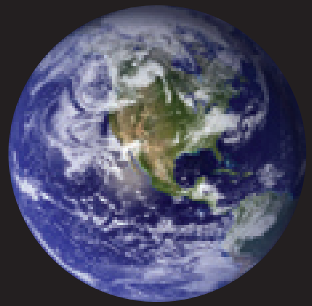
# Nio Security, Inc.
# **Annual Report**
# **2010**



When you get up in the morning, we have been working all night.
We have looked after the things that are dear to you.
While you were asleep, believing all doors were locked,
we have safeguarded life and property.
We don't practice opening hours or hang out a closed sign.

We'll always be here for you, looking after what matters most.

# *Embracing the market*

Nio's market reach has been significantly expanded during 2010. 18 months ago we decided on a new distribution strategy and have over the last months worked on its implementation. The result is that we entered 2011 with a number of new Nio distributors, among them several international leaders in the security industry. The expected sales through our current channels in 2011 and 2012 are more than five times Nio's sale last year. And the market reach continues to expand as new distributors and markets are added to our network.

Our dialogues with the most demanding security vendors in the industry have confirmed to us that Nio's products are state-of-the-art in the sophisticated video surveillance market. The capabilities of our technology never fail to impress even the most seasoned security professionals. Nio products not only establish new standards in terms of accuracy, reliability and image quality, but also in terms of being cost effective. Functions that many companies or real estate owners still use security personnel for are fully automated by Nio's technology. And the demand for efficient and cost-effective surveillance is growing rapidly. Threats from crime and terrorism are moving closer . Also the need for more everyday applications, like traffic monitoring is growing.

Nio is now prepared to embrace the market. At the beginning of the year, we still experienced some challenges in the production line. There is a considerable lead time on our products, caused by the limited availability of components. The production challenges were resolved in 2010 and Nio's production line is ready for the increased demand created by our new network of European distributors .

Another aspect of 2010 is improved cost control. The organization was significantly changed during the year and a more permanent cost base established. This means that the coming sales growth is expected to influence Nio's bottom line in a very significant way. While sales were at the same levels in 2009 and 2010, cost of sales was reduced by more than 70 per cent last year. Nio's gross margin consequently grew from 32 per cent to 57 per cent in 2010.
The Company's deficit was reduced by half in 2010 on our way towards profitability.

It is always sound advice when somebody tells you that you should learn to walk properly before you start running. However, in today's world those who remain walking will be left behind. So while we work night and day to expand our distribution and build revenue and profitability, we are also seeking new ways to use our technology. Nio's proprietary technology is derived from many years of research and development on complex algorithms. While currently applied in the software of our sophisticated video surveillance equipment, vast possibilities for further use are embedded in the technology. An area currently being explored is sophisticated medical monitoring of patients or elderly patients needing care, either in hospital or at home. Other options are still on the drawing board.

Going forward we will both walk and run. We will maintain walking where we need to establish stability and growth in our earnings, securing the business fundament and ensure shareholder value. And we will run where we see opportunities for taking our technology even further.

*The Nio team*


# *Introduction to Nio Security, Inc.*

**Nio Security, Inc. helps protect life and property through the development and sales of sophisticated video surveillance solutions. The Company's technology is unrivalled and its main products are:**

- CloseView® dynamic surveillance system with real time and multi object tracking capabilities
- SteadyEye® sophisticated video stabilizing system, are considered the most advanced video surveillance systems available.

## The video surveillance market

The world's security markets in general are enjoying high growth. Threats caused by crime and terrorism are on the increase and a growing number of property owners, businesses and public institutions seek to monitor their surroundings in order to improve security and safety.

Sophisticated users turn to the next generation video surveillance: solutions which provide improved accuracy, reliability and cost effectiveness. Modern solutions are fully automated, security guards in front of the video monitors are replaced by intelligent surveillance systems providing automatic camera tracking and crystal clear images of all predefined objects, regardless of where they move within camera range.

Advanced video solutions do also find a growing number of applications besides security. Intelligent video is used for traffic monitoring purposes in congested cities, along highways and railroads, in harbors and airports. Also the military and law enforcement organizations are turning to state-of-the-art video in order to protect personnel, monitor opponents undetected and replace traditional reconnaissance with more cost effective solutions.

## Nio's position and strategy

Nio Security is still a small company, holding a proprietary technology which arguably is world leading in the video surveillance market.

Being a small company with limited resources, Nio needs to rely on partners in order to successfully bring its solutions to the market. That is why Nio Security is in the process of establishing distributor agreements with large, international security vendors. Among the partners already onboard are G4S, Infratek, Genie and Euroma. These companies represent broad security offerings and massive market penetration. Nio's partners see the Company's advanced products as attractive and value adding elements of their portfolio.

Nio's main market strategy is to further develop its network of partners and distributors, integrating the Company's technology as components in the partners' solutions.

Scandinavia and North America are currently Nio's main markets. As sales volumes grow, Nio will seek to expand its reach and establish partnerships also throughout the rest of the world.

## Nio's technology

The task at hand is to identify the truly relevant objects in any given surrounding, catch the relevant objects on camera, zoom in and track the object's movements while providing crystal clear images enabling identification. In theory, all this can be managed by manually operating a video surveillance system. In addition to the cost element of manual operations, all experience demonstrates that manual operations have limitations with regards to attention, durability, image quality and ability to focus on the relevant details.

Nio's proprietary video technology is derived from many years of research and development as well as significant investments. Automating all the tasks currently done manually requires extensive algorithm and software development capabilities in the field of video analytics.

Competing technologies also offer automated video tracking. But Nio's technology is unrivalled in providing systems that are able to track several objects simultaneously and provide real time, high resolution images which focus on predefined objects.

## Nio's products

Nio Security offers two industry leading products: The CloseView® automated object tracker and the SteadyEye® video stabilization system.

CloseView® is an intelligent auto track PTZ (pan/ tilt/ zoom camera) controller enabling the video surveillance system to track several objects within camera range in real-time.

Serving up to four cameras at the same time, the system detects and identifies objects and movements in the picture and directs one of the connected cameras to zoom in, follow the object and provide identification of for example a face or registration plate. The remaining cameras continue to monitor the area or automatically concentrate on other suspicious objects.

In addition to providing crystal clear images (unlike the blurred or pixeled images most of us have seen extracted from security cameras) of suspicious persons or objects, CloseView® is unique also in offering real time tracking. This is simply not possible when using Internet Protocol (IP) cameras, where the compression of analogue signals delays the image processing. Hence it is difficult to follow a suspicious object in motion, simply because it will have moved on before the traditional solution has finished calculating and processing. Nio's real time technology has solved this problem.

SteadyEye® is a world leading product in stabilizing camera movements under extreme conditions. Video images from security or other monitoring cameras often shake. The source of this disturbance can be wind, trembling from machinery or air conditioning equipment or shaking caused by movement when observing from a vehicle, boat or airplane. When zooming in, the shaking movement is amplified in the video image.

SteadyEye® automatically neutralizes the camera's unsolicited movements and digitally stabilizes the video signal, proving sharp images even under challenging conditions. Also this technology is proprietary and the result of several years of research and development.

The unique features of SteadyEye® have made it a popular piece of equipment e.g. in police cars, on board navy vessels and in unmanned aerial vehicles (UAVs) as well as in locations with extreme climatic conditions.

# *Board of Directors Report*

## Description of the Business

Nio Security, Inc. is a US corporation incorporated in the state of Delaware with its registered address in Bokeelia, Florida, USA. The Company is a developer of intelligent video surveillance solutions for security applications. Named after the unsleeping guardians of Buddhist Temples, Nio's unique video surveillance technology provides 'Watchful Intelligence' to a worldwide customer base ranging from Fortune 500® companies and governments to small businesses.

Nio markets its products through a worldwide network of certified dealers, distributors, system integrators, and OEM's. Nio enjoys a constant flow of confirmations from commercial as well as military and government customers that they regard Nio's offering the best intelligent video surveillance products in the market.

Nio's core business is sophisticated video analytics. The Company is in the forefront of intelligent video analytics and solutions for the surveillance industry. Nio has developed products and applications in the specific areas of video algorithms, digital video motion analysis, video compression and control.

Nio's focuses on the surveillance space, as well as other areas where the Company's products and technology can be used. Future products will provide alternatives to the current systems, which require significant manual operation and attention. Nio will reduce operating costs and possible human error by introducing new products addressing these issues. Nio's product development takes into account known limitations in intelligent video analysis, thereby providing tools that assist a video guard and dramatically improve their efficiency.

Nio's algorithms have been developed over many years and represent a potential to be applied in several verticals, e.g. medical surveillance. These possibilities will be investigated and collaboration will be pursued with different research institutions, based on external research funding.

The Board of Directors believes that the Company represents the leading technology in intelligent video analytics and technology for the video surveillance industry. The company's software is embedded in the hardware in order to achieve the necessary speed of the solutions. This is contrary to Internet Protocol (IP) cameras, where the decoding of analogue signals delays the processing speed.

