

COLORSTARS GROUP AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 30, 2013

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CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANT

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

<u>Assets</u>	September 30, 2013	December 31, 2012
Current assets:		
Cash and equivalents	\$244,599	\$406,100
Accounts receivable, net of allowance for doubtful accounts of \$68,411 at September 30, 2013 and \$42,227 at December 31, 2012	181,339	189,468
Inventory	825,967	802,848
Prepaid expenses and other current assets	110,553	124,104
Total current assets	1,362,458	1,522,520
Equipment, net of accumulated depreciation	143,204	181,945
Investments	281,396	479,026
Deferred income tax assets	89,000	89,000
Intangible assets	349	1,272
Total assets	<u>\$1,876,407</u>	<u>\$2,273,763</u>
<u>Liabilities and stockholders' equity</u>		
Current liabilities:		
Short term loan	\$405,913	\$413,351
Accounts payable	197,716	305,855
Accrued expenses	27,840	27,578
Receipts in advance and other current liabilities	19,062	16,606
Total current liabilities	650,531	763,390
Stockholders' equity		
Common Stock –Par Value \$0.001 67,448,890 shares issued and outstanding at September 30, 2013 and December 31, 2012	67,449	67,449
Additional paid in capital	3,112,230	3,112,230
Accumulated other comprehensive income	375,722	332,722
Accumulated deficit	(2,329,525)	(2,002,028)
Total stockholders' equity	1,225,876	1,510,373
Total liabilities and stockholders' equity	<u>\$1,876,407</u>	<u>\$2,273,763</u>

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

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

	Three months ended September 30,	
	2013	2012
Net sales	\$345,430	\$753,672
Cost of goods sold	233,208	477,779
Gross profit	112,222	275,893
Operating expenses		
Selling, general and administrative	177,146	281,915
Research and development	17,021	21,625
Total operating expenses	194,167	303,540
Loss from operations	(81,945)	(27,647)
Other income (expenses)		
Interest expense (net)	(3,492)	(2,708)
Share of investee's operating results (net)	(39,000)	(22,778)
Impairment of investment	-	(201,698)
Gain (loss) on foreign exchange, net	(9,493)	(9,377)
Other, net	44	969
Loss before income tax	(133,886)	(263,239)
Income tax benefit (expense)	611	1,452
Net loss	(133,275)	(261,787)
Other comprehensive income (loss), net		
Translation adjustment	107,599	(24,302)
Total comprehensive loss	\$(25,676)	\$(286,089)
Earnings per share attributable to common stockholders:		
Basic and diluted per share	\$0.00	\$0.00
Gain on disposal of investment		
Weighted average shares outstanding:		
Basic and diluted	67,448,890	67,448,890

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

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

	Nine months ended September 30,	
	2013	2012
Net sales	\$1,281,480	\$2,166,012
Cost of goods sold	850,494	1,400,199
Gross profit	430,986	765,813
Operating expenses		
Selling, general and administrative	645,237	916,660
Research and development	48,182	73,773
Total operating expenses	693,419	990,433
Loss from operations	(262,433)	(224,620)
Other income (expenses)		
Interest expense (net)	(9,574)	(8,596)
Share of investee's operating results (net)	(124,108)	(18,643)
Impairment of investment		(203,242)
Gain (loss) on foreign exchange, net	15,489	(28,787)
Gain on disposal of investment	52,159	-
Other, net	5,985	5,367
Loss before income tax	(322,482)	(478,521)
Income tax benefit (expense)	(5,014)	6,030
Net loss	(327,496)	(472,491)
Other comprehensive income (loss), net		
Translation adjustment	43,000	15,936
Total comprehensive loss	\$(284,496)	\$(456,555)
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

