

COLORSTARS GROUP AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

March 31, 2013

**COLORSTARS GROUP AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANT

COLORSTARS GROUP AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(IN US\$)

	March 31, 2013	December 31, 2012
<u>Assets</u>		
Current assets:		
Cash and equivalents	\$259,496	\$406,100
Accounts receivable, net of allowance for doubtful accounts of \$43,497 at March 31, 2013 and \$42,227 at December 31, 2012	172,391	189,468
Inventory	784,612	802,848
Prepaid expenses and other current assets	118,981	124,104
	1,335,480	1,522,520
Equipment, net of accumulated depreciation	166,281	181,945
Investments	346,324	479,026
Deferred income tax assets	89,000	89,000
Intangible assets	797	1,272
	\$1,937,882	\$2,273,763
<u>Liabilities and stockholders' equity</u>		
Current liabilities:		
Short term loan	\$401,728	\$413,351
Accounts payable	169,120	305,855
Accrued expenses	35,542	27,578
Receipts in advance and other current liabilities	26,213	16,606
	632,603	763,390
Stockholders' equity		
Common Stock –Par Value \$0.001 67,448,890 shares issued and outstanding at March 31, 2013 and December 31, 2012	67,449	67,449
Additional paid in capital	3,112,230	3,112,230
Accumulated other comprehensive income	264,118	332,722
Accumulated deficit	(2,138,518)	(2,002,028)
	1,305,279	1,510,373
	\$1,937,882	\$2,273,763

The accompanying notes are an integral part of the financial statements.

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CONSOLIDATED STATEMENTS OF OPERATION AND COMPREHENSIVE LOSS
(UNAUDITED)
(IN US\$)

	Three months ended March 31,	
	2013	2012
Net sales	\$456,867	\$711,214
Cost of goods sold	283,725	482,603
Gross profit	173,142	228,611
Operating expenses		
Selling, general and administrative	215,514	328,596
Research and development	15,704	25,833
Total operating expenses	231,218	354,429
Loss from operations	(58,076)	(125,818)
Other income (expenses)		
Interest expense (net)	(3,263)	(3,178)
Share of investee's operating results (net)	(104,106)	(10,268)
Gain (loss) on foreign exchange, net	35,378	(26,035)
Other, net	1,401	2,330
Loss before income tax	(128,666)	(162,969)
Income tax benefit (expense)	(7,824)	5,677
Net loss	(136,490)	(157,292)
Earnings per share attributable to common stockholders:		
Basic and diluted per share	\$0.00	\$0.00
Weighted average shares outstanding:		
Basic and diluted	67,448,890	67,448,890
Comprehensive loss:		
Net loss	(136,490)	(157,292)
Other comprehensive loss:		
Foreign currency translation, net of taxes	(68,604)	72,137
Comprehensive loss	\$(205,094)	\$(85,155)

The accompanying notes are an integral part of the financial statements.

COLORSTARS GROUP AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)
(IN US\$)

	For three months ended March 31,	
	2013	2012
Cash flows from operating activities		
Net (loss)	\$(136,490)	\$(157,292)
Depreciation and amortization	11,303	11,442
Provision for doubtful accounts	2,489	4,216
Share of investment loss	132,702	10,268
Changes in operating assets and liabilities:		
Accounts receivable	14,589	19,947
Inventories	18,237	(96,087)
Prepaid expenses and other current assets	5,123	27,266
Accounts payable	(136,735)	(39,879)
Accrued expenses	7,963	(19,410)
Receipts in advance and other current liabilities	9,607	(4,579)
	(71,212)	(244,108)
 Cash flows from investing activities		
Addition to fixed assets	-	(51,085)
	-	(51,085)
 Effect of exchange rate changes on cash and cash equivalents	(75,392)	19,017
 Net (decrease) in cash and cash equivalents	(146,604)	(276,176)
Beginning cash and cash equivalents	406,100	989,078
 Ending cash and cash equivalents	\$259,496	\$712,902
 Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$3,262	\$3,130
Tax paid	\$7,824	-

The accompanying notes are an integral part of the financial statements.

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Nature of Business and Basis of Presentation

Nature of Business – Circletronics Inc., now ColorStars Group (“the Company”), was incorporated in Canada on January 21, 2005. Circletronics Inc.- was redomiciled to Nevada and its name changed to ColorStars Group on November 3, 2005. ColorStars Group owns 100% of the shares of ColorStars Inc.