Although Nio has a strong focus on various video surveillance markets, its products and core technology can be further developed into other markets where the analysis of video or moving pictures are a necessary component.

## Financial Situation and Outlook

The Company's financial difficulties during 2009, were resolved by an extensive refinancing in November 2009. The solution secured new funding and comprehensive debt repayment. It significantly strengthened the balance sheet and gave the Company the basis for a fresh start into 2010. The Company also initiated the closure of its San Diego operations and termination of the Tempest DVR product line. These initiatives have had a positive impact on operating expenses.

During 2010, the Company succeeded in stabilizing its operations and remains on track towards building revenue and reaching profitability. Operating expenses are stabilized and significant amounts are invested in parts and components to secure production in 2011. In its current state the business is highly scalable and Nio Security is well positioned for revenue growth and positive earnings from the distributor and dealership agreements established in 2010.

This has improved Nio's ability to build revenue in the fast growing security markets in America and Europe by selling Nio's existing products, and also the Company's ability to pursue mergers and/or acquisitions opportunities. In the Board's opinion, the Company is well positioned for growth with a small and flexible operation in the worldwide, fast growing video surveillance market.

Nio has started to explore the potential for additional applications of its technology, developed through earlier R&D activities on its algorithms and intellectual property. This might open new applications and markets for Nio's technology and create synergies with other emerging and maturing technologies.

The Board of Directors believes that the initiatives taken and the agreements entered into through 2010 will improve Nio's operating performance and strengthen the Company's attractiveness to investors. The Company will continuously investigate new opportunities to increase shareholder value in addition to organic growth.

## Market Performance

In 2010, Nio entered into several new contracts with leading security companies, mainly in Europe. Nio's solutions have been tested and approved, and initial orders have been received. Companies like Genie CCTV (UK), Euroma Telecom (Spain), Secure Vision Group (Denmark), Infratek (Norway) prepare the basis for a strong growth in the years to come. The dealership agreements are important milestones in developing Nio as a main provider of sophisticated video surveillance equipment in Europe.

In November 2010, Nio entered into a dealership agreement with G4S Secure Solutions which covers the Norwegian market and

represents an estimated sales volume of USD 2 million in 2011. Prior to the agreement, G4S tested Nio's products under various and extreme conditions before deciding to move forward with a partnership. G4S will market Nio's products in the Norwegian security market, and has already included the first units in planned deliveries to multiple installations with major end users in Norway. G4S offers security solutions in more than 110 markets worldwide and Nio will, on the basis of the cooperation, pursue further international business opportunities.

Nio sees numerous sales opportunities through distributors and integrators as well as in direct dialogue with security companies and new OEM and VAR agreements. In March 2010, Nio entered into an alliance with the Chinese company Shenzhen Domenor Technology Co. Ltd (Domenor) for OEM manufacturing of several Nio products. Domenor is a provider of ODM and OEM services, specifically targeting the security market. Through this new partnership, several of Nio's high-quality security cameras and peripherals will be manufactured by Domenor, meeting Nio's quality control standards. Domenor will also sell Nio technology both in China and in the export markets through an OEM agreement.

North America remained the largest market for Nio's products and Nio experienced stable growth through its US dealer network in 2010. The US operations are primarily focused to expand the network of security dealers but larger distributors will be targeted going forward.

## Financial Performance

For the year 2010, sales were US$ 895,060, compared to US$ 636,385 for the year 2009. North America remains the primary market for Nio products, representing 64 per cent of revenues in 2010 compared to 88 per cent in 2009. The Company's core products, the appliances based on proprietary technology, contributed to 85.9 per cent of sales in 2010. Smart cameras contributed to 7.4 per cent and Tempest's DVR business 0.2 per cent. The remaining 6.5 per cent consists of licence fees, fixed cameras and other auxiliary products. CloseView is the single most important product, contributing to 76.8 per cent of sales in 2010.

The gross margin for the year 2010 was 57 per cent, compared to 56 per cent for the year 2009, representing mainly sales of the Company's core products, CloseView® and Steady Eye®. Including Tempest and the DVR product line, the gross margin for 2009 was 32 per cent. Tempest's gross margins were weak due to generally lower margins on the DVR products and the allocation of the production facility's overhead expenses on a limited number of products manufactured.

Operating expenses were US$ 2,468,472 for the year 2010, compared to US$ 1,791,256 for the year 2009. Sales & Marketing expenses were 14.5 per cent of total operating expenses, Research & Development 5.3 per cent and general and administrative expenses 94.7 per cent. All costs related to research & development have been expensed, in 2010 as well as in previous years.

After interest expense, loss before other income and expense was US$ 2,291,771 for the year 2010, compared to a US$ 2,692,048 loss for 2009, and net loss for the year 2010 was US$ 2,216,063, compared to US$ 4,897,583 in 2009.

The Company's assets mainly consist of bank deposits, accounts receivables and inventory. Accounts receivables have been adjusted for all known uncollectible accounts. Current liabilities consist mainly of accounts payable and other current liabilities, all related to ongoing business.

During 2010, Nio entered into loan agreements aggregating a balance of NOK 9.46 million per December 31, 2010, mainly with major shareholders. Of these loans, NOK 3.1 million has maturity in 2012 and is considered as long term loans per December 31, 2010. Subsequent to the fourth quarter of 2010, the short term loans have been repaid with NOK 5 million.

Nio is monitoring its production process closely due to significant lead times for certain components used in the Company's core products. As a result, Nio has invested in parts and components for future production, and as of December 31, 2010 appoximately US$ 0.8 million of the inventory were such parts and components.

The Company's equity was negative per December 31, 2010. Subsequent to year end 2010, the private placement in January 2011 and the subsequent offering in February 2011 have strengthened the Company's equity with USD 2,425,291.

Nio's financial statements for 2010 include the wholly owned subsidiary Tempest Microsystems Inc. A Certification of Dissolution for Tempest was submitted on December 28, 2010, and the California Secretary of State confirmed on January 20, 2011 that Tempest has been dissolved.

As of December 31, 2010, the Company had approximately US$ 41 million of net operating loss carry forwards, which expire at various dates beginning in the tax year 2012 through to 2029.The availability to offset income taxes in future years may be restricted if the Company undergoes an ownership change, which may occur as a result of future sales of any stock and other events. The Company has not valued the loss carry forwards in its balance sheet per December 31, 2010.

The Board of Directors confirms that the financial statements have been prepared based on the assumptions of a going concern. In our opinion, the consolidated financial statements present, in all material respects, the financial position of Nio Security, Inc. and subsidiaries as of December 31, 2010.

## Accounting principles - IFRS

Nio's financial statements are prepared in conformity with US Generally Accepted Accounting Principles (US-GAAP) and on the going concern assumption. For a summary of significant accounting policies, see Note 2 in the Consolidated Financial Statements. As a US registered company reporting in US-GAAP, Nio is not required to report in conformity with IFRS. The Company has, however, assessed the possible differences for its financial reporting between US-GAAP and IFRS and to the Company's knowledge; there would not be any significant changes to the financial statements under IFRS.

## Shareholder Matters

Nio Security, Inc. is listed on the Oslo Stock Exchange, Norway, with the ticker symbol "NIO".

As of January 1, 2010, the number of authorized shares in the Company was 70 million, whereof 35,978,041 were issued and outstanding, each with a par value of US$ 0.10.

At the Annual Meeting of Shareholders on May 26, 2010, it was resolved to amend the Company's Amended and Restated Certificate of Incorporation to reflect an increase in the Company's authorized shares from 70,000,000 to 100,000,000 shares of Common Stock.

On 15 June, 2010, Nio completed a successful private placement of 3,500,000 new shares, subscribed by new and existing shareholders. A total of 39,478,041 shares were outstanding at December 31, 2010.

Nio has adopted stock option plans for its employees, consultants and directors, under which a total of 40,624 options were outstanding on January 1, 2010. During 2010, no options were granted or exercised and 20,990 options have expired. The total number of outstanding options under the Company's stock option plans was 19,634 at December 31, 2009. In addition, a total of 31,800,000 warrants were outstanding at December 31, 2010.

In January 2011, Nio completed a NOK 15 million private placement of 6,000,000 shares at a subscription price of NOK 2.50 per share. A prospectus for the listing of the new shares was approved by the Financial Supervisory Authority of Norway (Finanstilsynet) and a subsequent offering to existing shareholders not participating in the private placement was completed, resulting in subscription of additional 156,268 shares at NOK 2.50 per share. The new number of outstanding shares is 45,634,309.

## Remuneration of the Board of Directors and Management

As of January 1, 2010, the Company's Board of Directors consisted of four members, Mr. Espen Brodin as Chairman and Mr. Bjarne Støtvig, Mr. Lars Moldestad and Mr. Jon Skabo as directors. In the Annual Meeting of Shareholders on May 26, 2010, the Board of Directors was re-elected. Mr. Espen Brodin has also served as the Company's Chief Executive Officer during 2010. Nio compensates its board members with NOK 200,000 per year to the Chairman and NOK 100,000 per year to the other board members.

