

COLORSTARS GROUP

CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 30, 2015

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CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANT

COLORSTARS GROUP
CONSOLIDATED BALANCE SHEETS
(UnAUDITED)
(IN US\$)

<u>Assets</u>	September 30, 2015	December 31, 2014
Current assets:		
Cash and equivalents	\$99,503	\$75,397
Accounts receivable, net of allowance for doubtful accounts of \$57,428 at September 30, 2015 and \$53,327 at December 31, 2014. Net of due from affiliate account of \$556,759 at September 30, 2015 and \$372,549 at December 31, 2014.	247,901	449,703
Inventory	579,493	664,444
Prepaid expenses and other current assets	47,081	48,103
Total current assets	973,978	1,237,647
Equipment, net of accumulated depreciation	69,058	81,958
Investments	104,515	137,767
Other assets	16,812	26,496
Total assets	\$1,164,363	\$1,483,868
<u>Liabilities and stockholders' equity</u>		
Current liabilities:		
Short term loan	\$514,164	\$537,651
Accounts payable	218,535	404,319
Accrued expenses	13,320	21,366
Receipts in advance and other current liabilities	92,426	17,038
Total current liabilities	838,445	980,374
Commitments and contingencies		
Stockholders' equity		
Common Stock –Par Value \$0.001 67,448,890 shares issued and outstanding at September 30, 2015 and December 31, 2014	67,449	67,449
Additional paid in capital	3,112,230	3,112,230
Accumulated other comprehensive income	152,305	198,581
Accumulated deficit	(3,006,066)	(2,874,766)
Total stockholders' equity	325,918	503,494
Total liabilities and stockholders' equity	\$1,164,363	\$1,483,868

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

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

	Three months ended September 30,	
	2015	2014
Net sales	\$407,092	\$416,204
Cost of goods sold	279,763	340,502
Gross profit	127,329	75,702
Operating expenses		
Selling, general and administrative	104,749	120,999
Research and development	2,638	-
Total operating expenses	107,387	120,999
Loss from operations	19,942	(45,297)
Other income (expenses)		
Interest expense (net)	(2,572)	(1,976)
Share of investee's operating results (net)	-	-
Gain (loss) on foreign exchange, net	58,697	13,870
Other, net	-	(1,203)
Loss before income tax	76,067	(34,606)
Income tax benefit (expense)	(8,085)	(2,311)
Net loss	67,982	(36,917)
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	67,982	(36,917)
Other comprehensive loss:		
Foreign currency translation gain(loss), net of taxes	(99,825)	32,322
Comprehensive loss	\$(31,843)	\$(4,595)

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

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

	Nine months ended September 30,	
	2015	2014
Net sales	\$979,739	\$915,000
Cost of goods sold	779,607	696,111
Gross profit	200,132	218,889
Operating expenses		
Selling, general and administrative	361,927	410,083
Research and development	3,380	5,983
Total operating expenses	365,307	416,066
Loss from operations	(165,175)	(197,177)
Other income (expenses)		
Interest expense (net)	(8,458)	(6,222)
Share of investee's operating results (net)	-	(54,984)
Gain (loss) on foreign exchange, net	41,006	11,302
Other, net	528	1,554
Loss before income tax	(132,099)	(245,527)
Income tax benefit (expense)	799	1,403
Net loss	(131,300)	(244,124)
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	(131,300)	(244,124)
Other comprehensive loss:		
Foreign currency translation gain(loss), net of taxes	(46,276)	6,902
Comprehensive loss	\$(177,576)	\$(237,222)

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

COLORSTARS GROUP
CONSOLIDATED STATEMENT OF CASH FLOWS
(UnAUDITED)
(IN US\$)