Color Stars Inc. (“Color Stars TW”, “the Subsidiary”) was incorporated as a limited liability company in Taiwan, Republic of China in April 2003 and commenced its operations in May 2003. The Subsidiary is mainly engaged in manufacturing, designing and selling light-emitting diode and lighting equipment.

Basis of Presentation - The accompanying unaudited consolidated financial statements of ColorStars Group and Color Stars Inc. (“the Company”) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to the Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for a complete presentation of the financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair statement of the financial position, results of operations and cash flows for the three months ended March 31, 2013 and 2012 have been included. For further information, refer to the consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Operating results for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for any subsequent interim period or for the year ending December 31, 2013.

Basis of Consolidation - The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Note 2 - Recent Adopted Accounting Pronouncements

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income - In February 2013, the Financial Accounting Standards Board (“FASB”) issued ASU 2013-02, which requires disclosure of significant amounts reclassified out of accumulated other comprehensive income by component and their corresponding effect on the respective line items of net income. This guidance is effective for the Company beginning in the first quarter of 2013. The adoption of ASU 2013-02 only impacted disclosure requirements and did not have any effect on the operating results or the financial condition.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - Recently Issued Accounting Pronouncements

Foreign Currency Matters – Effective December 15, 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2013-05, *Foreign Currency Matters*. The parent entity is required to release any related cumulative translation adjustment into net income when the entity ceases to have a controlling financial interest in a subsidiary or group of assets. A pro rata portion of the cumulative translation adjustment should be released into net income upon a partial sale of such an equity method investment.

Note 4 - Concentration of Risk

Financial instruments that potentially subject the Company to significant concentration of credit risk consist principally of accounts receivable, cash and cash equivalents. The Company's cash and cash equivalents are maintained with high quality institutions, the compositions and maturities of which are regularly monitored by management. Through March 31, 2013, the Company had not experienced any losses on such deposits.

Accounts receivable include amounts due from customers primarily in the manufactory industry. The Company performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary, but generally requires no collateral. The Company also maintains allowances for potential credit losses. In estimating the required allowances, the Company takes into consideration the overall quality and aging of the receivable portfolio, the existence of a limited amount of credit insurance and specifically identified customer risks. Through March 31, 2013, such losses have been within management's expectations.

For the three months ended March 31, 2013, products sold to the Company's largest customer, accounted for approximately 10.79%. Products purchased from the Company's first two largest suppliers were accounted for approximately 81.41% of the total purchases.

Note 5 - Earnings Per Share

Basic net loss per share is computed by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period.

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated:

	Three months ended Mar 31,	
	2013	2012
Net loss attributable to common stockholders	<u>\$ (136,490)</u>	<u>\$ (157,292)</u>
Weighted average common stock outstanding - Basic and diluted	<u>67,448,890</u>	<u>67,448,890</u>
Earnings per share attributable to common stockholder Basic and diluted	<u>\$.00</u>	<u>\$.00</u>

Note 6 - Accumulated Other Comprehensive loss

The components of accumulated other comprehensive losses were as follows:

	<u>Foreign currency translation</u>
Balance, December 31, 2012	332,722
Foreign currency translation, net of taxes	<u>(68,604)</u>
Balance, March 31, 2013	<u>264,118</u>
Balance, December 31, 2011	226,527
Foreign currency translation, net of taxes	<u>72,137</u>
Balance, March 31, 2012	<u>298,664</u>

Note 7 - Long Term Investments

	<u>March 31, 2013</u>	<u>December 31, 2012</u>
Equity method investment – Anteya Technology Corp		
Carrying value of investment at the beginning	\$425,345	\$799,131
Share of associate’s loss	(102,794)	(378,173)
Exchange difference	(29,908)	4,387
	<u>292,643</u>	<u>425,345</u>
Equity method investment – Fin-Core Corporation		
Carrying value of investment at the beginning	-	196,087
Impairment for the year	-	(204,563)
Exchange difference	-	8,476
	<u>-</u>	<u>-</u>
Cost-method investments – Phocos		
At cost	53,681	142,038
Impairment for the year	-	(88,357)
	<u>53,681</u>	<u>53,681</u>
Carrying value at the end	<u>\$346,324</u>	<u>\$479,026</u>

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Long Term Investments (continued)

Anteya Technology Corp (Anteya) is a private company incorporated in Taiwan. The equity interest held by the Company is 20%.

Fin-Core Corporation (FCC) is a private company incorporated in Taiwan. The number of shares of Fin-Core held by the Company is 57,143 shares, 5.19% at March 31, 2013 and December 31, 2012. The Company recorded the investment in Fin-Core Corporation at cost.