For the year 2010, total compensation to the Board of Directors amounted to US$ 52,689. In addition, board members Mr. Brodin and Mr. Støtvig have been compensated for consultancy work in addition to the normal board fee according to consultancy agreements for a total amount of US$ 470,360 in 2010. None of the directors are entitled to any severance payment upon termination or expiration of their service as board members.

The following table shows the compensation paid to, and number of shares, options and warrants held by, the members of the Board of Directors and management of Nio and close associates or companies controlled by the Board of Directors or the management, as of December 31, 2010.

**Compensation USD**

| Name | Position | Board fee | Consulting | Salary | Shares | Options & Warrants |
|---|---|---|---|---|---|---|
| Espen Brodin | Chairman & CEO | 36,298 | 232,747 | 0 | 100,000 | 2,100,000 |
| Bjarne Støtvig | Director | 16,391 | 237,613 | 0 | 780,829 | 2,100,000 |
| Jon Skabo | Director | 0 | 0 | 0 | 8,281,235 | 13,704,386 |
| Lars Moldestad | Director | 0 | 0 | 0 | 11,936,696 | 10,195,614 |
| Tore Formo | CFO | 0 | 0 | 171,895 | 1,074,855 | 2,110,834 |
| Monica Andersen | CTO (from March 2010) | 0 | 27,621 | 119,872 | 25,000 | 0 |

## Personnel and Organization

Nio Security, Inc. has its registered address in Bokeelia, Florida, and has offices in Oslo (Norway), Memphis (Tennessee, USA) and Munich (Germany). As of December 31, 2010, Nio had 11 employees, whereof 5 were located in the US and 4 in Norway.

Nio has no arrangement for involving the employees in the capital of Nio. Nio previously had a stock option program for its employees, but no options have been allocated after the 2006 program. Warrants and options in Nio are detailed in Note 10 to the Financial Statements.

Of Nio's 11 employees, 4 are female. In future recruitment of new staff, Nio will continue to encourage diversity with regards to, including but not limited to, gender, cultural background and experience. The Company's has a low sickness absence ratio, and in the opinion of the board of directors, the Company's working environment is good.

Nio meets the requirements for mandatory pension ("obligatorisk tjenestepensjon") for its Norwegian employees.

The Company does not pollute the external environment. The Board of Directors takes on the responsibility for the Company's impact on the environment and it is the Company's management to set and follow up any environmental goals as well as to comply with legislation and regulations.

## Risk

The Company has suffered recurring losses from operations. The continuation of the Company as a going concern is dependent upon its ability to generate revenues and profits from the sale of its products and its ability to raise sufficient funding to meet any short-term needs. Despite the Company's recent initiatives, there is no assurance that the Company will become profitable in the immediate future, which could make it difficult to raise new capital if necessary.

The Company faces competition from existing competitors, as well as potential new competitors, which could result in loss of market share and diminished profits. The markets are characterized by technological advances, changes in customer requirements, and frequent new product introductions and enhancement. The Company's future success will depend mainly upon its ability to enhance its current products and to develop and introduce new products and services. In addition, there is risk associated with the marketing and sale of new products.

The Company's core products are being produced by subcontractors and production is depended upon sufficient and timely supply of components. Nio is dependent on its sub-contractors to deliver products and any delays or termination of its sub-contractors operations may hurt sales and operational performance.
The Company is exposed to exchange rate fluctuations, with revenues mainly in USD and EUR and operating expenses divided between USD, NOK and EUR.

The Company's current technology and products are only to a limited degree covered by registered patents and patent applications, and the Company pursues a policy to protect its technology and products through trade secrets and know-how. If the Company fails to protect its intellectual property rights, competitors may be able to use its technology and know how, and this could weaken the Company's competitive position, reduce revenue and increase costs.

## Responsibility Statement

We declare to the best of our knowledge that the financial statements for the year 2010 gives a true and fair view of the Company's assets, liabilities, financial position and results of operations, and that the report is produced according to prevailing accounting standards. We also declare, to the best of our knowledge, that this Board of Directors report provides a true and fair review of the development and performance of the business and the position of the entity and the group, together with a description of the most relevant risks and uncertainties the Company is exposed to as well as any description of transactions with related parties are correct.

*April 27, 2011*

Espen Brodin
*Chairman & CEO*
*(Sign.)*

Lars Moldestad
*Director*
*(Sign.)*

Jon B. Skabo
*Director*
*(Sign.)*

Bjarne Støtvig
*Director*
*(Sign.)*

## The Board of Directors are:

***Espen Brodin, Chairman & CEO*** Mr. Brodin has a long international career from the banking and IT industry. He was Senior Vice President of one the largest bank in Norway, and co-founder and President and CEO of Fast Search & Transfer (FAST). Mr. Brodin is serving as Board Member in various boards in Norway and abroad, and holds a Ph.D. in Philosophy

***Bjarne Støtvig, Director*** Mr. Støtvig has a long career from consultancy within real-estate, property management and IT industry. Furthermore, Mr. Støtvig has been working as a consultant for various companies both listed and unlisted in his fields financing, funding and organisational matters such as merger/acquisitions and serves as board member in various boards in Norway. Mr Støtvig holds a M.B.A. from Henley/Brunel University, London, UK and he is a Finnish Consul in Larvik, Sandefjord, Skien and Porsgrunn, Norway.

***Lars Moldestad, Director*** Mr. Moldestad has previously held the position as CEO (hired from Larsen Oil & Gas AS) in Petrolia ASA, Petrojack ASA and Petromena ASA. Mr. Moldestad has also previously worked for Finansbanken and Odfjell Drilling & Consulting Co. AS. Mr. Moldestad is educated from BI Norwegian School of Management.

***Jon Skabo, Director*** Mr. Skabo is currently partner in Skabo Offshore Ltd. From 2001 until 2006 Mr. Skabo was partner of S & T Energy N.V., from 1993 until 2001, partner of Jan Sundt AS, and from 1989 until 1993 shipbroker in Jan Sundt AS. Mr. Skabo's work experience includes involvement in the stock exchange listing of Safe Offshore ASA, Sævik Supply ASA, Havila Supply ASA and Deep Sea Supply ASA, work with new building of 15 FPSO's and Drilling Rigs, and sale of multiple second hand units.

# Corporate Governance

Nio Security, Inc. is a US public limited company incorporated in the State of Delaware, with its principle office in Bokeelia, Florida, USA. As a Delaware company, Nio is subject to Delaware company legislation and regulations. In addition, certain aspects of Norwegian Securities law apply to the company due to the listing on the Oslo Stock Exchange.

Nio's Board of Directors and management adhere to the Norwegian Code of Practice for Corporate Governance (updated in October 2010). The Company aims for compliance in all essential areas of the recommendation not fully met.

Adherence with the Code of Practice will be based on a "comply-or-explain" principle. If the Code of Practice is not complied with, an explanation shall be given as to why the company has chosen to deviate. The Code of Practice includes 15 main points and the Company's operations are in all material respects in accordance with these. Below is a brief item-by-item account of the Company's adherence to the Code of Practice.

## 1. Implementation and reporting on corporate governance

The Code of Practice is in material respects complied with through regular board meetings, ordinary follow-up of operations, periodic press releases and statements in annual reports and other information distribution systems. The Company will consider defining ethical and CSR guidelines in accordance with the Company's basic corporate values.

## 2. Business

The Code of Practice is complied with through the Company's articles of association and annual report. A description of the business is available on the Company's web site. In short, Nio's goal is to be one of the leading Intelligent Video Systems providers in the worldwide market for video surveillance products. These goals, along with the strategic focal areas for attaining them, are described in more detail elsewhere in the annual report and on the Company's web site.

## 3. Equity and dividends

The Code of Practice is complied with and the Company has adopted a dividend policy under which, all else being equal, the Company will aim to pay a dividend according to continued self-imposed restrictions concerning financial solidity and liquidity, all of which should be complied with. To date, the Company has not paid any dividends to shareholders.

Nio's equity at 31 December 2010 was negative with US$ 984,297. Nio's business model requires relatively low capital other than operating expenses. The Board of Directors constantly assesses the Company's need for financial strength in light of the Company's objectives, strategy and risk profile, and is currently in the process of strengthening the Company's financial position.

According to common practice for Delaware companies, the Company has an authorized number of shares available which is higher than the current number of issued shares. In compliance with the Company's by-laws and Delaware corporate law, the Board of Directors may issue shares up to this limit without shareholder approval.

## 4. Equal treatment of shareholders and transactions with close associates

The Company is compliant with the Code of Practice. The Company has only one class of shares listed on the Oslo Stock Exchange. Under Delaware law, no pre-emption rights of existing shareholders exists, but after concluding a private placement in January 2011 the Company carried out a subsequent offering to existing shareholders.

