and approximately \$950,927 of operating lease liabilities, including noncurrent operating lease liabilities of approximately \$727,513 as a result of adopting this standard. The difference between ROU operating lease assets and operating lease liabilities was primarily due to previously accrued rent expense relating to periods prior to January 1, 2019. As part of our adoption, we elected the following practical expedients: we have not reassessed whether any expired or existing contracts are or contain leases, we have not reassessed lease classification for any expired or existing leases; we have not reassessed initial direct costs for any existing leases; and we have not separated lease and nonlease components. The adoption of the standard did not have a material impact on our operating results or cash flows. The comparative periods have not been restated for the adoption of ASU 2016-02.

In June 2018, the FASB issued ASU No. 2018-07, *Compensation – Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting* ("ASU 2018-07"), which is intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share-based compensation. ASU 2018-07 is effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods, with early adoption permitted but no earlier than an entity's adoption date of Topic 606. The Company adopted the provisions of ASU 2018-07 effective January 1, 2019. Adopting ASU 2018-07 had no impact on the Company's consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), which was further amended in 2015 and 2016 (Topic 606). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes previous revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the previous revenue guidance. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented (full retrospective method), or apply the requirements in the year of adoption, through a cumulative adjustment (modified retrospective method). The Company adopted Topic 606 effective January 1, 2018 using the modified retrospective method. The adoption of Topic 606 resulted in the following changes: a change to franchisee agreements recorded prior to 2017; and the timing of certain contractual agreements which the Company deemed as immaterial. Revenue recognition related to the Company’s other revenue streams remained substantially unchanged following the adoption of Topic 606 and therefore did not have a material impact on its revenues. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation - Stock Compensation: Scope of Modification Accounting* (“ASU 2017-09”), which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity will account for the effects of a modification unless the fair value of the modified award is the same as the original award, the vesting conditions of the modified award are the same as the original award and the classification of the modified award as an equity instrument or liability instrument is the same as the original award. ASU 2017-09 is effective for fiscal year 2019. The update is to be adopted prospectively to an award modified on or after the adoption date. Early adoption is permitted. We adopted ASU 2017-09 in 2018 and the impact was not material to our consolidated financial statements and related disclosures.

We do not believe that any other recently issued and adopted accounting standards, in addition to those referenced above, had a material effect on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

As a “smaller reporting company” as defined by Item 10 of Regulation S-K, Rekor is not required to provide information required by this Item.

Item 4. Controls and Procedures

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation under the supervision and with the participation of management, including our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) of the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this review, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of March 31, 2019.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rule 13a-15(f) of the Exchange Act.

Our management assessed the effectiveness of our internal control over financial reporting as of March 31, 2019, based on the criteria set forth in “Internal Control – Integrated Framework (2013)” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment and due to the material weaknesses described below, our management concluded that, as of March 31, 2019, our internal control over financial reporting was not effective.

Management Progress on Addressing Material Weakness

We identified material weaknesses for the years ended December 31, 2018 and 2017, which were related to our internal control over financial reporting. To address the material weaknesses, we hired a Chief Accounting Officer, formed a disclosure control committee, educated our Board of Directors on SEC filings and triggering events for financial reporting, implemented a financial reporting timetable, reviewed procedures for draft documents, implemented monthly certification of financial reports, tracked monthly financial activity, and had our executives review financial results and budgets. In addition, we augmented our accounting reporting staff by hiring an accounting manager and are realigning our accounting staff in order to strengthen internal controls over financial reporting. These efforts, which are ongoing, have improved the design and operational effectiveness of our control processes and systems for financial reporting, however, our management concluded that as of March 31, 2019, the material weaknesses identified for the years ended December 31, 2018 and 2017 had not been remediated. Otherwise, there was no change in our internal control over financial reporting during the quarter ended March 31, 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We may from time to time be subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these claims cannot be predicted with certainty, we do not believe that the outcome of any of these legal matters will have a material adverse effect on our results of operations or financial condition. As of March 31, 2019, we were not aware of any material legal proceedings or claims.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in “Risk Factors” in our Annual Report on Form 10-K as filed with the SEC on April 11, 2019.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sales of Unregistered Securities

On March 12, 2019, as partial consideration for its acquisition of certain assets of OpenALPR, Rekor issued 600,000 shares of its common stock to the seller, valued at \$396,600. On the same date, Rekor issued senior secured promissory notes in an aggregate principal amount of \$20 million and warrants to purchase 2,500,000 shares of its common stock, which are immediately exercisable at an exercise price of \$0.74 per share, to certain individuals and entities.

The foregoing issuances were issued in reliance upon the exemptions from registration under the Securities Act of 1933, as amended, provided by Section 4(a)(2) and Rule 506 of Regulation D promulgated thereunder.

Use of Proceeds

In November 2018, Rekor completed a public offering of its common stock (the “Offering”) and issued and sold 4,125,000 shares of its common stock at a public offering price of \$0.80 per share.

The offer and sale of all of the shares in the Offering was registered under the Securities Act pursuant to a registration statement on Form S-3 (File No. 333-224423) (the “S-3 Registration Statement”), which was declared effective by the SEC on April 30, 2018, a preliminary prospectus supplement to the S-3 Registration Statement filed with the SEC on October 25, 2018 (the “Preliminary Prospectus Supplement”), a free writing prospectus filed with the SEC on October 24, 2018 (the “Free Writing Prospectus”), and a final prospectus supplement to the S-3 Registration Statement filed with the SEC on October 31, 2018 (the “Final Prospectus Supplement” and the S-3 Registration Statement as supplemented by the Preliminary Prospectus Supplement and the Final Prospectus Supplement, together with the Free Writing Prospectus, the “Registration Statement”). Under the Registration Statement, Rekor registered 4,125,000 shares of common stock and 618,750 shares of common stock issuable upon exercise of the underwriters’ option to purchase additional shares of common stock at a public offering price of \$0.80 per share for a registered aggregate offering price of approximately \$3.8 million. Following the sale of the shares in connection with the closing of the Offering on November 1, 2018, the Offering terminated. The Offering commenced on October 24, 2018 and did not terminate until the sale of all of the shares offered. ThinkEquity, a division of Fordham Financial Management, Inc. and The Benchmark Company, LLC acted as joint book-running managers of the Offering.