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 September 30,	
	2013	2012
Cash flows from operating activities		
Net (loss)	\$(133,275)	\$(261,787)
Depreciation and amortization	14,445	11,279
Provision for doubtful accounts	963	35,931
Share of investment loss	39,000	22,778
Impairment of investment	-	201,698
Changes in operating assets and liabilities:		
Other assets	-	(567)
Accounts receivable	(26,396)	55,401
Inventories	(37,479)	50,702
Prepaid expenses and other current assets	22,923	(26,263)
Accounts payable	(41,436)	(143,529)
Accrued expenses	(5,479)	(2,418)
Receipts in advance and other current liabilities	6,983	589
Cash flows (used in) operating activities	<u>(159,751)</u>	<u>(56,186)</u>
 Cash flows from investing activities		
Addition to fixed assets	-	(942)
Cash flows (used in) investing activities	<u>-</u>	<u>(942)</u>
 Cash flows from financing activities		
Loan from/ (repayment to) stockholder	-	(100,000)
Cash flow (used in) provided from financing activities	<u>-</u>	<u>(100,000)</u>
 Effect of exchange rate changes on cash and cash equivalents	<u>97,090</u>	<u>(8,190)</u>
 Net (decrease) in cash and cash equivalents	(62,661)	(165,318)
Beginning cash and cash equivalents	<u>307,260</u>	<u>614,414</u>
 Ending cash and cash equivalents	<u><u>244,599</u></u>	<u><u>\$449,096</u></u>
 Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$(3,493)	\$2,974
Tax paid	627	23,484

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

(UNAUDITED)
(IN US\$)

	For nine months ended September 30,	
	2013	2012
Cash flows from operating activities		
Net (loss)	\$(327,496)	\$(472,491)
Depreciation and amortization	36,297	34,118
Gain on disposal of investment	(52,159)	-
Provision for doubtful accounts	26,792	42,057
Share of investment loss	124,108	18,643
Impairment of investment	-	203,242
Changes in operating assets and liabilities:		
Other assets	-	(34,106)
Accounts receivable	(18,662)	65,442
Inventories	(23,118)	(56,586)
Prepaid expenses and other current assets	13,551	12,931
Accounts payable	(108,139)	(187,954)
Accrued expenses	261	(20,970)
Receipts in advance and other current liabilities	2,455	35,904
	(326,110)	(359,770)
Cash flows from investing activities		
Addition to fixed assets	-	(56,608)
Proceed from sale of investment	105,840	-
	105,840	(56,608)
Cash flows from financing activities		
Loan from/ (repayment to) stockholder	-	(100,000)
	-	(100,000)
Effect of exchange rate changes on cash and cash equivalents	58,769	(23,604)
Net (decrease) in cash and cash equivalents	(161,501)	(539,982)
Beginning cash and cash equivalents	406,100	989,078
Ending cash and cash equivalents	244,599	\$449,096
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	9,690	\$8,893
Tax paid	5,014	23,484

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 pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). 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 nine months ended September 30, 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 nine months ended September 30, 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

Income tax - In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update (“ASU”) No. 2013-11 “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.” ASU No. 2013-11 is a new accounting standard on the financial statement presentation of unrecognized tax benefits. The new standard provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. The new standard becomes effective for the Company on January 1, 2014 and it should be applied prospectively to unrecognized tax benefits that exist at the effective date with retrospective application permitted. The Company is currently assessing the impacts of this new standard.

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - 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 September 30 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 September 30, 2013, such losses have been within management's expectations.

For the nine months ended September 30, 2013, products sold to the Company's largest customer, accounted for approximately 31.55%. Products purchased from the Company's first two largest suppliers were accounted for approximately 83.50% of the total purchases.

Note 4 - 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 September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net loss attributable to common stockholders	\$(133,275)	\$(261,787)	\$(327,496)	\$(472,491)
Weighted average common stock outstanding – Basic and diluted	67,448,890	67,448,890	67,448,890	67,448,890
Earning per share attributable to common stockholder Basic and diluted	\$.00	\$.00	\$.00	\$.00

Note 5 - Accumulated Other Comprehensive loss

The following table includes the changes in accumulated other comprehensive (loss) by component under the ASC on "Comprehensive Income" for the three months and nine months ended September 30, 2013:

	Foreign currency translation
Three months ended September 30, 2013	
Balance, June 30, 2013	\$268,123
Foreign currency translation, net of taxes	107,599
Balance, September 30, 2013	<u>\$375,722</u>
	Foreign currency translation
Nine months ended September 30, 2013	
Balance, December 31, 2012	\$332,722
Foreign currency translation, net of taxes	43,000
Balance, September 30, 2013	<u>\$375,722</u>

Note 6 - Long Term Investments

	September 30, 2013	December 31, 2012
Equity method investment – Anteya Technology Corp		
Carrying value of investment at the beginning	\$425,345	\$799,131
Share of associate's loss	(124,108)	(378,173)
Exchange difference	(19,841)	4,387
Carrying value at the end	<u>281,396</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
Carrying value at the end	<u>-</u>	<u>-</u>
Cost-method investments – Phocos		
At cost	53,681	142,038
Impairment for the year	-	(88,357)
Disposal	(53,681)	-
Carrying value at the end	<u>-</u>	<u>53,681</u>
Net value	<u>\$281,396</u>	<u>\$479,026</u>

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - 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 September 30, 2013 and December 31, 2012. The Company recorded the investment in Fin-Core Corporation at cost, less accumulated impairments.