## 5. Freely negotiable shares

The Company is compliant with the Code of Practice. The Company has no limitations on the ownership or sale of the Company's shares. All shares of Nio are freely negotiable and no form of restriction on negotiability is included in the Company's articles of association.

## 6. General meetings

The Code of Practice is in material respects complied with. Notices for shareholder meetings are sent by mail to all shareholders according to the Company's by-laws and articles of association. The annual general meeting ensures the shareholders' participation in the body that exercises the highest authority in the Company and in which the Company's articles of association are adopted.

## 7. Nomination committee

The Code of Practice in this instance is not complied with. As a Delaware corporation, the governing law does not require a nomination committee.

## 8. Corporate assembly and board of directors: composition and independence

The Code of Practice is in material respects complied with. The annual shareholders meeting elect representatives to the Board. The resolution on the composition of the Board takes place with a simple majority. The Company will seek to nominate members of the Board representing all shareholders and being independent to management. Due to the size of the Company and difficulties in attracting interest from independent representatives, some of the current directors have also been part of the Company's management.

For the election of a new Board at the annual shareholder meeting in 2011, the proposal regarding its composition will be in line with the provisions in the Code of Practice. As a Delaware company, the

board members have unlimited periods, but the board members will be proposed, elected and re-elected at the General Assembly to be held annually. As a Delaware company, the Company does not have an independent election committee

## 9. The work of the board of directors

The Code of Practice is in material respects complied with. The Board has the prime responsibility for the management of the Company and holds a supervisory position towards the executive management and the Company's activities. In addition to monitoring and advisory duties, the Board's main tasks consist of participating in compiling the Company's strategy. The Board appoints the CEO.

## 10. Risk management and internal control

The Code of Practice is complied with. The Board of Directors constantly assesses the Company's need for necessary internal control systems in light of the size and complexness of the Company's business.

## 11. Remuneration to the board of directors

The Code of Practice is in material respects complied with. Remuneration to board members is at a sufficiently competitive level in order to ensure the desired composition of the board. The remuneration is a fixed amount and has no performance related elements. The current board members have warrants to purchase shares in the Company.

The remuneration is not linked to the Company's performance. No board members have been granted share options and no directors take part in incentive programs available for management and/or other employees.

As a general rule, no members of the Board of Directors (or companies with which they are associated) shall take on specific assignments for the Company in addition to their appointment as director. If such assignments are made, it shall be disclosed to the full Board and the remuneration shall be approved by the Board. Further, all remuneration paid to each of the directors shall be described in the Annual Report.

## 12. Remuneration of the executive management

The Code of Practice is complied with. The remuneration for the Chief Executive Officer is set by the Board. The Board also establishes guidelines for the remuneration of other members of the group management, including both the level of fixed salaries, the principles for and scope of bonus schemes and option grants. The Company has incentive stock option programs, which includes a vesting period. This program is described in the notes to the attached financial statement.

## 13. Information and communications

The Code of Practice is complied with. The Company assigns importance to informing its owners and investors about the Company's development and economic and financial status. Prompt financial reporting reduces the possibility of leakage and contributes to the equal treatment of shareholders. Responsibility for investor relations (IR) and price sensitive information rests with the company's chief executive officer (CEO) and chief financial officer (CFO). Each year the Company publishes to the market the dates of reporting for planned major events.

## 14. Take-overs

The Code of Practice is complied with. The board of directors is pragmatic with respect to a possible take over of the Company, and the main responsibility of the Board under such circumstances is to maximize value for the shareholders, while simultaneously looking after the interest of the company's employees and customers.

## 15. Auditor

The Code of Practice is complied with, except for specific guidelines for the management's opportunity to use the auditor for other services than audit. Nio uses the auditors as advisors for general financial purposes and in connection with the preparation of tax returns and tax advice generally. For the 2010 fiscal year, the auditors have not participated in the board meeting that approved the annual financial statements or presented to the board a review of its work and the Company's internal procedures. The auditor was paid US$ 59,212 for services in 2010.

## SHAREHOLDERS

The 20 largest shareholders as per April 26, 2011 hold 41,288,728 shares:

| | | | |
|---|---|---|---|
| 1 | Lars Moldestad | 13 355 509 | 29,3 % |
| 2 | Bellamare Resources Ltd | 9 936 235 | 21,8 % |
| 3 | Alba AS | 3 997 019 | 8,8 % |
| 4 | Six SIS AG. | 2 115 773 | 4,6 % |
| 5 | Pål Karsten Fevang | 1 704 971 | 3,7 % |
| 6 | Grieg Holdings AS | 1 560 000 | 3,4 % |
| 7 | MP Pensjon | 1 119 980 | 2,5 % |
| 8 | Silvercoin Industries AS | 1 010 673 | 2,2 % |
| 9 | Epsilon AS | 1 000 000 | 2,2 % |
| 10 | Midelfart Invest AS | 930 000 | 2,0 % |
| 11 | Bawa AS | 780 829 | 1,7 % |
| 12 | Tore Formo | 754 483 | 1,7 % |
| 13 | Citibank N.A. | 547 946 | 1,22 % |
| 14 | Jon Herman Smedsrud | 498 509 | 1,1 % |
| 15 | Trumpy AS | 400 000 | 0,9 % |
| 16 | John Knudsen Holding | 320 000 | 0,7 % |
| 17 | Viventus AS | 319 854 | 0,7 % |
| 18 | Molasset AS | 314 044 | 0,7 % |
| 19 | Ralph Carballal | 313 774 | 0,7 % |
| 20 | Ystholmen AS | 309 129 | 0,7 % |
| | **TOTAL 20 LARGEST** | **41 288 728** | **90,5 %** |
| | **OTHER** | **4 345 581** | **9,5 %** |
| | **TOTAL** | **45 634 309** | **100,0 %** |

# *Nio Security, Inc. financial statements with auditors´report thereon as of and for the years ended December 31, 2010 and 2009*

# *Independent auditors' report*

The Board of Directors of Nio Security, Inc.

We have audited the accompanying balance sheets of Nio Security, Inc. and Subsidiary as of December 31, 2010 and 2009, and the related statements of operations, shareholders' equity (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Nio Security, Inc. as of December 31, 2010 and 2009, and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As set forth in the accompanying financial statements, the Company has incurred substantial losses in each of the last two years and has limited amounts of working capital at December 31, 2010. These factors raise substantial doubt about the Company's ability to continue as a going concern. As discussed in Note 1 to the financial statements, the continuation of the Company as a going concern is dependent upon its ability to raise sufficient funding to meet its short-term needs and its future ability to generate revenues and profits from the sale of its products. Management's plans to achieve these objectives are also described in Note 1. There is no assurance that the Company will be successful in these endeavors. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

***Israeloff, Trattner & Co. P.C.***
*April 25, 2011*
*Garden City, New York*

Israeloff, Trattner & Co. P.C.
CERTIFIED PUBLIC ACCOUNTANTS · FINANCIAL CONSULTANTS
1225 Franklin Avenue, Garden City, NY 11530 (516) 240-3300 Fax (516) 240-3310 www.israeloff.com

Other Office
Empire State Building
350 Fifth Ave.
New York, NY

# INDEPENDENT AUDITORS' REPORT

The Board of Directors
of Nio Security, Inc.

We have audited the accompanying balance sheets of Nio Security, Inc. as of December 31, 2010 and 2009, and the related statements of operations, shareholders' equity (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Nio Security, Inc. as of December 31, 2010 and 2009, and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As set forth in the accompanying financial statements, the Company has incurred substantial losses in each of the last two years and has limited amounts of working capital at December 31, 2010. These factors raise substantial doubt about the Company's ability to continue as a going concern. As discussed in Note 1 to the financial statements, the continuation of the Company as a going concern is dependent upon its ability to raise sufficient funding to meet its short-term needs and its future ability to generate revenues and profits from the sale of its products. Management's plans to achieve these objectives are also described in Note 1. There is no assurance that the Company will be successful in these endeavors. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Israeloff, Trattner & Co. P.C.