Rekor received aggregate gross proceeds from the Offering of approximately \$3.3 million, and aggregate net proceeds of approximately \$2.8 million after deducting underwriting discounts and commissions of \$0.2 million and offering expenses of \$0.3 million, for total expenses, including underwriting discounts and commissions of \$0.5 million. No payments for such expenses were made directly or indirectly to any of Rekor’s officers, directors, or their associates, any persons owning 10% or more of any class of Rekor’s equity securities or any of Rekor’s affiliates.

There has been no material change in Rekor’s planned use of the net proceeds from the Offering as described in the Final Prospectus Supplement.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed/ Furnished Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Certificate of Amendment to Amended and Restated Certificate of Incorporation of Novume Solutions, Inc. as filed with the Secretary of State of Delaware on April 26, 2019	8-K	001-38338	3.1	4/30/19	
3.2	Amended and Restated Bylaws of Rekor Systems, Inc.	8-K	001-38338	3.2	4/30/19	
4.1	Form of Warrant issued by Novume Solutions, Inc. on March 12, 2019	8-K	001-38338	4.1	3/18/19	
4.2	Form of Senior Secured Note issued by Novume Solutions, Inc. on March 12, 2019	8-K	001-38338	4.2	3/18/19	
4.3	Note Purchase Agreement, dated as of March 12, 2019, by and among Novume Solutions, Inc., Cedarview Capital Management, LP, the Guarantors from time to time party thereto, U.S. Bank National Association, and the Purchasers from time to time party thereto	8-K	001-38338	4.3	3/18/19	
10.1#	Employment Agreement, dated as of November 14, 2018, by and between Novume Solutions, Inc. and Matthew Hill	8-K	001-38338	10.2	11/15/18	
10.2	Asset Purchase Agreement, dated as of November 14, 2018, by and among Novume Solutions, Inc., OpenALPR Technology, Inc. and Matthew Hill	8-K	001-38338	10.1	11/15/18	
10.3	Amendment No. 1 to Purchase Agreement, dated as of February 15, 2019, by and among Novume Solutions, Inc., OpenALPR Technology, Inc. and Matthew Hill	8-K	001-38338	10.1	3/18/19	
10.4	Amendment No. 2 to Purchase Agreement, dated as of March 12, 2019, by and among Novume Solutions, Inc., OpenALPR Technology, Inc. and Matthew Hill	8-K	001-38338	10.2	3/18/19	
10.5	Sublease effective January 1, 2019 by and between BlueWater Federal Solutions, Inc. and AOC Key Solutions, Inc.	10-K	001-38338	10.17	4/11/19	
10.6	Sublease effective May 9, 2019 by and between Cardinal Health 121, LLC and Rekor Systems, Inc.					*
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer					*
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer					*
32.1	Section 1350 Certification of Chief Executive Officer					**
32.2	Section 1350 Certification of Chief Financial Officer					**
101.INS	XBRL Instance Document					*
101.SCH	XBRL Taxonomy Extension Schema Document					*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					*

* Filed herewith.

** Furnished herewith.

Indicates management contract or compensatory plan.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Rekor Systems, Inc.

/s/ Robert A. Berman
Name: Robert A. Berman
Title: Chief Executive Officer,
Director
(Principal Executive Officer and Authorized Signatory)
Date: May 14, 2019

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
<u>/s/ Robert A. Berman</u> Robert A. Berman	Chief Executive Officer (Principal Executive Officer) and Director	May 14, 2019
<u>/s/ Riaz Latifullah</u> Riaz Latifullah	EVP, Corporate Development (Principal Financial and Accounting Officer)	May 14, 2019
<u>/s/ James K. McCarthy</u> James K. McCarthy	Chairman of the Board and Director	May 14, 2019
<u>/s/ Richard Nathan</u> Dr. Richard Nathan	Director	May 14, 2019
<u>/s/ Glenn Goord</u> Glenn Goord	Director	May 14, 2019
<u>/s/ Paul de Bary</u> Paul de Bary	Director	May 14, 2019
<u>/s/ Christine J. Harada</u> Christine J. Harada	Director	May 14, 2019
<u>/s/ David Hanlon</u> David Hanlon	Director	May 14, 2019

SUBLEASE AGREEMENT

This Sublease Agreement (“**Sublease**”) is entered into as of this 9th day of May, 2019 (“**Effective Date**”), by and between **Cardinal Health 121, LLC**, a Delaware limited liability company (hereinafter “**Sublandlord**”) and **Rekor Systems, Inc.**, a Delaware corporation (hereinafter “**Subtenant**”).

Recitals

A. Sublandlord has leased from **Exeter 7164 Columbia Gateway, LLC**, a Delaware limited liability (hereinafter “**Landlord**”), certain premises, containing approximately 31,241 rentable square feet of floor area known as Suites 100, 300, and 400 in the building located at 7172 Columbia Gateway Driveway, Columbia, Maryland 21046 (such building hereinafter referred to as the “**Building**,” and such premises hereinafter referred to as the “**Premises**”) pursuant to the terms of a certain lease agreement dated March 5, 2010 (hereinafter the “**Original Lease**”), as amended by that First Amendment to Lease dated October 3, 2013 (hereinafter, the “**First Amendment**”) and collectively with the Original Lease and any other amendments or modifications, hereinafter the “**Lease**”), a copy of which is attached hereto as Exhibit A.

B. Sublandlord is willing to sublease to Subtenant a portion of the Premises including approximately 8,738 rentable square feet of floor area in Suite 400 (hereinafter the “**Subleased Premises**”) as depicted on Exhibit B, attached hereto, and Subtenant is willing to sublease the Subleased Premises from Sublandlord subject and pursuant to the terms hereinafter set forth.