Phocos AG is a private company incorporated in Germany. The equity interest held by the Company is 2.38%. Investment in Phocos AG is stated at cost.

The unaudited financial information of Anteya Technology Corp. as of March 31, 2013 and December 31, 2012 and for three months ended March 31, 2013 and 2012 (in US dollars) are as follows:

<u>Balance sheet</u>	March 31, 2013	December 31, 2012
Current assets	\$3,884,495	\$4,634,083
Non-current assets	912,385	730,201
Total assets	4,796,880	5,364,284
Current liabilities	2,349,914	2,475,513
Non-current liabilities	650,175	762,048
Stockholders' equity	1,796,791	2,126,723
Total stockholders' equity and liabilities	4,796,880	\$5,364,284
	Three months ended March 31,	
<u>Statement of operation</u>	2013	2012
Net sale	\$686,140	\$1,087,950
Cost of goods sold	(591,635)	(865,817)
Gross profit	94,505	222,133
Operating and non-operating expenses	(306,337)	(270,413)
Net profit	\$(211,832)	\$(48,280)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 - Inventory

Inventories stated at the lower of cost or market value are as follows:

	March 31, 2013	December 31, 2012
Finished goods	\$784,612	\$802,848

Note 9 - Income Taxes

The Company is subject to U.S. federal income tax as well as income tax in states and foreign jurisdictions. For the major taxing jurisdictions, the tax years 2006 through 2013 remain open for state and federal examination. The Company believes assessments, if any, would be immaterial to its consolidated financial statements. With respect to the foreign jurisdiction, the Company is no longer subject to income tax audits for the year 2013 (inclusive).

The income tax provision information is provided as follows:

	Three months ended March 31,	
	2013	2012
Component of income (loss) before income taxes:		
United States	\$(56,312)	\$(49,598)
Foreign	(72,354)	(113,371)
Income (loss) before income taxes	\$(128,666)	\$(162,969)
Provision for income taxes		
Current		
U.S. federal	-	-
State and local	-	-
Foreign	\$(7,824)	\$5,677
Income tax benefit (expense)	\$(7,824)	\$5,677

Note 10 - Accrued Expenses

	March 31, 2013	December 31, 2012
Salaries and allowance	\$15,874	\$16,351
Insurance	6,218	7,138
Tax payable	5,386	-
Others	8,064	4,089
	\$35,542	\$27,578

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Bank Short Term Debt

	March 31, 2013	December 31, 2012
Bank loan payable to Taiwan banks	\$401,728	\$413,351

The Company signed revolving credit agreements with a lending institution. The interest rate on short-term borrowings outstanding as of March 31, 2013 ranges from 3.146% to 3.166% per annum, as of December 31, 2012, interest rate ranges from 3.15% to 3.166% per annum. The short term debt is secured by:

1. personal guarantee from directors
2. the realty property of spouse of directors

Note 12 - Geographic Information

Product revenues for the three months ended March 31, 2013 and 2012 are as follows:

	Three months ended Mar 31,	
	2013	2012
Customers based in:		
Europe	\$224,963	\$403,166
Asia	71,005	81,072
United States	55,329	179,466
Others	105,570	47,510
	\$456,867	\$711,214

Note 13 - Related Party Transactions

The Company has recorded expenses for the following related party transactions for three months ended March 31, 2013 and 2012:

	Three months ended March 31,	
	2013	2012
Purchase from Anteya Technology Corp	\$193,692	\$270,628
Rent paid to Mr. Wei-Rur Chen	12,206	12,125

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Related Party Transactions (continued)

As of the balance sheet date indicated, the Company had the following liabilities recorded with respect to related party transactions:

	March 31, 2013	December 31, 2012
Liabilities:		
Anteya Technology Corp	\$124,015	\$148,798

The Company leases office space from Mr. Wei-Rur Chen which the term for the agreement is from November 2010 to November 2015.

The Company conducted business with a related party company Anteya Technology Corp. The Company owns 20% of the outstanding common stock of Anteya Technology Corp as of March 31, 2013. All transactions were at market-based prices.

Note 14 - Commitments

	Three months ended March 31,	
	2013	2012
Rent expenses	\$31,427	\$95,510

The company leases offices in Taiwan and in California, US under operating leases. Minimum future rental payments due under non-cancelable operating leases with remaining terms at March 31, 2013 are as follows:

2013	54,776
2014	48,207
2015	40,976
	<u>143,959</u>

Note 15 - Subsequent Events

The Company evaluated all events subsequent to March 31, 2013 through the date of the issuance of the financial statements and there are no other significant or material transactions to be reported.