April 25, 2011
Garden City, New York

# NIO SECURITY, INC. BALANCE SHEETS

DECEMBER 31, 2010 AND 2009

| | | | Parent and Subsidiary * | Parent Only** | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **2009** | **2010** | **2009** |
| **ASSETS** | | | | | |
| **Current Assets:** | | | | | |
| Cash and cash equivalents | $ 21 547 | $ 620 484 | $ 621 142 | $ 21 547 | $ 620 484 |
| Trade accounts receivable, net | 79 500 | 55 236 | 55 963 | 79 500 | 55 236 |
| Inventories | 1 026 655 | 251 589 | 251 589 | 1 026 655 | 251 589 |
| Current assets of discontinued operations | - | 1 664 | - | - | - |
| Other current assets | 20 370 | 25 179 | 25 458 | 20 370 | 25 179 |
| Total Current Assets | 1 148 072 | 954 152 | 954 152 | 1 148 072 | 952 488 |
| **Other Assets:** | | | | | |
| Property and equipment, net | 47 327 | 37 492 | 37 492 | 47 327 | 37 492 |
| Other assets | 291 893 | 197 913 | 197 913 | 291 893 | 197 913 |
| Total Other Assets | 339 220 | 235 405 | 235 405 | 339 220 | 235 405 |
| TOTAL ASSETS | $ 1 487 292 | $ 1 189 557 | $ 1 189 557 | $ 1 487 292 | $ 1 187 893 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)** | | | | | |
| **Current Liabilities:** | | | | | |
| Current maturities of long-term debt | $ 1 087 806 | $ 52 070 | $ 167 261 | $ 1 087 806 | $ 52 070 |
| Accounts payable | 595 590 | 314 486 | 339 371 | 595 590 | 314 486 |
| Accrued expenses and other current liabilities | 254 997 | 45 581 | 182 732 | 254 997 | 45 581 |
| Current liabilities of discontinued operations | - | 277 227 | - | - | - |
| Total Current Liabilities | 1 938 393 | 689 364 | 689 364 | 1 938 393 | 412 137 |
| Long-term debt, less current portion | 533 196 | - | - | 533 196 | - |
| Total Liabilities | 2 471 589 | 689 364 | 689 364 | 2 471 589 | 412 137 |
| COMMITMENTS AND CONTINGENCIES | | | | | |
| **Shareholders' Equity (Deficit):** | | | | | |
| Common stock, $0.10 par value, 100,000,000 shares authorized, 39,478,041 and 35,978,041 shares issued and outstanding, respectively | 3 947 804 | 3 597 804 | 3 597 804 | 3 947 804 | 3 597 804 |
| Additional paid-in capital | 47 205 951 | 46 824 378 | 46 824 378 | 47 205 951 | 46 824 378 |
| Accumulated deficit | (52 138 052) | (49 921 989) | (49 921 989) | (52 138 052) | (49 646 426) |
| Total shareholders' equity (deficit) | (984 297) | 500 193 | 500 193 | (984 297) | 775 756 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT) | $ 1 487 292 | $ 1 189 557 | $ 1 189 557 | $ 1 487 292 | $ 1 187 893 |

* The parent and subsidiary column for 2009 groups the individual line items of the subsidiary with the individual line items of the parent ignoring reclass- ification requirements under applicable accounting guidance. A column for 2010 is not presented as the amounts are identical to the actual 2010 amounts.

** The parent only columns for 2010 and 2009 are for illutrative purposes and report the balance sheet of the parent only, ignoring assets and liabilities of the subsidiary required under accounting guidance.



See the accompanying notes to the consolidated statements

# NIO SECURITY, INC. STATEMENT OF OPERATIONS AND COMPREHENSIVE LOSS

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

| | | | Parent and Subsidiary * | Parent Only** | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **2009** | **2010** | **2009** |
| Sales | $ 895 060 | $ 636 385 | $ 899 171 | $ 895 060 | $ 636 385 |
| Cost of sales | 382 944 | 280 849 | 607 406 | 382 944 | 280 849 |
| Gross profit | 512 116 | 355 536 | 291 765 | 512 116 | 355 536 |
| **Operating expenses:** | | | | | |
| Marketing, general and administrative | 1 952 770 | 1 696 633 | 2 272 382 | 1 952 770 | 1 696 633 |
| Research and development | 515 702 | 94 623 | 97 746 | 515 702 | 94 623 |
| Interest expense | 191 021 | 339 744 | 443 565 | 191 021 | 339 744 |
| Foreiegn currency exchange losses | 144 394 | 916 584 | 916 584 | 144 394 | 916 584 |
| Total operating expenses | 2 803 887 | 3 047 584 | 3 730 277 | 2 803 887 | 3 047 584 |
| Loss before other income and expense | (2 291 771) | (2 692 048) | (3 438 512) | (2 291 771) | (2 692 048) |
| **Other income (expense):** | | | | | |
| Loss on disposition of subsidiary assets | - | - | (1 858 412) | - | - |
| Other income | 75 708 | 315 778 | 399 341 | 75 708 | 315 778 |
| Loss from continuing operations | (2 216 063) | (2 376 270) | (4 897 583) | (2 216 063) | (2 376 270) |
| **Discontinued operations:** | | | | | |
| Loss on disposition of subsidiary assets | - | (1 858 412) | - | - | - |
| Loss from discontinued operations | - | (662 901) | - | - | - |
| Net loss | $ (2 216 063) | $ (4 897 583) | $ (4 897 583) | $ (2 216 063) | $ (2 376 270) |
| **Per share data:** | | | | | |
| Basic and diluted net loss per share | $ (0,06) | $ (0,93) | $ (0,93) | N/A | N/A |
| Basic and diluted weighted average common shares outstanding | 37 799 959 | 5 251 933 | 5 251 933 | N/A | N/A |

* The parent and subsidiary column for 2009 groups the individual line items of the subsidiary with the individual line items of the parent ignoring reclass- ification requirements under applicable accounting guidance. A column for 2010 is not presented as the amounts are identical to the actual 2010 amounts.

** The parent only columns for 2010 and 2009 are for illutrative purposes and report the balance sheet of the parent only, ignoring assets and liabilities of the subsidiary required under accounting guidance.

See the accompanying notes to the consolidated statements

## NIO SECURITY, INC. STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

| | Common stock Shares | Common stock Amount | Paid-in Capital | Accumulated Deficit | Total Stockholders` Equity (Deficit) |
|---|---|---|---|---|---|
| BALANCES AT JANUARY 1, 2009 | 2 308 237 | $ 230 824 | $ 43 038 451 | $ (45 024 406) | $ (1 755 131) |
| Issuance of stock upon conversion of debt | 14 371 558 | 1 437 156 | 3 831 356 | - | 5 268 512 |
| Sale of stock through private placement | 19 298 246 | 1 929 824 | (71 517) | - | 1 858 307 |
| Issuance of options to directors and employees | - | - | 26 088 | - | 26 088 |
| Net loss | - | - | - | (4 897 583) | (4 897 583) |
| BALANCES AT DECEMBER 31, 2009 | 35 978 041 | $ 3 597 804 | $ 46 824 378 | $ (49 921 989) | $ 500 193 |
| Sale of stock through private placement | 3 500 000 | 350 000 | 381 573 | - | 731 573 |
| Net loss | - | - | - | (2 216 063) | (2 216 063) |
| BALANCES AT DECEMBER 31, 2010 | 39 478 041 | $ 3 947 804 | $ 47 205 951 | $ (52 138 052) | $ (984 297) |



See the accompanying notes to the consolidated statements

# NIO SECURITY, INC. STATEMENT OF CASH FLOWS

## FOR THE YEARS ENDED DECEMBER 31, 2010 and 2009

| | | | Parent and Subsidiary * | | Parent only * | |
|---|---|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** | **2010** | **2009** |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | | |
| Net loss | $(2 216 063) | $(4 897 583) | $(2 216 063) | $(4 897 583) | $(2 216 063) | $(2 376 270) |
| Adjustments to reconcile net loss to net cash used by operating activities: | | | | | | |
| Loss on disposition of subsidiary assets | | 1 858 412 | | 1 858 412 | - | |
| Loss from discontinued operations | - | 662 901 | | - | - | - |
| Interest accrued on long term debt | 131 231 | | 131 231 | - | 131 231 | - |
| Loss on disposition of fixed assets | - | 46 997 | - | 46 997 | - | 46 997 |
| Stock-based compensation | - | 26 088 | - | 26 088 | - | 26 088 |
| Depreciation | 49 778 | 57 451 | 49 778 | 97 444 | 49 778 | 57 451 |
| Amortization | - | - | - | 90 756 | - | - |
| Change in assets and liabilities: | | | | | | |
| Trade accounts receivable | (24 264) | 79 275 | (23 537) | 93 528 | (24 264) | 79 275 |
| Inventories | (775 066) | 374 886 | (775 066) | 249 985 | (775 066) | 374 886 |
| Current assets of discontinued operations | 1 664 | 188 380 | - | - | - | - |
| Other assets of discontinued operations | - | 15 169 | - | - | - | - |
| Other current assets | 4 809 | 50 239 | 5 088 | 49 961 | 4 809 | 50 239 |
| Other assets | (93 980) | 121 567 | (93 980) | 121 857 | (93 980) | 121 567 |
| Accounts payable | 281 104 | 828 929 | 256 219 | 781 113 | 281 104 | 828 929 |
| Accrued expenses and other current liabilities | 78 185 | (207 771) | (58 966) | (383 683) | 78 185 | (207 771) |
| Current liabilities of discontinued operations | (277 227) | (638 610) | - | - | - | - |
| Other liabilities of discontinued operations | - | (1 139 891) | | - | - | - |
| Liability for subsidiary insolvency | - | (138 581) | | (138 581) | - | (138 581) |
| Net cash used by operating activities | (2 839 829) | (2 712 142) | (2 725 296) | (2 003 706) | (2 564 266) | (1 137 190) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | | |
| Advances to subsidiary | | - | | - | (275 563) | (1 574 952) |
| Purchase of property and equipment | (59 613) | - | (59 613) | - | (59 613) | - |
| Net cash used by investing activities | (59 613) | - | (59 613) | - | (335 176) | (1 574 952) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | | |
| Net proceeds of common stock issued | 731 573 | 1 858 307 | 731 573 | 1 858 307 | 731 573 | 1 858 307 |
| Proceeds from short-term loan and lines of credit | 1 568 932 | 778 561 | 1 568 932 | 778 561 | 1 568 932 | 778 561 |
| Proceeds (Repayment) of bank loans | - | - | (115 191) | (717 159) | - | - |
| Net cash provided by financing activities | 2 300 505 | 2 636 868 | 2 185 314 | 1 919 709 | 2 300 505 | 2 636 868 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (598 937) | (75 274) | (599 595) | (83 997) | (598 937) | (75 274) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 620 484 | 695 760 | 621 142 | 705 139 | 620 484 | 695 760 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 21 547 | $ 620 484 | $ 21 547 | $ 621 142 | $ 21 547 | $ 620 484 |
| SUPPLEMENTAL CASH FLOW INFORMATION | | | | | | |
| NON-CASH INVESTING AND FINANCING ACTIVITIES: | | | | | | |
| Issuance of shares in repayment of funded and trade debt | $ - | $ 5 268 512 | $ - | $ 5 268 512 | $ - | $ 5 268 512 |
| CASH PAID FOR: | | | | | | |
| Interest during the year | $ 60 304 | $ 75 102 | $ 60 304 | $ 75 102 | $ 60 304 | $ 4 990 |