	For three months ended September 30,	
	2015	2014
Cash flows from operating activities		
Net (loss)	\$67,982	\$(36,917)
Depreciation and amortization	8,811	9,304
Provision for doubtful accounts	4,194	-
Changes in operating assets and liabilities:		
Accounts receivable	(99,094)	128
Inventories	40,144	6,385
Prepaid expenses and other current assets	16,101	(3,769)
Accounts payable	24,450	5,705
Accrued expenses	(2,810)	(1,295)
Receipts in advance and other current liabilities	11,737	14,987
	71,515	(5,472)
Cash flows from financing activities		
Proceeds from bank loan	-	55,987
	-	55,987
Effect of exchange rate changes on cash and cash equivalents	(80,012)	(10,618)
Net (decrease) in cash and cash equivalents	(8,497)	39,897
Beginning cash and cash equivalents	108,000	116,335
Ending cash and cash equivalents	99,503	\$156,232
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$2,601	\$1,978
Tax paid	(3)	(2,286)

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

(UNAUDITED)
(IN US\$)

	For nine months ended September 30,	
	2015	2014
Cash flows from operating activities		
Net (loss)	\$(131,300)	\$(244,124)
Depreciation and amortization	26,601	27,865
Gain on disposal of investment	-	-
Provision for doubtful accounts	6,761	2,300
Share of investment loss	-	54,984
Changes in operating assets and liabilities:		
Accounts receivable	195,041	22,306
Inventories	84,951	14,644
Prepaid expenses and other current assets	4,698	7,105
Accounts payable	(185,784)	(85,167)
Accrued expenses	(8,046)	(4,888)
Receipts in advance and other current liabilities	75,388	20,107
	68,310	(184,868)
 Cash flows from financing activities		
Increase in short-term loans	-	155,934
	-	155,934
 Cash flows from investing activities		
Addition to fixed assets	(10,093)	-
	(10,093)	-
 Effect of exchange rate changes on cash and cash equivalents	(34,111)	(1,791)
 Net (decrease) in cash and cash equivalents	24,106	(30,725)
Beginning cash and cash equivalents	75,397	186,957
 Ending cash and cash equivalents	\$99,503	\$156,232
 Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$8,487	\$6,287
Tax paid	(3)	(1,403)

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, 2015 and 2014 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, 2014. Operating results for the nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for any subsequent interim period or for the year ending December 31, 2015.

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.

COLORSTARS GROUP AND SUBSIDIARIES
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 September 30, 2015, 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, 2015, such losses have been within management's expectations.

For the nine months ended September 30, 2015, products sold to the Company's largest customer, accounted for approximately 57.48%. Products purchased from the Company's first two largest suppliers were accounted for approximately 39.31% 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 September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net loss attributable to common stockholders	\$67,982	\$(36,917)	\$(131,300)	\$(244,124)
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 6 - Accumulated Other Comprehensive loss

The components of accumulated other comprehensive losses were as follows:

	Foreign currency translation
Balance, December 31, 2014	\$198,581
Foreign currency translation, net of taxes	<u>(46,276)</u>
Balance, September 30, 2015	<u>152,305</u>
Balance, December 31, 2013	261,108
Foreign currency translation, net of taxes	<u>(6,902)</u>
Balance, September 30, 2014	<u>\$254,206</u>

Note 7 - Long Term Investments

	September 30, 2015	December 31, 2014
Cost-method investment – Anteya Technology Corp		
Carrying value of investment at the beginning	\$137,767	\$223,990
Share of associate's loss	-	(54,606)
Exchange difference	<u>(33,252)</u>	<u>(31,617)</u>
Carrying value at the end	<u>104,515</u>	<u>137,767</u>
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	<u>-</u>	<u>-</u>
Net value	<u>\$104,515</u>	<u>\$137,767</u>

COLORSTARS GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Long Term Investments (continued)

The Company adopted the provisions of SFAS 157, which require us to determine the fair value of financial assets and liabilities using a specified fair-value hierarchy. The objective of the fair-value measurement of our financial instruments is to reflect the hypothetical amounts at which we could sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date (exit price). SFAS 157 describes three levels of inputs that may be used to measure fair value, as follows:

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability that are supported by little or no market activity and that are significant to the fair value of the underlying asset or liability.

Anteya Technology Corp (Anteya) is a private company incorporated in Taiwan. The equity interest held by the Company is 17.33% on September 30, 2015.

