

COLORSTARS GROUP AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 30, 2014

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CONSOLIDATED FINANCIAL STATEMENTS

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TABLE OF CONTENTS

	<u>PAGE NO.</u>
Report of Independent Registered Public Accountant	1
Consolidated Balance Sheets	
As of September 30, 2014 and December 31, 2013 (audited)	2
Consolidated Statements of Operation and Comprehensive Loss for three months ended September 30, 2014 and 2013	3
Consolidated Statements of Operation and Comprehensive Loss for nine months ended September 30, 2014 and 2013	4
Consolidated Statement of Cash Flows for three months ended September 30, 2014 and 2013	5
Consolidated Statement of Cash Flows for nine months ended September 30, 2014 and 2013	6
Notes to Consolidated Financial Statements	7-13

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANT

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

<u>Assets</u>	September 30, 2014	December 31, 2013
Current assets:		
Cash and equivalents	\$156,232	\$186,957
Accounts receivable, net of allowance for doubtful accounts of \$59,140 at September 30, 2014 and \$42,227 at December 31, 2013	101,419	126,025
Inventory	778,691	793,335
Prepaid expenses and other current assets	58,354	65,459
Total current assets	1,094,696	1,171,776
Equipment, net of accumulated depreciation	122,448	153,062
Investments	166,782	223,990
Intangible assets	-	139
Total assets	<u>\$1,383,926</u>	<u>\$1,548,967</u>
<u>Liabilities and stockholders' equity</u>		
Current liabilities:		
Short term loan	\$558,146	\$402,212
Accounts payable	102,275	187,443
Accrued expenses	16,025	20,913
Receipts in advance and other current liabilities	28,960	8,853
Total current liabilities	<u>705,406</u>	<u>619,421</u>
Commitments and Contingencies – Note 13		
Stockholders' equity		
Common Stock –Par Value \$0.001 67,448,890 shares issued and outstanding at September 30, 2014 and December 31, 2013	67,449	67,449
Additional paid in capital	3,112,230	3,112,230
Accumulated other comprehensive income	254,206	261,108
Accumulated deficit	(2,755,365)	(2,511,241)
Total stockholders' equity	<u>678,520</u>	<u>929,546</u>
Total liabilities and stockholders' equity	<u>\$1,383,926</u>	<u>\$1,548,967</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,	
	2014	2013
Net sales	\$416,204	\$345,430
Cost of goods sold	340,502	233,208
Gross profit	75,702	112,222
Operating expenses		
Selling, general and administrative	120,999	177,146
Research and development	-	17,021
Total operating expenses	120,999	194,167
Loss from operations	(45,297)	(81,945)
Other income (expenses)		
Interest expense (net)	(1,976)	(3,492)
Share of investee's operating results (net)	-	(39,000)
Gain (loss) on foreign exchange, net	13,870	(9,493)
Other, net	(1,203)	44
Loss before income tax	(34,606)	(133,886)
Income tax benefit (expense)	(2,311)	611
Net loss	(36,917)	(133,275)
Other comprehensive income (loss), net		
Translation adjustment	32,322	107,599
Total comprehensive loss	\$(4,595)	\$(25,676)
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 STATEMENTS OF OPERATION AND COMPREHENSIVE LOSS
(UNAUDITED)
(IN US\$)

	Nine months ended September 30,	
	2014	2013
Net sales	\$915,000	\$1,281,480
Cost of goods sold	696,111	850,494
Gross profit	218,889	430,986
Operating expenses		
Selling, general and administrative	410,083	645,237
Research and development	5,983	48,182
Total operating expenses	416,066	693,419
Loss from operations	(197,177)	(262,433)
Other income (expenses)		
Interest expense (net)	(6,222)	(9,574)
Share of investee's operating results (net)	(54,984)	(124,108)
Gain (loss) on foreign exchange, net	11,302	15,489
Gain on disposal of investment	-	52,159
Other, net	1,554	5,985
Loss before income tax	(245,527)	(322,482)
Income tax benefit (expense)	1,403	(5,014)
Net loss	\$(244,124)	\$(327,496)
Other comprehensive income (loss), net		
Translation adjustment	6,902	43,000
Total comprehensive loss	\$(237,222)	\$(284,496)
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	
	2014	30, 2013
Cash flows from operating activities		
Net (loss)	\$(36,917)	\$(133,275)
Depreciation and amortization	9,304	14,445
Provision for doubtful accounts	-	963
Share of investment loss	-	39,000
Changes in operating assets and liabilities:		
Other assets	-	-
Accounts receivable	128	(26,396)
Inventories	6,385	(37,479)
Prepaid expenses and other current assets	(3,769)	22,923
Accounts payable	5,705	(41,436)
Accrued expenses	(1,295)	(5,479)
Receipts in advance and other current liabilities	14,987	6,983
	(5,472)	(159,751)
 Cash flows from financing activities		
Proceeds from bank loan	55,987	-
	55,987	-
 Effect of exchange rate changes on cash and cash equivalents	(10,618)	97,090
 Net increase (decrease) in cash and cash equivalents	39,897	(62,661)
Beginning cash and cash equivalents	116,335	307,260
 Ending cash and cash equivalents	156,232	\$244,599
 Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$(1,978)	\$(3,493)
Tax paid	2,286	627

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

(UNAUDITED)
(IN US\$)