Agreement

It is mutually agreed:

Section 1. Subleased Premises. Sublandlord hereby subleases the Subleased Premises to Subtenant, together with all obligations and all parking and other rights attributable to the Subleased Premises under the Lease, if any, and Subtenant hereby subleases the Subleased Premises and such obligations and rights from Sublandlord. Subtenant has had an opportunity to inspect the Subleased Premises and accepts it in their “AS IS” condition. Sublandlord shall have no obligation to undertake any improvements, alterations, or maintenance obligations on behalf of Subtenant, provided, however, Sublandlord shall notify Landlord of any maintenance deficiencies or repair obligations of Landlord under the Lease within two (2) business days after Subtenant notifies Sublandlord of such deficiencies. Except as otherwise expressly stated in this Sublease, Subtenant shall be responsible for performing all obligations of Sublandlord owed to Landlord under the terms of the Lease with respect to the maintenance and repairs of the Subleased Premises. Sublandlord covenants that Subtenant may peaceably and quietly enjoy the Subleased Premises without disturbance by Sublandlord or any person claiming by, through or under Sublandlord, subject nevertheless to the terms and conditions of this Sublease and to the Lease and any other leases, mortgages, or other matters to which this Sublease is subordinate.

Section 2. Term. The term of this Sublease (“**Term**”) shall commence on the later of (i) May 1, 2019 or (ii) the date Sublandlord tenders possession of the Subleased Premises to

Section 3. Subtenant (the "**Commencement Date**") and shall expire August 31, 2021, unless sooner terminated as provided in this Sublease (the "**Termination Date**"). In no event shall Subtenant have any right to extend the Term beyond the term of the Sublease. Within thirty (30) days of the Commencement Date, Sublandlord and Subtenant shall execute a commencement date certificate substantially in the form of Exhibit G, attached hereto (the "Commencement Date Certificate").

Section 4. Annual Base Rent. Commencing on the Commencement Date and throughout the Term, Subtenant shall pay to Sublandlord monthly base rent ("**Base Rent**") for the Subleased Premises at the rate per month set forth in the table below. Commencing on the anniversary of the Commencement Date (and if the Commencement Date is not the first day of the month, then the first day of the calendar month in which the Commencement Date occurs), and continuing for every twelve (12) month period thereafter, Base Rent shall increase in accordance with the schedule listed in the table below. If the Commencement Date is not the first day of the calendar month, the monthly installment of Base Rent payable by Subtenant shall be prorated on a day for day basis in accordance with the terms of Section 4.1 of the Lease. Base Rent shall be paid monthly in advance, on or before the first business day of every calendar month throughout the Term in accordance with the following schedule:

Lease Year	Annual Base Rent per Rentable Square Foot	Annual Base Rent Total	Monthly Base Rent Payment Totals
Year 1	\$16.50	\$144,177.00	\$12,014.75
Year 2	\$17.16	\$149,944.08	\$12,495.34
Start of Year 3 through the Termination Date	\$17.85	\$155,973.30	\$12,997.78

Sublandlord and Subtenant hereby acknowledge that the Base Rent payable pursuant to this Section 3 includes Subtenant's proportionate share of Tenant's Share of Operating Expense Increases, Real Property Taxes, utility charges, and all other charges payable by Sublandlord under the Lease for the Subleased Premises.

Section 5. Base Rent Abatement Period. Notwithstanding anything to the contrary contained in this Sublease, provided that Subtenant is not in default of its obligations under this Sublease prior to or during the Base Rent Period (as such term is defined hereunder), commencing on the Commencement Date and continuing throughout the first (1st) sixty-one (61) days of the Term of this Sublease (the "**Base Rent Abatement Period**"), Base Rent shall be abated by an amount equal to one hundred percent (100%) of the Base Rent otherwise due.

Section 6. Advanced Rent Payment. Upon the execution and delivery of the Sublease, Subtenant shall pay to Sublandlord an amount equal to \$25,012.53 ("**Advanced Rent Payment**"), comprised collectively of the installment of the Base Rent due for the first (1st) full calendar month of the Term and the installment of the Base Rent due for the last full calendar month of the Term ("**Advanced Rent Payment**"). The Advanced Rent Payment shall be applied to the first and last monthly installments of Base Rent, respectively, coming due under this Sublease.

Section 7. Utilities and Janitorial Services. Charges for the utility services consumed by Subtenant in or at the Subleased Premises during the Term (including electricity, and natural gas provided by Landlord) shall be included in the Base Rent. All Building services and utility services (to the extent applicable) shall be provided in accordance with the terms of Section 11 of the Lease. Sublandlord shall not be liable to Subtenant for or any interruption or termination of utility services. Subtenant shall provide, at its own expense, any janitorial services it may use or require for the Subleased Premises. Subtenant shall not exceed the occupancy density ratio allocated to the Subleased Premises in accordance with Section 11.2 of the Lease during the Term. In the event Subtenant exceeds such density ratio in connection with its use of the Subleased Premises, Subtenant acknowledges and agrees that Subtenant shall be solely liable and responsible for all of the obligations and covenants of the Tenant under Section 11.2 of the Lease occasioned by such excessive usage, including without limitation, all costs and expenses in connection with any additional services and utilities supplied to the Subleased Premises, any installation of additional systems and equipment serving the Subleased Premises, and any repair to Subleased Premises due to damage or wear and tear. To the extent Landlord does not provide any service to Sublandlord under the Lease that are not otherwise reimbursed as Operating Expenses, Subtenant shall contract directly with the service provider for such services (which shall include, but shall not be limited to telecommunications services).

Sublandlord agrees, upon Subtenant's request, to use reasonable efforts (excluding litigation or other adversarial proceedings), at Subtenant's expense, (a) to cause Landlord to provide any Building services contemplated under the Lease to be provided to Subtenant, or (b) to obtain Landlord's consent or approval under the Lease whenever required by the Lease, including promptly requesting such consent or approval from Landlord. Sublandlord and Subtenant hereby agree that reasonable efforts shall include, without limitation, Sublandlord promptly (x) providing written notice to Landlord (or oral notice if permitted under the terms of the Lease) after Sublandlord receives notice from Subtenant hereunder, (y) providing Subtenant with copies of written notices or written responses received from Landlord relating to the Building services or any requested consents or approval, and (z) otherwise keeping Subtenant reasonably informed as to communications with Landlord relating to the Sublease Premises and the use thereof, the Building services and any requested consents or approvals hereunder or under the Lease.