Phocos AG is a private company incorporated in Germany. On May 27, 2013, the Company sold all of its shares to third party. The total proceeds were EURO84,000 or USD105,840. The sale of the investment resulted in a USD52,159 gain.

The unaudited financial information of Anteya Technology Corp. as of September 30, 2013 and December 31, 2012 and for nine months ended September 30, 2013 and 2012 (in US dollars) are as follows:

<u>Balance sheet</u>	September 30, 2013	December 31, 2012
Current assets	\$3,887,730	\$4,634,083
Non-current assets	838,800	730,201
Total assets	<u>4,726,530</u>	<u>5,364,284</u>
Current liabilities	2,806,245	2,475,513
Non-current liabilities	455,884	762,048
Stockholders' equity	<u>1,464,401</u>	<u>2,126,723</u>
Total stockholders' equity and liabilities	<u>\$4,726,530</u>	<u>\$5,364,284</u>
	Nine months ended September 30,	
<u>Statement of operation</u>	2013	2012
Net sale	\$2,178,089	\$3,756,783
Cost of goods sold	<u>(1,894,189)</u>	<u>(2,912,419)</u>
Gross profit	283,900	844,364
Operating and non-operating expenses	<u>(837,575)</u>	<u>(934,520)</u>
Net profit (loss)	<u>\$(553,675)</u>	<u>\$(90,156)</u>

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Inventory

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

	September 30, 2013	December 31, 2012
Finished goods	\$825,967	\$802,848

Note 8 - 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 September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
(Loss) before provision for income taxes	\$(133,886)	(263,239)	\$(322,482)	(478,521)
Provision for income taxes	\$611	\$1,452	\$(5,014)	\$6,030

Note 9 - Accrued Expenses

	September 30, 2013	December 31, 2012
Salaries and allowance	\$13,405	\$16,351
Insurance	4,942	7,138
Tax payable	2,126	-
Others	7,367	4,089
	\$27,840	\$27,578

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Bank Short Term Debt

	September 30, 2013	December 31, 2012
Bank loan payable to Taiwan banks	\$405,913	\$413,351

The Company signed revolving credit agreements with a lending institution. The interest rate on short-term borrowings outstanding as of September 30, 2013 is from 3.146% to 3.3% 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 11 - Geographic Information

Product revenues for the nine months ended September 30, 2013 and 2012 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Customers based in:				
Europe	\$185,955	\$416,516	\$667,574	\$1,172,745
Asia	60,859	158,180	237,794	307,586
United States	79,811	100,797	279,260	467,671
Others	18,805	78,179	96,852	218,010
	\$345,430	\$753,672	\$1,281,480	\$2,166,012

Note 12 - Related Party Transactions

The Company has recorded expenses for the following related party transactions for nine months ended September 30, 2013 and 2012:

	Nine months ended September 30,	
	2013	2012
Purchase from Anteya Technology Corp	\$544,659	\$916,532
Rent paid to Mr. Wei-Rur Chen	36,327	36,354

Note 12 - Related Party Transactions (continued)

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

	September 30, 2013	December 31, 2012
Liabilities:		
Anteya Technology Corp	\$61,412	\$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 September 30, 2013. All transactions were at market-based prices.

Note 13 - Commitments

	Nine months ended September 30, 2013	September 30, 2012
Rent expenses	\$87,798	\$92,709

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 September 30, 2013 are as follows:

2013	18,266
2014	73,964
2015	57,640
	<u>\$148,970</u>

Note 14 - Subsequent Events

The Company evaluated all events subsequent to September 30, 2013 through the date of the issuance of the financial statements and there are no other significant or material transactions to be reported except below:

The Company borrowed a short-term loan in sum of NTD12,000,000, equivalent to USD405,000, from Bank SinoPac (located in Taiwan) on October 25, 2013, which is charged at 1.94% per annum and due to repay on April 24, 2014. This short-term loan was used to repay the short term loan which was carried at \$405,913 on the consolidated balance sheet as at September 30, 2013.