

COLORSTARS GROUP AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

June 30, 2014

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CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANT

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

	June 30, 2014	December 31, 2013
<u>Assets</u>		
Current assets:		
Cash and equivalents	\$116,335	\$186,957
Accounts receivable, net of allowance for doubtful accounts of \$59,052 at June 30, 2014 and \$42,227 at December 31, 2013	103,847	126,025
Inventory	785,076	793,335
Prepaid expenses and other current assets	54,585	65,459
	1,059,843	1,171,776
Equipment, net of accumulated depreciation	134,121	153,062
Investments	182,310	223,990
Deferred income tax assets	853	-
Intangible assets	-	139
	1,377,127	1,548,967
<u>Liabilities and stockholders' equity</u>		
Current liabilities:		
Short term loan	\$502,160	\$402,212
Accounts payable	96,571	187,443
Accrued expenses	17,320	20,913
Receipts in advance and other current liabilities	13,973	8,853
	630,024	619,421
Stockholders' equity		
Common Stock –Par Value \$0.001 67,448,890 shares issued and outstanding at June 30, 2014 and December 31, 2013	67,449	67,449
Additional paid in capital	3,112,230	3,112,230
Accumulated other comprehensive income	286,528	261,108
Accumulated deficit	(2,719,104)	(2,511,241)
	747,103	929,546
Total liabilities and stockholders' equity	\$1,377,127	\$1,548,967

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 June 30,	
	2014	2013
Net sales	\$287,755	\$479,484
Cost of goods sold	203,590	326,569
Gross profit	84,165	152,915
Operating expenses		
Selling, general and administrative	135,488	251,507
Research and development	5,983	15,453
Total operating expenses	141,471	266,960
Loss from operations	(57,306)	(114,045)
Other income (expenses)		
Interest expense (net)	(2,352)	(2,821)
Share of investee's operating results (net)	-	18,248
Gain (loss) on foreign exchange, net	(13,077)	(10,039)
Gain disposal of investment	-	52,159
Other, net	(3,256)	4,541
Loss before income tax	(75,991)	(51,957)
Income tax benefit (expense)	2,027	2,123
Net loss	(73,964)	(49,834)
Other comprehensive income (loss), net		
Translation adjustment	32,081	4,005
Total comprehensive loss	\$(41,883)	\$(45,829)
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\$)

	Six months ended June 30,	
	2014	2013
Net sales	\$499,844	\$936,493
Cost of goods sold	357,616	616,162
Gross profit	142,228	320,331
Operating expenses		
Selling, general and administrative	289,022	468,266
Research and development	5,965	31,155
Total operating expenses	294,987	499,421
Loss from operations	(152,759)	(179,090)
Other income (expenses)		
Interest expense (net)	(4,245)	(6,081)
Share of investee's operating results (net)	(54,815)	(85,122)
Gain (loss) on foreign exchange, net	(2,475)	25,066
Gain on disposal of investment	-	52,159
Other, net	2,742	5,942
Loss before income tax	(211,552)	(187,126)
Income tax benefit (expense)	3,689	(5,641)
Net loss	\$(207,863)	\$(192,767)
Other comprehensive income (loss), net		
Translation adjustment	(26,296)	(64,598)
Total comprehensive loss	\$(234,159)	\$(257,365)
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 June 30,	
	2014	2013
Cash flows from operating activities		
Net (loss)	\$(73,964)	\$(49,834)
Depreciation and amortization	9,621	10,402
Gain on disposal of investment	-	(52,159)
Provision for doubtful accounts	-	23,340
Share of investment loss	-	(18,248)
Changes in operating assets and liabilities:		
Other assets	-	-
Accounts receivable	(18,482)	(6,855)
Inventories	(14,783)	(3,876)
Prepaid expenses and other current assets	7,841	(14,495)
Accounts payable	21,895	70,032
Accrued expenses	(34,627)	(2,223)
Receipts in advance and other current liabilities	2,376	(14,135)
Cash flows (used in) operating activities	<u>(100,123)</u>	<u>(58,051)</u>
Cash flows from investing activities		
Addition to fixed assets	-	-
Proceed from sales of investment	-	105,840
Cash flows provided from (used in) investing activities	<u>-</u>	<u>105,840</u>
Effect of exchange rate changes on cash and cash equivalents	<u>23,965</u>	<u>(25)</u>
Net increase (decrease) in cash and cash equivalents	(76,158)	47,764
Beginning cash and cash equivalents	<u>192,493</u>	<u>259,496</u>
Ending cash and cash equivalents	<u><u>116,335</u></u>	<u><u>\$307,260</u></u>
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$2,414	\$2,935
Tax paid	(2,026)	-

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

(UNAUDITED)
(IN US\$)

	For six months ended June 30,	
	2014	2013
Cash flows from operating activities		
Net (loss)	\$(207,863)	\$(192,767)
Depreciation and amortization	18,561	21,890
Gain on disposal of investment	-	(52,159)
Provision for doubtful accounts	2,300	25,829
Share of investment loss	54,815	85,121
Changes in operating assets and liabilities:		
Other assets	-	-
Accounts receivable	22,178	7,734
Inventories	8,259	14,361
Prepaid expenses and other current assets	10,874	(9,372)
Accounts payable	(90,872)	(66,703)
Accrued expenses	(3,593)	5,740
Receipts in advance and other current liabilities	5,120	(4,528)
Cash flows (used in) operating activities	(180,221)	(164,854)
 Cash flows from financing activities		
Increase in short-term loans	99,947	
Cash flows provided from (used in) financing activities	99,947	
 Cash flows from investing activities		
Addition to fixed assets	-	-
Proceed from sale of investment	-	105,840
Cash flows provided from (used in) investing activities	-	105,840
 Effect of exchange rate changes on cash and cash equivalents	9,652	(39,826)
 Net (decrease) in cash and cash equivalents	(70,622)	(98,840)
Beginning cash and cash equivalents	186,957	406,100
 Ending cash and cash equivalents	\$116,335	\$307,260
 Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$4,309	\$6,197
Tax paid	(3,689)	5,641

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 six months ended June 30, 2014 and 2013 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, 2013. Operating results for the six months ended June 30, 2014 are not necessarily indicative of the results to be expected for any subsequent interim period or for the year ending December 31, 2014.