Section 8. Use of Subleased Premises. Subtenant shall use the Subleased Premises for general office use only in conformance with the terms of the Lease, and for no other purpose. Subtenant shall have no right to erect or change any Building Signage without the express written consent of Sublandlord, which consent shall not be unreasonably withheld, conditioned, or delayed, provided however, Sublandlord's consent shall be subject to and conditioned upon Landlord's express consent in accordance with the terms of the Lease. Subtenant shall have no right to use any existing external or backup generator currently used by Sublandlord at the Subleased Premises.

Section 9. Subordination of Sublease. This Sublease shall be subject to and subordinate to the terms of the Lease. Upon the termination of the Lease for any reason, this Sublease shall automatically terminate and Subtenant shall vacate the Subleased Premises in accordance with the requirements for surrender of the Premises by the Tenant under Section 7.2 of the Lease.

Section 10. Alterations and Improvements. Notwithstanding any terms in the Lease to the contrary, Subtenant may not make or permit to be made, alterations or improvements to the Subleased Premises (including without limitation, telecommunications, data transmission and other wiring), without the prior written consent of Sublandlord, which consent shall not be unreasonably withheld, conditioned, or delayed, provided however, Sublandlord's consent shall be subject to and conditioned upon Landlord's express consent in accordance with the terms of the Lease. All such alterations or improvements to be performed by Subtenant, including any work requested by Subtenant as necessary for Subtenant to prepare the Subleased Premises for its occupancy as approved and described in the work letter attached as Schedule I to Exhibit C, and as detailed in the drawings from Banta Campbell Architects, Inc. and attached as Schedule I to Exhibit C ("**Subtenant's Improvements**"), shall be made in accordance with the express terms of the Lease and shall be subject to all approval or removal requirements contained in the Lease. At the time of Sublandlord's and Landlord's approval of any alterations or improvements in accordance with the terms of this Sublease, Sublandlord or Landlord shall notify Subtenant in writing whether or not Subtenant will be required to remove any such alterations or improvements prior to the expiration of the Term and restore any portion of the Subleased Premises to its original condition. Subtenant shall promptly pay all costs and expenses attributable to any and all alterations and improvements and shall indemnify Sublandlord and Landlord against any (i) mechanics' liens or other liens or claims filed or asserted as a result thereof and against any costs related thereto or (ii) expenses which may be incurred as a result of building code violations attributable to such alterations or improvements. Subtenant shall promptly repair any damage to the Subleased Premises or to the Building caused by any and all alterations or improvements. Subtenant shall indemnify Sublandlord and Landlord for any claims, causes of action, or damages arising from or associated with such alterations. Subtenant's obligation to indemnify Landlord and Sublandlord pursuant to this Section 9 shall survive the termination of this Sublease. Unless Sublandlord otherwise requires removal by Subtenant during the Term, any alterations or improvements to the Subleased Premises, except movable furniture and equipment and trade fixtures, shall become the property of Sublandlord, and shall not be removed by Subtenant.

Section 11. Existing Personal Property. Subtenant shall have the right to use Sublandlord's furniture and equipment ("**Personal Property**") listed on Exhibit D at no additional cost and expense to Subtenant during the Term. Sublandlord does not warrant the suitability of the Personal Property and Subtenant shall accept such Personal Property in its "AS IS" condition with all faults. Subtenant shall maintain the Personal property in good condition, subject to reasonable wear and tear from regular use. Sublandlord shall have no obligation or liability for the repair or replacement of the Personal Property. Subtenant shall have the right to relocate and modify the Personal Property, provided however, the Personal Property shall not be removed from the Subleased Premises without Sublandlord's express written consent, which consent shall not be unreasonably withheld, conditioned or delayed. In the event Sublandlord consents to the removal of any of the Personal Property from the Subleased Premises during the Term, then: (i) such removal and storage of the Personal Property shall be at Subtenant's sole cost and expense; (ii) Subtenant shall be solely responsible for any repair or replacement of the Personal Property occasioned by such removal; and (iii) Sublandlord shall continue to own all such Personal Property during the Term, subject to the automatic transfer of the Personal Property to Subtenant described herein. Upon the expiration of the Term, provided that Subtenant is not in default of its obligations under this Sublease, the Personal Property shall automatically be transferred and conveyed to Subtenant for an amount equal to \$1.00. Sublandlord shall have the right to provide a bill of sale to Subtenant to reflect such sale. After such transfer of the Personal Property as provided herein, Subtenant shall thereafter be solely responsible for removing the Personal Property following its occupancy of the Subleased Premises in accordance with the terms of the Lease.

Section 12. Sublandlord Representations. Sublandlord represents and warrants to Subtenant that to the best knowledge of Sublandlord, neither Landlord nor Sublandlord is in default in the performance of any covenant, agreement or condition contained in the Lease, and the Lease is in full force and effect.

Section 13. Parking. Subject to the use restrictions expressly stated in Section 16.1 of the Lease, during the Term, Subtenant shall have the non-exclusive right to use sixty (60) unreserved parking spaces allocated to Sublandlord under the Lease, subject to the rights of any existing subtenant(s). The unreserved parking spaces allocated to Sublandlord under the Lease are shaded in yellow on the parking site plan attached hereto as Exhibit E (the "**Parking Site Plan**").

Section 14. Assignment or Subletting. Subtenant shall not assign this Sublease or any estate or interest therein or right of occupancy thereunder (including any mortgage or other collateral assignment) or sublet the Subleased Premises or any part thereof without the prior written consent of Sublandlord and Landlord, as may be required under the Lease, which consent shall not be unreasonably withheld, conditioned, or delayed, provided however, Sublandlord's consent shall be subject to and conditioned upon Landlord's express consent in accordance with the terms of the Lease.