* The parent and subsidiary column for 2009 groups the individual line items of the subsidiary with the individual line items of the parent ignoring reclass- ification requirements under applicable accounting guidance. A column for 2010 is not presented as the amounts are identical to the actual 2010 amounts.

** The parent only columns for 2010 and 2009 are for illutrative purposes and report the balance sheet of the parent only, ignoring assets and liabilities of the subsidiary required under accounting guidance.

See the accompanying notes to the consolidated statements

# NIO SECURITY, INC.

# *Notes to Financial Statements*

## 1. BUSINESS, ORGANIZATION AND BASIS OF PRESENTATION

Nio Security, Inc. ("Nio") was incorporated in the State of Delaware in 1992. Nio's corporate offices are headquartered in Florida with offices in Memphis, Tennessee, Munich, Germany and Oslo, Norway.

On August 1, 2007, Nio acquired 100% of the outstanding shares of Tempest Microsystems, Inc. ("Tempest"), a company located in Poway, California. Tempest was established in 1999 and offered a range of digital video recorders for the security industry based on a PC platform. In January, 2010 the Poway, CA office was closed and the Tempest DVR line was discontinued. Certain Tempest assets were transferred to the previous owners as consideration for repayment of long-term loans. (See Note 3).

Nio US develops and markets video processing and compression software and appliances based on in-house developed video processing and video analysis technology as well as video cameras. Nio has an existing suite of products that offer function and cost benefits to owners of existing and/or planned video surveillance systems employed in a wide range of applications.

Nio's products are sold to commercial as well as military and governmental users worldwide. The Company's operations comprise a single segment under accounting principles generally accepted in the United States of America.

### Going concern

As reported in the accompanying financial statements, the Company incurred net losses of $2,216,063 and, $4,897,583 for the years ended December 31, 2010 and, 2009 respectively. The Company had limited amounts of working capital and negative stockholders' equity at December 31, 2010. These factors raise considerable doubt about the Company's ability to continue as a going concern. Management has been able to raise funds in January 2011 through the sale of shares and successfully repaid a major part of its outstanding debt. The Company believes that it will continue as a going concern as a result of the sale of new shares coupled with the cost cutting measures taken in 2009 and 2010. However, there is no assurance that the Company will be successful. The accompanying financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

### Recent accounting guidance

During 2010, authoritative guidance was issued on revenue recognition, consolidation of variable interest entities and fair value disclosures for non-financial assets and liabilities, and additional fair value disclosures for financial assets, which are not yet effective for the Company's financial statements or when effective, would not have a material impact on the Company's financial statements upon adoption.

### Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Financial statement presentation

The financial statements include the financial statements of Nio and its wholly-owned subsidiary, Tempest (through the date of its termination). All significant inter-company balances and transactions have been eliminated.

### Parent and subsidiary and parent only financial information

Financial information presented on the balance sheet, statement of operations and cash flows for the years 2010 and 2009 under the parent and subsidiary columns represent the assets, liabilities, revenues and expenses and cash flow activities of Nio and its subsidiary Tempest ignoring adjustments and reclassifications otherwise required for discontinued operations under applicable accounting guidance. Parent only financial information presented ignore assets and liabilities of the subsidiary and losses on disposition of subsidiary assets and from discontinued operations required under accounting guidance.

### Financial instruments

The Company's financial instruments include cash, trade accounts receivables and trade accounts payable and bank debt for which carrying values approximate fair values due to the short maturities of those instruments. The fair value of long-term debt is based on current rates at which the Company could borrow funds with similar remaining maturities.

### Cash and cash equivalents

For financial statement purposes, the Company considers all highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents. The Company maintains its cash in bank deposit accounts in the United States of America and overseas which, at times, may exceed applicable insurance limits. The Company has not experienced any such losses in these accounts and does not believes it is exposed to any significant credit risk on cash and cash equivalents.

### Trade accounts receivable and allowance for doubtful accounts

The Company has established an allowance for doubtful accounts receivable based upon factors such as the credit risk of specific customers, historical trends and other data. Based on management's evaluation of collectibility, allowances for doubtful accounts of $2,817 and $12,060 were established at December 31, 2010 and 2009, respectively.

### Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market and consist of finished products at the Company's warehouses in Memphis, Tennessee and Oslo, Norway and work-in-process inventory at a third-party vendor in Augsburg, Germany.

### Property and equipment

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is provided using straight-line and accelerated methods over the estimated useful lives of the assets. Fully depreciated assets are written off although they may still be utilized. The estimated useful lives of the various classes of assets are as follows: Computer software: 3 years; computer equipment: 3-10 years; furniture, fixtures and other: 5-7 years.

### Research and development expenses

Software development costs consist principally of compensation and benefits paid to the Company's employees. All software development costs not qualifying for capitalization are expensed as research and development costs when incurred.

The Company's policy is to expense all software development costs prior to establishing technological feasibility. Because the Company's products have reached this state of development almost concurrently with general release, the Company has not capitalized any software development costs.

### Income taxes

On January 1, 2009, the Company adopted the authoritative accounting guidance on uncertain tax positions. The new guidance provides a threshold for determining when an income tax benefit can be recognized for financial statement purposes. The threshold for financial statement reporting generally is higher than the threshold for claiming deductions in income tax returns. Under the new guidance, the tax benefit from an uncertain tax position can be recognized for financial statement purposes only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities including the resolution of appeals or litigation processes, if any. The new rules also provide guidance on classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Management believes there were no material uncertain tax positions at the date of adoption and through December 31, 2010.

The Company provides deferred income taxes resulting from temporary differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the tax rate expected to be in effect when taxes are actually paid or recovered.

Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more than fifty percent likely of being realized. Temporary differences result principally from net operating loss
carry-forwards, the use of inventory uniform capitalization rules for tax purposes and accrued compensation costs and bad debt allowances that are not yet deductible for tax purposes.

The Company files U.S. federal income tax returns and state and local income tax returns in Florida, California, Tennessee and New York. Returns filed in these jurisdictions for tax years ended on or after December 31, 2007 are subject to examination by the relevant taxing authorities.

## Foreign currency transactions

Transactions in currencies other than the U.S. dollar are recorded in U.S. dollars at exchange rates prevailing at the transaction dates. Exchange gains and losses are included in the Company's results of operations.

## Stock option plans

The Company accounts for stock options granted to its employees and directors at the fair value at date of grant. Expense recognition is given for all compensatory options issued and expected to vest, including those with an exercise price equal to or greater than market value at the grant date. Such expense is recorded over the recipients' expected service period applicable to the grant.

## Accounting for the impairment or disposal of long-lived assets

The Company follows the applicable accounting guidance for long-lived assets and certain identifiable intangibles. These are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

## Goodwill

Goodwill is the excess of cost over the fair value of net assets (including identifiable intangibles) acquired in a business acquisition. Goodwill is not amortized but rather tested at least annually for impairment or whenever events or changes in circumstances indicate that the carrying amount of the asset might not be fully recoverable. In accordance with the applicable accounting guidance, the Company compares the fair value of the acquired business to its carrying amount on an annual basis to determine if there is potential goodwill impairment. If the fair value of the acquired business is less than its carrying values, an impairment loss is recorded to the extent that the fair value of the goodwill is less than its carrying value. Fair values for acquired businesses are determined based on discounted cash flows, market multiples or appraised values.