	For nine months ended September	
	2014	30, 2013
Cash flows from operating activities		
Net (loss)	\$(244,124)	\$(327,496)
Depreciation and amortization	27,865	36,297
Gain on disposal of investment	-	(52,159)
Provision for doubtful accounts	2,300	26,792
Share of investment loss	54,984	124,108
Changes in operating assets and liabilities:		
Accounts receivable	22,306	(18,662)
Inventories	14,644	(23,118)
Prepaid expenses and other current assets	7,105	13,551
Accounts payable	(85,167)	(108,139)
Accrued expenses	(4,888)	261
Receipts in advance and other current liabilities	20,107	2,455
	(184,868)	(326,110)
Cash flows from investing activities		
Addition to fixed assets	-	-
Proceed from sale of investment	-	105,840
	-	105,840
Cash flows provided from (used in) investing activities	-	105,840
Cash flows from financing activities		
Increase in short-term loans	155,934	
	155,934	
Cash flows provided from (used in) financing activities	155,934	
Effect of exchange rate changes on cash and cash equivalents	(1,791)	58,769
Net (decrease) in cash and cash equivalents	(30,725)	(161,501)
Beginning cash and cash equivalents	186,957	406,100
Ending cash and cash equivalents	\$156,232	\$244,599
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$6,287	\$9,690
Tax paid	(1,403)	5,014

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 nine months ended September 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 nine months ended September 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 September 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 September 30, 2014, such losses have been within management's expectations.

For the nine months ended September 30, 2014, products sold to the Company's largest customer, accounted for approximately 18.03%. Products purchased from the Company's first two largest suppliers were accounted for approximately 32.78% 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,	
	2014	2013	2014	2013
Net loss attributable to common stockholders	\$(36,917)	\$(133,275)	\$(244,124)	\$(327,496)
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 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, 2014:

	Foreign currency translation
Three months ended September 30, 2014	
Balance, June 30, 2014	\$286,528
Foreign currency translation, net of taxes	(32,322)
Balance, September 30, 2014	<u>\$254,206</u>
Nine months ended September 30, 2014	
Balance, December 31, 2013	\$261,108
Foreign currency translation, net of taxes	(6,902)
Balance, September 30, 2014	<u>\$254,206</u>

Note 6 - Long Term Investments

	September 30, 2014	December 31, 2013
Equity method investment – Anteya Technology Corp		
Carrying value of investment at the beginning	\$223,990	\$425,345
Share of associate's loss	(54,984)	(173,570)
Exchange difference	(2,224)	(27,785)
Carrying value at the end	<u>166,782</u>	<u>223,990</u>
Cost-method investments – Phocos		
At cost	-	53,681
Impairment for the year	-	(53,681)
Carrying value at the end	<u>-</u>	<u>-</u>
Net value	<u>\$166,782</u>	<u>\$223,990</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 September 30, 2014 and December 31, 2013. 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, 2014 and December 31, 2013 and for nine months ended September, 2014 and 2013 (in US dollars) are as follows:

<u>Balance sheet</u>	September 30, 2014	December 31, 2013
Current assets	\$3,669,958	\$3,655,318
Non-current assets	983,420	799,974
Total assets	<u>4,653,378</u>	<u>4,455,292</u>
Current liabilities	3,597,591	2,891,306
Non-current liabilities	147,763	358,049
Stockholders' equity	<u>908,024</u>	<u>1,205,937</u>
Total stockholders' equity and liabilities	<u>4,653,378</u>	<u>\$4,455,292</u>
	Nine months ended September 30,	2013
<u>Statement of operation</u>	2014	2013
Net sale	\$1,409,764	\$2,178,089
Cost of goods sold	<u>(1,383,157)</u>	<u>(1,894,189)</u>
Gross profit	26,607	283,900
Operating and non-operating expenses	<u>(746,690)</u>	<u>(837,575)</u>
Net loss	<u>\$(720,082)</u>	<u>\$(553,675)</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, 2014	December 31, 2013
Finished goods	\$778,691	\$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 September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Loss before provision for income taxes	\$(34,606)	\$(133,886)	\$(245,527)	\$(322,482)
(Provision) benefit for income taxes	\$(2,311)	\$611	\$1,403	\$(5,014)

Note 9 - Accrued Expenses

	September 30, 2014	December 31, 2013
Salaries and allowance	\$10,992	\$4,931
Insurance	4,932	11,959
Tax payable	22	-
Others	79	4,023
	\$16,025	\$20,913

COLORSTARS GROUP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Bank Short Term Debt

	September 30, 2014	December 31, 2013
Bank loan payable to Taiwan banks	\$558,146	\$402,212

The Company signed revolving credit agreements with a lending institution. The interest rate on short-term borrowings outstanding as of September 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 September 30, 2014 and 2013 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Customers based in:				
Europe	\$64,604	\$185,955	\$332,660	\$667,574
Asia	199,872	60,859	255,233	237,794
United States	149,255	79,811	323,740	279,260
Others	2,473	18,805	3,367	96,852
	\$416,204	\$345,430	\$915,000	\$1,281,480

Note 12 - Related Party Transactions

The Company has recorded expenses and sales for the following related party transactions for nine months ended September 30, 2014 and 2013:

	Nine months ended September 30,	
	2014	2013
Purchase from Anteya Technology Corp	\$213,069	\$544,659
Rent paid to Mr. Wei-Rur Chen	35,874	36,327
Sale to Anteya Technology Corp	165,016	-

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

	Nine months ended September 30,	
	2014	2013
Receivable:		
Mr. Wei-Rur Chen	2,400	-

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, 2014	December 31, 2013
Liabilities:		
Anteya Technology Corp	\$49,791	\$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 September 30, 2014. All transactions were at market-based prices.

Note 13 – Commitments and Contingencies:

	Nine months ended 30, 2014	September 30, 2013
Rent expenses	\$75,028	\$87,798

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, 2014 are as follows:

2014	18,228
2015	65,818
	<u>\$84,046</u>

Note 14 - Subsequent Events

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