Section 15. Waiver of Subrogation. Any provision of the Lease with respect to the waiver of subrogation shall apply under this Sublease, except that "Sublandlord" shall be substituted for "Landlord" and "Subtenant" shall be substituted for "Tenant." In addition to the foregoing, any obligation under Section 8.4 of the Lease for Tenant to waive any rights of subrogation with respect to claims against Landlord shall apply to Subtenant, and Subtenant affirmatively waives and hereby releases any right of recovery against Landlord in accordance with the requirements of Section 8.4 of the Lease.

Section 16. Insurance. Subtenant shall maintain with respect to the Subleased Premises all insurance required to be maintained by Sublandlord pursuant to the Lease. Such insurance shall name Sublandlord as an additional insured, and, if any of such insurance is required by the Lease to cover Landlord or anyone else or to name Landlord or anyone else as an additional insureds, it shall also be required to cover Landlord and such others and name Landlord and such others as an additional insureds. Subtenant shall provide certificates of insurance to Sublandlord prior to taking occupancy of the Subleased Premises and upon renewals of such policies. Subtenant shall endeavor to provide a thirty (30) day written notice of any cancellation prior to the policy(ies) expiration date. If Subtenant should fail to comply with the foregoing requirements relating to insurance, Landlord and Sublandlord shall have the right, but not the obligation, to obtain such insurance on Subtenant's behalf, in which event Subtenant shall reimburse Landlord and/or Sublandlord, as the case may be, on demand for all reasonable costs and expenses incurred by such party in obtaining such insurance.

Section 17. Indemnification. Without limiting any specific agreement of Subtenant to indemnify, defend and/or hold Sublandlord harmless provided for in this Sublease, Subtenant acknowledges and agrees that any and all provisions of the Lease providing for the Tenant hereunder to indemnify, defend and/or hold harmless the Landlord, and any and all waivers of the tenant under the Lease, are hereby incorporated into this Sublease and made by Subtenant to, for the benefit of and in favor of Sublandlord. The foregoing indemnity shall not relieve any insurance carrier of its obligations under policies required to be carried by Subtenant pursuant to the provisions of this Sublease to the extent that such policies cover the results of such acts or conduct. In addition to the foregoing, Subtenant agrees, to the fullest extent permitted by law, to indemnify, defend, and hold Sublandlord and its employees, partners, agents, contractors, and lenders harmless from and against any and all loss, cost, expense, or liability (including, without limitation, reasonable attorneys' fees, accountants' fees, and court costs) resulting from any claims or causes of action existing in favor of or asserted by any party arising out of or relating to Subtenant's failure to perform any duties or obligations imposed on Subtenant under this Sublease.

Section 18. Compliance with Lease. Except as otherwise expressly provided under this Sublease, Subtenant shall comply with all of the obligations imposed by the Lease on Sublandlord, and Subtenant shall indemnify, defend and hold harmless Sublandlord from any default by Subtenant under this Sublease or the Lease. In the event of any conflict between the terms of the Lease and this Sublease, the terms of this Sublease shall control as between Sublandlord and Subtenant. Subtenant, its employees, agents, licensees and visitors will at all times faithfully observe and comply with the Rules and Regulations, as set forth in Exhibit C of the Lease.

Section 19. Subtenant's Default. The occurrence of any one or more of the following events shall be deemed a default and breach of this Sublease by Subtenant (each an "**Event of Default**"):

A. Subtenant's failure to make any payment of Base Rent or any other payment required to be made by Subtenant hereunder, as and when due which failure shall continue for five (5) business days after receipt of written notice from Sublandlord;

B. Subtenant's failure to perform or observe any term, condition, covenant or obligation required to be performed or observed by it under this Sublease (other than a default under Section 18.A of this Sublease), for more than thirty (30) days after receipt of written notice thereof from Sublandlord (or such longer period as may be allowed under the terms of the Lease to cure such failure); and

C. Subtenant's failure to perform or observe any term, condition, covenant or obligation required to be performed or observed by Sublandlord under the Lease, and such failure continues beyond any applicable notice or cure period provided for in the Lease.

Any occurrence under Section 18.A, Section 18.B, or Section 18.C of this Sublease shall be deemed an event of default under the Lease with respect to Subtenant under this Sublease. Upon the occurrence of any Event of Default under this Sublease, Sublandlord shall have all rights afforded to Landlord under the Lease.

Section 20. Security Deposit. Upon Subtenant's execution of this Sublease, Subtenant shall deposit with Sublandlord one monthly installment of Base Rent in the amount equal to \$12,014.75 as the "**Security Deposit**" which shall be retained by Sublandlord as security for Subtenant's payment of Base Rent, and performance of its other obligations under the provisions of this Sublease. On the occurrence of an event of default, Sublandlord shall be entitled, at its sole discretion, to (a) apply any or all of such sum in payment of any Base Rent due and unpaid, any expense incurred by Sublandlord in curing any such event of default, and any damages incurred by Sublandlord by reason of such event of default (including but not limited to reasonable attorneys' fees); or (b) retain any or all of such sum in liquidation of any or all damages suffered by Sublandlord by reason of such default. The Security Deposit shall not be applied to the last month's installment of Base Rent; rather, upon the expiration of this Sublease, provided Subtenant is not in default of its obligations hereunder, any of the Security Deposit then remaining shall be returned to Subtenant within thirty (30) days after the Expiration Date.

Section 21. Miscellaneous.

A. Waiver. One or more waivers of any breach by Sublandlord of any covenant or condition of this Sublease shall not be construed as a waiver of subsequent breach of the same covenant or condition, and the consent or approval by Sublandlord to or for any act by the other requiring consent or approval shall not be deemed to render unnecessary consent or approval to or for any subsequent similar act. No breach of a covenant or condition of this Sublease shall be deemed to have been waived by Sublandlord, unless such waiver is in writing signed by Sublandlord.