At December 31, 2009, the Company recorded a loss on the disposition of its subsidiary. Such loss included the write off of $669,788 of goodwill originally recorded when the subsidiary was acquired in 2007. (See Notes 3 and 6).

## Intangible assets, net

Intangible assets are amortized using the straight-line method over their estimated period of benefit. The Company periodically evaluates the recoverability of intangible assets and takes into account events or circumstances that warrant revised estimates of useful lives or that indicate that impairment exists. The Company has recorded a loss on the disposition of its subsidiary in 2009. (See Note 3), which included the write off of $1,310,673 of unamortized balances of intangibles originally recorded when the subsidiary was acquired in 2007.

## Loss per common share

Basic and diluted loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding. Due to net losses in 2010 and, 2009 outstanding common stock purchase options and warrants were anti-dilutive and accordingly were excluded from this calculation.
(See Note 10).

## Reverse stock split and increase in authorized shares

On June 2, 2009, the Company elected to amend and restate its certificate of incorporation to reflect an increase in the Company's authorized shares from thirty million to seventy million shares of common stock and change the par value per share of its common stock from fifty cents (USD 0.50) to ten cents (USD 0.10) and a reverse ten to one split of the outstanding common stock. The accompanying financial statements give full retroactive effect to the revised capital structure and also recognize adjustments for fractional shares. On May 28, 2010, the Company elected to amend and restate its certificate of incorporation to reflect an increase in the Company's authorized common shares from seventy million to one hundred million shares.

## 3. DISPOSITION OF TEMPEST

On January 21, 2010 the Company reached an agreement with the previous owner of Tempest to sell certain assets in return for $553,500, which amount had been advanced to pay certain bank debt in December 2009. The following details the assets sold and the resulting loss on the sale, all recognized as of December 31, 2009:

| | | |
|---|---|---|
| Fixed assets | $ | 122,814 |
| Inventories | | 289,930 |
| Other assets | | 18,707 |
| Goodwill | | 669,788 |
| Patents | | 180,000 |
| Trademarks | | 1,130,673 |
| Total assets sold | | 2,411,912 |
| Cash received | | 553,500 |
| Net loss | $ | 1,858,412 |

## 4. INVENTORIES

Nio's inventories, which were the same for Nio only and Nio and Tempest, at December 31 consist of the following:

| | 2010 | 2009 |
|---|---|---|
| Finished products | $ 198,072 | $ 72,018 |
| Work-in-process | 828,583 | 179,571 |
| Total inventory | $ 1,026,655 | $ 251,589 |

## 5. PROPERTY AND EQUIPMENT

Property and equipment, which were the same for Nio only and Nio and Tempest, consist of the following as of December 31:

| | | 2010 | | 2009 |
|---|---|---|---|---|
| Computer software | $ | - | $ | 132,482 |
| Furniture, fixtures and computer equipment | | 80,681 | | 14,446 |
| | | 80,681 | | 146,928 |
| Less: Accumulated depreciation | | 33,354 | | 109,436 |
| Property and equipment, net | $ | 47,327 | $ | 37,492 |

Depreciation expense for the years ended December 31, 2010 and, 2009 for Nio only was $49,778 and $57,451, respectively. Depreciation expense for Nio and Tempest was $49,778 and $111,880 respectively for the years ended December 31, 2010 and 2009.

## 6. INTANGIBLE ASSETS AND GOODWILL

Amortization expense of intangible assets was $90,756 for the year ended December 31, 2009. All intangible assets were sold as of such date. (See Note 3).

The Company had elected to perform the annual impairment test on goodwill during the fourth quarter of each year, unless circumstances arose that required more frequent testing. As of December 31, 2009, the remaining balance of goodwill of $669,788 was written off as the assets it related to were sold. (See Notes 1 and 3).

## 7. OTHER ASSETS

Other assets include security deposits on office leases and certain value added tax refunds due from German and Norwegian tax authorities.

## 8. INCOME TAXES

As of December 31, 2010, the Company had approximately $40,884,000 of net operating loss carry-forwards, which expire at various dates beginning in tax year 2012 through 2029. The availability to offset income taxes in future years may be restricted if the Company undergoes an ownership change, which may occur as a result of future sales of any stock and other events. For the years ended December 31, 2010 and, 2009, the Company incurred taxable losses for domestic income tax purposes and, as such, had no related federal or state income tax expense.

The tax effect of temporary differences that give rise to the Company's deferred tax assets and liabilities at December 31, 2010 and 2009 are as follows:

| | 2010 | 2009 |
|---|---|---|
| Net operating loss carry-forwards | $ 16,353,000 | $ 16,051,000 |
| Less: Valuation allowance | 16,353,000 | 16,051,000 |
| Net deferred income tax assets | $ - | $ - |

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income. The Company has determined that it is more likely than not that it will not realize the benefit of its deferred tax assets and as such has recorded an allowance against 100% of its deferred tax assets.

The increase in the valuation allowance for deferred income tax assets for the years ended December 31, 2010 and 2009 was $302,000 and $667,000, respectively. These increases are the result of losses incurred in 2010 and 2009 by the Company.

## 9. FINANCING

### Short-term loans

In 2007 and through October 1, 2008, the Company entered into various short-term loans with various lenders, all of such debt being secured by all of the Company's intellectual property rights. During this period certain loans were extended and additional amounts borrowed. Interest on these loans was either 15% or 20%. As last increased and/or extended a total of US$ 2,082,031, plus accrued interest, was outstanding and due to be repaid on October 1, 2008.

On the due date on October 1, 2008, the Company was not able to repay the short-term loans and began negotiations with the lenders and possible new investors to restructure its debt. On December 22, 2008, the Company completed a funding which included an extension of the maturity of the existing short-term loans, combined with new loans in the amount of NOK 6.1 million. The existing short term loans including accrued interest amounted to NOK 14,150,365 (US$ 2,055,784), and the total new loan facility was NOK 20,250,365 (US$ 2,903,032), with maturity on June 29, 2009. The interest rate was 10% per annum and the lenders were given a first priority security interest in all of the Company's available intellectual property rights, including trademark and patents and all of the shares then held by the Company in its U.S. subsidiary, Tempest Microsystems Inc. In addition, the Company issued 1,720,000 new warrants giving the lenders the right to purchase new shares at a price of NOK 1.00 per share through June 29, 2009. The new lenders received 1,220,000 warrants and the existing lenders received 500,000 warrants.

Prior to maturity on June 29, 2009, the Company extended the short-term loan due date until August 31, 2009 on the same terms.

On August 31, 2009, the Company was not able to repay the short term loan and continued dialogue with the lenders under the short term loan agreement in order to secure a new financing. In November, 2009, the Company finalized a refinancing, whereof the lenders under the short term loan agreed to convert the outstanding principal and accrued interest thereon into share capital of the Company based on a conversion price of NOK 1.92 per share. As a result, 10,541,097 new shares were issued to the lenders in December, 2009. Contemporaneously, 3,830,461 new shares were issued to various vendors in payment of certain trade debt. A total of US$ 5,268,512 was satisfied by these stock issuances.

During 2010, the Company entered into loan agreements aggregating a balance of NOK 9.46 million (US$ 1,621,002), primarily with major shareholders. Of these loans, NOK 3.1 million (US$ 533,196) have maturities in 2012 and are classified as long-term loans at December 31, 2010. Subsequent to December 31, 2010, NOK 5 million ($856,540) of loans with maturities in 2011 were repaid.

### Long-term loans

On September 20, 2007, as a result of Nio's acquisition of Tempest, an agreement was signed between Nio and Vineyard Bank, whereby Nio assumed an outstanding loan with a balance of $475,291. On the same date Nio's assumed a second loan of Tempest to the same bank; the outstanding loan balance was $923,878.

On December 31, 2009, the Company entered into an agreement with California Bank and Trust (successor to Vineyard Bank) regarding full pre-payment of the Company's two long-term loans for a US $1,107,000 payment and forgiveness of interest of $33,709, included in other income. As part of the agreement, the Company paid US $553,500 to the bank on December 31, 2009. In addition, the previous owner of Tempest, who was guarantor for the loans, paid the remaining $553,500 and, in return, received certain assets. (See Note 3). The two loans were paid in full as of December 31, 2009.

Also at December 31, 2009, a revolving line of credit of Tempest, which had been assumed by the Company, had an outstanding balance of $115,191, with interest at prime plus 3.5%. The line was repaid in August, 2010.

## 10. SHAREHOLDERS' EQUITY

### Oslo bors registration

The Company's shares are traded on the Oslo Stock Exchange ("OSLO BØRS") with the "NIO" ticker symbol.