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, 2015 and December 31, 2014. 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 September 30, 2015 and 2014 and for the nine months ended September 30, 2015 and 2014 (in US dollars) are as follows:

<u>Balance sheet</u>	<u>September 30, 2015</u>	<u>September 30, 2014</u>
Current assets	\$2,494,707	\$3,669,958
Non-current assets	1,099,030	983,420
Total assets	<u>3,593,737</u>	<u>4,653,378</u>
Current liabilities	911,340	3,597,591
Non-current liabilities	1,686,338	147,763
Stockholders' equity	<u>996,059</u>	<u>908,024</u>
Total stockholders' equity and liabilities	<u>3,593,737</u>	<u>\$4,653,378</u>

Note 7 - Long Term Investments (continued)

<u>Statement of operation</u>	Nine months ended September 30,	
	2015	2014
Net sale	\$1,697,522	\$1,409,764
Cost of goods sold	(1,512,362)	(1,383,157)
Gross profit	185,160	26,607
Operating and non-operating expenses	(788,668)	(746,690)
Net profit (loss)	<u>\$(603,508)</u>	<u>\$(720,082)</u>

Note 8- Inventory

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

	September 30,	December 31,
	2015	2014
Finished goods	\$756,021	\$849,036
Allowance for Inventory Valuation and Obsolescence Losses	(176,528)	(184,592)
Total	<u>\$579,493</u>	<u>\$664,444</u>

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 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,	
	2015	2014	2015	2014
Component of income (loss) before income taxes:				
United States	\$13,068	\$(15,122)	\$(249,344)	\$(79,415)
Foreign	(89,135)	(19,484)	117,245	(166,112)
Net loss	<u>\$(76,067)</u>	<u>\$(34,606)</u>	<u>\$(132,099)</u>	<u>\$(245,527)</u>
Provision for income taxes				
Current				
U.S. federal	-	-	-	-
State and local	-	-	-	-
Foreign	\$(8,085)	\$(2,311)	\$(799)	\$1,403
Income tax benefit	<u>\$(8,085)</u>	<u>\$(2,311)</u>	<u>\$(799)</u>	<u>\$1,403</u>

Note 10 - Accrued Expenses

	September 30, 2015	December 31, 2014
Salaries and allowance	\$8,924	\$10,424
Insurance	4,396	4,841
Tax payable	-	6,101
	<u>\$13,320</u>	<u>\$21,366</u>

Note 11 - Bank Short Term Debt

	September 30, 2015	December 31, 2014
Bank loan payable to Taiwan banks	<u>\$514,164</u>	<u>\$537,651</u>

The Company signed revolving credit agreements with a lending institution. The interest rate on short-term borrowings outstanding as of September 30, 2015 is 1.94% per annum, as of December 31, 2014, 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 12 - Geographic Information

Product revenues for the six months ended June 30, 2015 and 2014 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Customers based in:				
Europe	\$142,831	\$64,604	\$335,815	\$332,660
Asia	5,529	199,872	22,348	255,233
United States	255,457	149,255	618,248	323,740
Others	3,275	2,473	3,328	3,367
	<u>\$407,092</u>	<u>\$416,204</u>	<u>\$979,739</u>	<u>\$915,000</u>

Note 13 - Related Party Transactions

The Company has recorded expenses for the following related party transactions for nine months

ended September 30, 2015 and 2014:

	Nine months ended September 30,	
	2015	2014
Purchase from Anteya Technology Corp	\$80,533	\$213,069
Rent paid to Mr. Wei-Rur Chen	34,334	35,874
Sale to Anteya Technology Corp	-	165,016

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

	September 30, 2015	December 31, 2014
Anteya Technology Corp		
Due from affiliate (liabilities)	\$(6,867)	\$284,981
Mr. Wei-Rur Chen		
Due from affiliate	(75,612)	-

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, 2015. All transactions were at market-based prices.

Note 14 - Commitments

	Nine months ended September 30,	
	2015	2014
Rent expenses	\$48,315	\$75,028

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, 2015 are as follows:

2015	10,763
	<u>\$10,763</u>

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COLORSTARS GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15 - Subsequent Events

The Company evaluated all events subsequent to September 30, 2015 through the date of the issuance of the financial statements, there are no other significant or material transactions to be reported.