B. Entire Agreement. This Sublease and the Exhibits attached hereto set forth all of the covenants, promises, agreements, conditions and understandings between Sublandlord and Subtenant concerning the Subleased Premises and there are no covenants, promises, agreements, conditions or understandings, either oral or written, between them other than as are herein set forth. No alteration, amendment, change, or addition to this Sublease shall be binding upon Sublandlord or Subtenant unless reduced to writing and signed by each party.

C. Notices. Any notice required or permitted to be given under this Sublease or by law shall be deemed to have been given if reduced to writing and delivered in person or mailed by registered, certified mail, or overnight express mail, postage prepaid to the party who is to receive such notice. Such notice to Sublandlord and Subtenant shall be mailed to their respective addresses set forth below. When so mailed, the notice shall be deemed to have been given as of one (1) business day after the date it was mailed if sent by overnight express mail or courier, and three (3) business days after the date it was mailed if sent by registered or certified mail. The address of the parties may be changed by giving written notice thereof to the other party.

Notices to Subtenant:

Rekor Systems, Inc.,
Attn: Director of Administration
xxx xxxxx xx
xxxx, xx xxxxx
Email xxxxx@rekorsystems.com
Telephone xxx-xxx-xxxx

Notices to Sublandlord: Cardinal Health 121, LLC,
c/o Cardinal Health, Inc.
7000 Cardinal Place
Dublin, Ohio 43017
Attn: Corporate Real Estate

D. Captions and Capitalized Terms. The captions appearing in this Sublease are inserted only as a matter of convenience and in no way define, limit, construe or describe the scope or intent of such sections nor in any way affect this Sublease. Capitalized terms used herein, if not otherwise defined herein, shall have the meaning ascribed to such terms as stated in the Lease.

E. Broker's Commissions. Each of the parties represents and warrants that there are no claims for brokerage commissions or finder's fees in connection with the execution of this Sublease, other than CBRE, Inc. on behalf of Sublandlord ("**Broker**"), and that no other broker or finder procured or negotiated this Sublease or is entitled to any commissions or fees in connection herewith. Sublandlord will pay the Broker a commission pursuant to a separate agreement. Sublandlord and Subtenant each shall indemnify and hold the other harmless from and against any and all costs, expenses (including reasonable attorneys' fees), and liabilities relating to any compensation, commissions, or charges by any broker or agent with whom the indemnifying party has had or claims to have had any dealings.

F. Successors. All rights and liabilities herein given to or imposed upon the respective parties hereto shall extend to and bind the several respective successors and assigns of said parties, subject to the restrictions on assignment contained herein; and if there shall be more than one (1) person or entity which makes up a party, they shall be bound jointly and severally by the terms, covenants and agreements herein.

G. Surrender of the Premises. Upon the expiration or earlier termination of this Sublease, or upon the exercise by Sublandlord of its right to reenter the Subleased Premises without terminating this Sublease, Subtenant shall immediately surrender the Subleased Premises to Sublandlord, together with all alterations, improvements and other property as provided elsewhere herein, in broom-clean condition and in good order, condition and repair, except for ordinary wear and tear and damage which Subtenant is not obligated to repair, failing which Sublandlord may restore the Subleased Premises to such condition at Subtenant's expense. Upon such expiration or termination, Subtenant shall have the right to remove its personal property and trade fixtures. Subtenant shall promptly repair any damage caused by any such removal, and shall restore the Subleased Premises to the condition existing prior to the installation of the items so removed.

H. Holding Over. Subtenant shall have no right to occupy the Subleased Premises or any portion thereof after the Termination Date or the earlier termination of this Sublease. In the event that Subtenant shall remain in possession of the Subleased Premises following the Termination Date, Subtenant shall indemnify, save, protect, defend and hold Sublandlord and Landlord harmless from and against all cost, expense, and damages including, without limitation, attorneys' fees and consequential damages, arising from such holdover. In the event of such holdover, such occupancy shall be a tenancy from month to month upon all terms and conditions of this Sublease pertaining to the obligations of Subtenant, except that, Subtenant shall pay to Sublandlord an amount as monthly any payments Base Rent equal to the great of (i) all sums payable by Sublandlord to Landlord under the Lease as a result of such holdover; or (ii) two hundred percent (200%) of the monthly installment of the Base Rent payable under this Sublease for the period immediately prior to the holdover period. In the event of any holdover, Sublandlord may exercise all remedies available to Sublandlord in an Event of Default under this Sublease.

I. Authority. Sublandlord and Subtenant mutually represent and warrant that each has the authority and power to enter into this Sublease and that this Sublease constitutes a legal, valid and binding obligation of both Sublandlord and Subtenant.

J. Landlord Consent to Sublease. The parties acknowledge that this Sublease is expressly contingent upon each of Subtenant and Sublandlord receiving and approving, in their sole discretion, an instrument executed by Landlord confirming its consent to this Sublease and such other matters as either party may require, in substantially the same form attached hereto as Exhibit F (the "**Consent**"). Sublandlord shall use commercially reasonable efforts to obtain such Consent. In the event Landlord does not so Consent within thirty (30) days of the Effective Date, either party may terminate this Sublease upon written notice to the other party after the expiration of such 30-day period, but before Landlord delivers the Consent. If this Sublease is so terminated, Sublandlord shall promptly return any prepaid Base Rent and the Security Deposit to Subtenant.

K. Applicable Law. This Sublease shall be governed by and construed in accordance with the laws of the State of Maryland.

L. Counterparts. This Sublease may be executed in one or more counterparts, each of which shall be deemed to be an original Sublease, but all of which shall constitute but one and the same Sublease. All parties hereto may rely upon emailed signatures (including signatures in Portable Document Format) as if such signatures were originals. All parties hereto agree that an emailed signature page may be introduced into evidence in any proceeding arising out of or related to this Sublease as if it were an original signature page.

(Signatures on following page)

IN WITNESS WHEREOF, Sublandlord and Subtenant have caused this Sublease to be signed by their duly authorized officers or agents as of the day and year first above written.