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 June 30, 2014, 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 June 30, 2014, such losses have been within management's expectations.

For the six months ended June 30, 2014, products sold to the Company's largest customer, accounted for approximately 18.43%. Products purchased from the Company's first two largest suppliers were accounted for approximately 68.93% 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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net loss attributable to common stockholders	\$(73,964)	\$(49,834)	\$(207,863)	\$(192,767)
Weighted average common stock outstanding – Basic and diluted	67,448,890	67,448,890	67,448,890	67,448,890
Earnings per share attributable to common stockholder Basic and diluted	\$.00	\$.00	\$.00	\$.00

Note 5 - Accumulated Other Comprehensive loss

The components of accumulated other comprehensive losses were as follows:

	<u>Foreign currency translation</u>
Balance, December 31, 2013	\$261,108
Foreign currency translation, net of taxes	<u>(6,661)</u>
Balance, March 31, 2014	254,447
Foreign currency translation, net of taxes	<u>32,081</u>
Balance, June 30, 2014	<u><u>\$286,528</u></u>

Note 6 - Long Term Investments

	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Equity method investment – Anteya Technology Corp		
Carrying value of investment at the beginning	\$167,015	\$425,345
Share of associate's loss	-	(173,570)
Exchange difference	15,295	(27,785)
	<u>182,310</u>	<u>223,990</u>
Carrying value at the end		
Equity method investment – Fin-Core Corporation		
Carrying value of investment at the beginning	-	-
Impairment for the year	-	-
Exchange difference	-	-
	<u>-</u>	<u>-</u>
Carrying value at the end		
Cost-method investments – Phocos		
At cost	-	53,681
Impairment for the year	-	(53,681)
	<u>-</u>	<u>-</u>
Carrying value at the end		
	<u>-</u>	<u>-</u>
Net value	<u><u>\$182,310</u></u>	<u><u>\$223,990</u></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 17.33%.

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 June 30, 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. 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 June 30, 2014 and December 31, 2013 and for six months ended June, 2014 and 2013 (in US dollars) are as follows:

<u>Balance sheet</u>	June 30, 2014	December 31, 2013
Current assets	\$3,443,210	\$3,655,318
Non-current assets	977,348	799,974
Total assets	4,420,558	4,455,292
Current liabilities	3,105,342	2,891,306
Non-current liabilities	209,570	358,049
Stockholders' equity	1,105,646	1,205,937
Total stockholders' equity and liabilities	4,420,558	\$4,455,292
	Six months ended June 30,	
<u>Statement of operation</u>	2014	2013
Net sale	\$847,200	\$1,547,428
Cost of goods sold	(895,048)	(1,340,105)
Gross profit	(47,848)	207,323
Operating and non-operating expenses	(494,092)	(571,562)
Net profit (loss)	\$(541,940)	\$(364,239)

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:

	June 30, 2014	December 31, 2013
Finished goods	\$785,076	\$793,335

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 2014 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 2014 (inclusive).

The income tax provision information is provided as follows:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Loss before provision for income taxes	\$(75,991)	\$(51,957)	\$(211,552)	\$(187,126)
Provision for income taxes	\$(2,027)	\$(2,123)	\$(3,689)	\$5,641

Note 9 - Accrued Expenses

	June 30, 2014	December 31, 2013
Salaries and allowance	\$12,553	\$4,931
Insurance	4,513	11,959
Tax payable	174	-
Others	80	4,089
	\$17,320	\$20,979

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Bank Short Term Debt

	June 30, 2014	December 31, 2013
Bank loan payable to Taiwan banks	\$502,160	\$402,212

The Company signed revolving credit agreements with a lending institution. The interest rate on short-term borrowings outstanding as of June 30, 2014 is 1.94% per annum, as of December 31, 2013, interest rate is 1.94% 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 six months ended June 30, 2014 and 2013 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Customers based in:				
Europe	\$133,305	\$257,384	\$267,627	\$482,542
Asia	31,913	71,906	56,415	177,274
United States	122,537	117,162	174,895	198,481
Others	-	33,032	907	78,196
	\$287,755	\$479,484	\$499,844	\$936,493

Note 12 - Related Party Transactions

The Company has recorded expenses for the following related party transactions for six months ended June 30, 2014 and 2013:

	Six months ended June 30,	
	2014	2013
Purchase from Anteya Technology Corp	\$151,705	\$395,992
Rent paid to Mr. Wei-Rur Chen	23,843	24,264

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

	Six months ended June 30,	
	2014	2013
Receivable:		
Mr. Wei-Rur Chen	5,653	-

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:

	June 30, 2014	December 31, 2013
Liabilities:		
Anteya Technology Corp	\$52,374	\$107,498

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 17.33% of the outstanding common stock of Anteya Technology Corp as of June 30, 2014. All transactions were at market-based prices.

Note 13 - Commitments

	Six months ended June 30, 2014	2013
Rent expenses	\$24,896	\$62,626

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 June 30, 2014 are as follows:

2014	48,207
2015	40,976
	<u>\$89,183</u>

Note 14 - Subsequent Events

The Company evaluated all events subsequent to June 30, 2014 through the date of the issuance of the financial statements and there are no other significant or material transactions to be reported.