### Authorized shares

Pursuant to a shareholders' meeting on May 26, 2010, the Company's number of authorized shares is 100,000,000 each with a par value of $0.10.

### Private placements

On November 30, 2009, the Company completed its refinancing and issued a total of 33,669,804 new shares of its common stock, including: (a) 19,298,246 shares to the investors in the private placement of NOK 11,000,000 at par value (US $0.10, $1,941,302 in the aggregate); (b) 10,541,097 shares at a share price of NOK 1.92; to the lenders from the conversion of the NOK 20,250,365 short term loan; and (c) 3,830,461 shares at a share price of NOK 1.92 to other creditors as consideration for other debt, all at the approximate US dollar equivalent of $0.3666. For the listing of the new shares, a prospectus was accepted by the Oslo Stock Exchange on December 17, 2009. The number of shares outstanding as of December 31, 2009 was 35,978,041.

On June 15, 2010, the Company initiated a private placement of 3,500,000 shares at a subscription price of NOK 1.40 (US$ .215) per share, and on June 24, 2010 the private placement was concluded and 3,500,000 new shares were issued at the offered terms. Total proceeds amounted to NOK 4,900,000 (US$ 753,118) less approximately US$ 21,545 in placement fees. After this transaction, the number of outstanding shares was 39,478,041.

## Stock option/warrant plans

The Company has various stock option plans. The Company's 2001 and 2004 plans provide for grants of up to 5,000 and 123,000 options, respectively and the 2006 plan limits the total number of options available for grant is to 10% of the outstanding shares at the time of any grant. These three plans limit the amount of options that may be granted to non-employee directors to 500 (an aggregate of 1,500 for all three plans), and for the 2004 plan, no more than 10% may be granted to non-employee directors and for the 2006 plan, no more than 20% may be granted to non-employee directors.

In 2009, 172,000 warrants with an exercise price of NOK 10.00 (US$ 1.40) were granted to the lenders in the short term loan facility in December 2008. The warrants were cancelled in connection with the repayment of the short term loan through conversion into shares in November, 2009.

In addition, in November, 2009, as part of the refinancing, the investors in the private placement were granted warrants to purchase 15,000,000 shares at NOK 2.50 per share and 15,000,000 shares at NOK 5.00 per share which expire no later than December 31, 2012. In accordance with applicable guidance, no net accounting value is ascribed to the warrants. In addition, 1,800,000 warrants to purchase shares at NOK 2.50 per share with expiry not later than December 31, 2012 were issued to board members and officers.

Options granted under the 2001, 2004 and 2006 Plans may be incentive stock options or non-qualified stock options, as determined by a Committee of the Board of Directors (the "Committee") at the time of grant. Incentive stock options are generally to be granted at a price not less than the fair market value of the stock on the date of grant, or at a price not less than 110% of the fair market value, if granted to a participant who is a greater than a 10% owner of the Company. Non-qualified stock options may be granted at a price to be determined by the Committee, which may be equal to, greater than, or less than the fair market value at the date of grant.

Option vesting terms are established by the Committee at the time of grant. The expiration dates of all options granted are determined at the time of grant and may not exceed ten years from date of grant, or five years from date of grant for participants who own greater than 10% of the Company. At December 31, 2010 there were 300, 7,834 and 11,500 options outstanding under the above Plans, respectively and 31,800,000 warrants outstanding.

During the years ended December 31, 2010 and, 2009, the Company recognized stock-based compensation expense of $0 and, $26,088 respectively, in connection with the vesting of stock options granted to employees and directors using the fair value method. No compensatory stock options were granted in either 2010 or 2009.

The following summarizes stock options and warrant activities under the, 2001, 2004 and 2006 Plans for the years ended December 31, 2010 and, 2009:

| | Weighted Number of Shares | Average Exersise Price |
|---|---|---|
| Options outstanding at January 1, 2009 | 215,753 | 5.90 |
| Granted (warrants) | 31,800,000 | 0.65 |
| Cancelled (warrant) | 172,000 | 1.40 |
| Expired | 3,129 47.12 | 47.12 |
| Total outstanding at December 31, 2009 | 31,840,624 | 0.71 |
| Cancelled (options) | 20,900 | 26.67 |
| Expired | 90 | 275.00 |
| Total outstanding at December 31, 2010 | 31,819,634 | $ 0.64 |

The following tables summarize information about stock options and warrants outstanding at December 31, 2009 and 2010:

| Exercise Prices | Number Outstanding at December 31, 2009 | Weighted Average Contractual Life | Weighted Average Exercise Price | Number of Shares Exercisable at December 31, 2009 | Weighted Average Exercise Price |
|---|---|---|---|---|---|
| 6,08 | 9 834 | 5,07 | 6,08 | 9 834 | 6,08 |
| 13,29 | 3 000 | 5,92 | 13,29 | 3 000 | 13,29 |
| 15,00 | 1 200 | 2,99 | 15,00 | 1 200 | 15,00 |
| 34,74 | 26 500 | 6,96 | 34,74 | 26 500 | 34,74 |
| 275,00 | 90 | 0,26 | 275,00 | 90 | 275 |
| 0,43 | 16 800 000 | 3,00 | 0,43 | 16 800 000 | 0,43 |
| 0,87 | 15 000 000 | 3,00 | 0,87 | 15 000 000 | 0,87 |
| | 31 840 624 | 3,00 | 0,67 | 31 840 624 | 0,67 |

| Exercise Prices | Number Outstanding at December 31, 2010 | Weighted Average Contractual Life | Weighted Average Exercise Price | Number of Shares Exercisable at December 31, 2010 | Weighted Average Exercise Price |
|---|---|---|---|---|---|
| 6,00 | | | | | |
| 13,11 | 4 834 | 4,07 | 6,00 | 4 834 | 6,00 |
| 15,00 | 3 000 | 4,92 | 13,11 | 3 000 | 13,11 |
| 34,26 | 300 | 1,99 | 15,00 | 300 | 15,00 |
| 0,43 | 11 500 | 5,96 | 34,26 | 11 500 | 34,26 |
| 0,87 | 16 800 000 | 2,00 | 0,43 | 16 800 000 | 0,43 |
| | 15 000 000 | 2,00 | 0,87 | 15 000 000 | 0,87 |
| | 31 819 634 | 2,00 | 0,64 | 31 819 634 | 0,64 |

## 11. MAJOR CUSTOMERS

Three customers accounted for 75%, 14% and 4%, respectively, of the outstanding accounts receivable balance at December 31, 2010 and three customers accounted for 37%, 23% and 15%, respectively, of the outstanding accounts receivable balance at December 31, 2009. Three customers accounted for 58% (25%, 18%, 15%), and 24% (13%, 6% and 5%) of total sales for the years ended December 31, 2010 and 2009 respectively.

## 12. COMMITMENTS AND CONTINGENCIES

The Company is obligated under lease agreements in Tennessee and Florida, USA, and Oslo, Norway. The lease for the California location was assumed by the buyer pursuant to the sale of the Tempest assets effective January 2010. (See Note 3).

Rent expense for Nio only for the years ended December 31, 2010 and 2009 was $45,004 and $89,864, respectively. Rent expense for Nio and Tempest was $45,004 and $165,282 for the years ended December 31, 2010 and 2009 respectively.

Minimum future lease payments under the existing leases as of December 31, 2010 are approximately:

| | |
|---|---|
| 2011 | 141,493 |
| 2012 | 67,023 |
| | $ 208,516 |

## 13. RELATED PARTY TRANSACTIONS

The Company incurred a total of $470,360 and $384,160 for the years ended December 31, 2010 and 2009, respectively, in fees to board members for various per diem consulting work performed as well as $52,689 and $48,647 in board fees for the years ended December 31, 3010 and, 2009 respectively.

## 14. SUBSEQUENT EVENTS

In January 2011, Nio completed a NOK 15 million private placement of 6,000,000 shares at a subscription price of NOK 2.50 per share. A prospectus for the listing of the new shares was approved by the Financial Supervisory Authority of Norway (Finanstilsynet) on February 15, 2011, and a subsequent offering to existing shareholders not participating in the private placement resulted in subscription of an additional 156,268 shares at a subscription price of NOK 2.50 per share. After the private placement and the subsequent offering, the new number of outstanding shares was 45,634,309.

For purposes of disclosure in the financial statements, management has evaluated subsequent events through April 25, 2011, the date the financial statements were available to be issued.

Watchful Intelligence

**Nio Security, Inc.**
10700 Stringfellow Rd. #10
Bokeelia, FL 33922
USA
Phone: +1 239 282 0563
Fax: +1 239 282 2391

**Nio Security, Inc.**
Fridtjof Nansens plass 7
0160 Oslo
Norway
Phone: +47 22 60 73 00
Email: investor@niosec.com

www.niosec.com

GRAPHIC DESIGN: TOMAANENSEN.NO PHOTO: PATRICK JOUST, patrickjoust@yahoo.com