SUBLANDLORD:

CARDINAL HEALTH 121, LLC,
a Delaware limited liability company

By: /s/ Marino Colatruglio
Name: Marino Colatruglio
Its: Authorized Signatory

SUBTENANT:

REKOR SYSTEMS, INC.,
a Delaware corporation

By: /s/ Robert Berman
Name: Robert Berman
Its: Authorized Signatory

Drafted and approved as to form by:

/s/ Karim A. Ali
Karim A. Ali
Porter Wright Morris & Arthur LLP

EXHIBIT A

Lease

Omitted.

EXHIBIT B

Subleased Premises

Omitted.

EXHIBIT C

Subtenant's Improvements Work Letter

This Subtenant's Improvements Work Letter shall set forth the terms and conditions relating to the construction of the Subtenant's Improvements in the Subleased Premises.

SECTION 1

Lease Requirements.

In addition to any requirements under the Sublease and this Exhibit C, all the Subtenant's Improvements shall be completed by Subtenant in accordance with the requirements applicable to the Tenant as set forth in Section 7.3 of the Lease (Alterations and Additions); provided that if any approval or consent is required from Landlord under Section 7.3 of the Lease, for purposes of this Sublease such approval or consent shall require the approval and/or consent of Sublandlord and Landlord.

SECTION 2

Subtenant Obligations.

Any Subtenant's Improvements in or about the Subleased Premises that Subtenant shall desire to make shall be presented to Sublandlord and Landlord in written form, with plans and specifications which are sufficiently detailed to obtain a building permit, provided a building permit is required under applicable law, regulations or ordinances. If Sublandlord and Landlord each consent to the Subtenant's Improvements, such consent shall be conditioned upon Subtenant acquiring a building permit from the applicable governmental agencies, furnishing a copy thereof to Sublandlord and Landlord prior to the commencement of the work, and compliance by Subtenant with all conditions of said permit in a prompt and expeditious manner. Subtenant shall not commence the Subtenant's Improvements until Sublandlord and Landlord have approved in writing Subtenant's plans and specifications. To the extent a building permit is required under applicable law, regulations or ordinances, Sublandlord agrees to reasonably cooperate with Subtenant in obtaining the same at no cost or expense to Sublandlord. Subtenant shall have the right to use its own, architect, engineers, and contractors, subject to Sublandlord's and Landlord's review and approval. The Subtenant's Improvements shall be completed in a good workmanlike manner and in accordance with the terms of the Lease. Within thirty (30) days of Subtenant's substantial completion of Subtenant's Improvements, Subtenant shall submit to Sublandlord (i) as-built drawings of the Subleased Premises in CAD or other electronic form reasonably acceptable to Sublandlord; and (ii) final waivers of liens, owner's sworn statements, contractor's sworn statements, and architects' certificates in such form as may be reasonably required by Sublandlord from all parties performing labor or supplying materials or services in connection with the Subtenant's Improvements, showing that all of said parties have been compensated in full and waiving all liens in connection with the Subleased Premises and Building.

SCHEDULE I

TO EXHIBIT C

Subtenant's Drawings

Omitted.

EXHIBIT D

Personal Property

Omitted.

EXHIBIT E

Parking Site Plan

Omitted.

EXHIBIT F

FORM OF

LANDLORD'S CONSENT TO SUBLEASE

THIS CONSENT TO SUBLEASE (the "Consent") is made this ____ of _____, 2019, by **EXETER 7164 COLUMBIA GATEWAY, LLC**, a Delaware limited liability company ("Master Landlord"); **CARDINAL HEALTH 121, LLC**, a Delaware limited liability company ("Sublessor"); and **REKOR SYSTEMS, INC.**, a Delaware corporation ("Sublessee").

WITNESSETH:

A. Master Landlord and Sublessor are parties to that certain lease agreement (hereinafter the "Original Lease"), as amended by that First Amendment to Lease dated October 3, 2013 (hereinafter, the "First Amendment" and collectively with the Original Lease and any other amendments or modifications, hereinafter the "Master Lease") for certain premises containing approximately 31,241 rentable square feet of floor area known as Suites 100, 300, and 400 in the building located at 7172 Columbia Gateway Driveway, Columbia, Maryland 21046 (the "Premises"), as more fully described in the Master Lease.

B. Sublessor desires to enter into a sublease agreement with Sublessee ("Sublease Agreement"), whereby Sublessor will sublease to Sublessee a portion of the Premises including approximately 8,738 rentable square feet of floor area in Suite 400 and has requested that Master Landlord consent thereto.

NOW, THEREFORE, in consideration of the foregoing recitals, which are true and correct and incorporated herein by reference, and for the mutual covenants set forth herein, the parties hereto, intending to be legally bound, hereby agree as follows:

1. A true, correct and complete copy of the Sublease Agreement between Sublessor and Sublessee is attached hereto as Exhibit "A".

2. Master Landlord hereby consents to the sublease of the premises described in the Sublease Agreement to Sublessee. In the event that Sublessor and Sublessee desire to modify or amend the Sublease Agreement in any way, Sublessor and Sublessee shall be required to obtain Master Landlord's consent thereto, and any further sublease of the Premises shall require Master Landlord's consent.

3. The parties hereto agree that: (i) this Consent does not constitute approval by Master Landlord of the terms, conditions and/or requirements of the Sublease Agreement but only approval as to the sublet of the subleased premises by Sublessor to Sublessee; (ii) Master Landlord's consent to the Sublease Agreement shall not create privity of contract between Master Landlord and Sublessee with respect to the Sublease Agreement; (iii) the Sublease Agreement is subject to and subordinate to all provisions of the Master Lease and Sublessor shall remain liable for performance of all obligations and liabilities under the Master Lease; (iv) the Sublease Agreement shall in no way whatsoever expand the liability or obligations of Master Landlord; (v) any termination of the Master Lease for any cause whatsoever, shall at Master Landlord's sole option in Master Landlord's absolute discretion, either (a) immediately terminate the Sublease Agreement, or (b) operate as an assignment to Master Landlord of the Sublease Agreement as if Master Landlord was the sublessor thereunder; (vi) Sublessor's obligation to indemnify and hold Master Landlord harmless as set forth in the Master Lease shall include, but not be limited to, indemnification from any claims arising from the use of the Property, or any portion thereof, by Sublessee, its agents, employees, invitees, representatives, or contractors, or any negligence or willful misconduct by any of said parties, and (vii) this Consent shall not be deemed an expressed or implied affirmation or representation of any factual statements or recitations contained in the Sublease Agreement. Further, nothing herein shall be deemed as Master Landlord's consent or approval to any planned or anticipated improvements or alterations to the Premises and any such improvements must be consented to and performed in accordance with the Master Lease. In the event of a Sublessor default under the Master Lease, Master Landlord may elect, in its sole discretion, by providing written notice to Sublessee to have Sublessee pay all sums due under the Sublease Agreement directly to Master Landlord and upon receipt of such notice, Sublessee shall, notwithstanding anything to the contrary in the Sublease Agreement and without being in default of the Sublease Agreement pay such sums directly to Master Landlord.

4. Any notice or communication with any party hereto that such party may desire or be required to give to any other party under or with respect to this Consent shall be given in the manner required by the notice provisions of the Master Lease. The current notice addresses of the parties are as follows:

Master Landlord:

101 West Elm Street, Suite 600
Conshohocken, PA 19428
Attn: Chief Financial Officer

Sublessor:

Cardinal Health 121, LLC
c/o Cardinal Health, Inc.
7000 Cardinal Place
Dublin, Ohio 43017
Attn: Corporate Real Estate

Sublessee:

Rekor Systems, Inc.,
Attn: Director of Administration
xxx xxxxx xx
xxxx, xx xxxxx
Email xxxxx@rekorsystems.com
Telephone xxx-xxx-xxxx

5. Sublessee shall provide Master Landlord and Master Landlord shall provide Sublessee with a copy of any notices of default that Sublessee or Master Landlord may send to Sublessor pursuant to the terms of the Sublease Agreement and Master Lease Agreement.

[Remainder of page left intentionally blank.]
[Signatures on following page]

IN WITNESS WHEREOF, the parties have executed this Consent as of the date first set forth hereinabove.

MASTER LANDLORD:

EXETER 7164 COLUMBIA GATEWAY, LLC,
a Delaware limited liability company

By: Exeter Operating Partnership III, L.P.,
a Delaware limited partnership,
its sole member

By: Exeter Operating Partnership III GP LLC,
a Delaware limited liability company,
its sole general partner

By: Exeter Industrial REIT III LLC,
a Delaware limited liability company,
its sole member

By: _____
Name: _____
Title: _____

SUBLESSOR:

CARDINAL HEALTH 121, LLC
a Delaware limited liability company

By: _____
Name: Marino Colatruglio
Its: Authorized Signatory

SUBLESSEE:

REKOR SYSTEMS, INC.,
a Delaware corporation

By: _____
Name: Robert Berman
Title: Authorized Signatory

Drafted and approved
as to form by:

Karim A. Ali, Esq.
Porter Wright Morris & Arthur LLP

EXHIBIT "A"

SUBLEASE AGREEMENT

EXHIBIT G

FORM OF

COMMENCEMENT DATE CERTIFICATE

This Certificate, dated as of May __, 2019, is being provided pursuant to the terms and provisions of that certain Sublease Agreement dated May __, 2019 (the "Sublease") between **Cardinal Health 121, LLC**, a Delaware limited liability company (hereinafter "**Sublandlord**") and **Rekor Systems, Inc.**, a Delaware corporation (hereinafter "**Subtenant**")

Sublandlord and Subtenant hereby confirm and certify as follows:

1. Sublandlord has delivered the Subleased Premises in accordance with the Lease as of May __, 2019.
2. The Commencement Date of the Sublease is May __, 2019.
3. The Termination Date of the Term of the Sublease is August 31, 2021.

SUBLANDLORD

SUBTENANT

Cardinal Health 121, LLC,
a Delaware limited liability company

Rekor Systems, Inc.,
a Delaware corporation

By: _____
Name: Marino Colatruglio
Title: Authorized Signatory

By: _____
Name: Robert Berman
Title: Authorized Signatory

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT**

I, Robert A. Berman, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Rekor Systems, Inc..
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a15(e) and 15d15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a15(f) and 15d 15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information. and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2019

/s/ Robert A. Berman

Robert A. Berman
President and Chief Executive Officer
Principal Executive Officer

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT**

I, Riaz Latifullah, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Rekor Systems, Inc..
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a15(e) and 15d15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a15(f) and 15d 15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information. and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2019

/s/ Riaz Latifullah
Riaz Latifullah
EVP Corporate Development
Principal Financial and Accounting Officer

**CERTIFICATION
OF
PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned hereby certify, pursuant to, and as required by, 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the SarbanesOxley Act of 2002, that the Quarterly Report of Rekor Systems, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 14, 2019

/s/ Robert A. Berman

Robert A. Berman
President and Chief Executive Officer
Principal Executive Officer

A signed original of this written statement required by Section 906 of the SarbanesOxley Act of 2002 has been provided to Rekor Systems, Inc. and will be retained by Rekor Systems, Inc. and furnished to the Securities and Exchange Commission or its staff upon request. The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

**CERTIFICATION
OF
PRINCIPAL FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANE-SOXLEY ACT OF 2002**

The undersigned hereby certify, pursuant to, and as required by, 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the SarbanesOxley Act of 2002, that the Quarterly Report of Rekor Systems, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 14, 2019

/s/ Riaz Latifullah

Riaz Latifullah

EVP Corporate Development

Principal Financial and Accounting Officer

A signed original of this written statement required by Section 906 of the SarbanesOxley Act of 2002 has been provided to Rekor Systems, Inc. and will be retained by Rekor Systems, Inc. and furnished to the Securities and Exchange Commission or its staff upon request. The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.
