

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549**

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2013

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File No. 001-33935

**FAB UNIVERSAL CORP.**

(Exact name of registrant as specified in its charter)

COLORADO  
(State or other jurisdiction of  
incorporation or organization)

87-0609860  
(I.R.S. Employer  
Identification No.)

5001 Baum Blvd. Suite 770  
Pittsburgh, Pennsylvania 15213  
(Address of Principal Executive Offices)

Registrant's Telephone Number: (412) 621-0902

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.001 par value	NYSE MKT

Securities Registered pursuant to Section 12(g) of the Act:  
Common Stock, \$0.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ]  
No

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. [ ]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer” and “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the registrant’s voting and nonvoting common equity held by non-affiliates of the registrant as of the last business day of June 30, 2013, the registrant’s most recently completed second fiscal quarter, was \$64,382,003 based on the last sales price of the registrant’s common stock reported on the NYSE MKT on that date. The determination of affiliate status for the purposes of this calculation is not necessarily a conclusive determination for other purposes. The calculation excludes shares held by directors, officers, and stockholders whose ownership exceeded 10% of the registrant’s outstanding Common Stock. Exclusion of these shares should not be construed to indicate that any such person controls, is controlled by or is under common control with the registrant.

As of June 26, 2014, there were 20,805,860 shares of common stock, par value \$0.001, of the registrant issued and outstanding.\*

\* Unless otherwise indicated herein, all share figures in this Annual Report retroactively reflect the reverse split of the registrant’s outstanding shares of common stock in the ratio of one for twelve, which was effectuated on February 22, 2012.

## DOCUMENTS INCORPORATED BY REFERENCE

Not applicable

### PART I

#### Item 1. Business.

##### OVERVIEW

Founded in 1995, the business of FAB Universal Corp., a Colorado corporation (“FAB”, “Parent”, “Company”, “we”, “our” or “us” or words of similar import), includes the sale of digital media through Retail, Wholesale and Digital Platforms. Additionally, we license our kiosk business and provide podcast hosting services. Our legacy Software business focuses on selling and supporting speech recognition and text-to-speech technology from AT&T.

The Company operates through its two subsidiaries, Webmayhem, Inc. (“Libsyn”), a Pennsylvania corporation, which operates our podcast hosting and distribution services. Digital Entertainment International Ltd. (“DEI”), a company incorporated under the law of the Hong Kong Special Administrative Region, is also a wholly owned subsidiary of FAB Universal, and operates its wholly-owned subsidiary, Beijing Dingtai Guanqun Culture Co., Ltd. (“DGC”), which operates Beijing FAB Culture Media Co., Ltd. (“FAB Media”), a variable interest entity (“VIE”), and Beijing FAB Digital Entertainment Products Co., Ltd. (“FAB Digital”), a wholly owned subsidiary of FAB Media. DGC controls the management of the operating entities, FAB Media and FAB Digital, through VIE contracts.

Our products and services include:

**Retail** - We conduct our retail business through our flagship stores. Each store is over 20,000 square feet in size and carries copyright protected audio and video products in China, including CDs, VCDs, DVDs, blu-rays, books, magazines and portable electronic devices. The flagship stores are recognized by many Chinese consumers as the most trusted place to buy copyright protected products.

**Wholesale** – Our wholesale business provides audio-video products such as compact discs, video compact discs and digital video discs as well as celebrity derivative products, digital products and mobile devices. FAB distributed these products to over 80 customers. FAB’s wholesale business caters to three types of customers: large retail stores, FAB license

stores and small wholesale/resellers. Order fulfillment is handled by FAB's vehicle fleet or through direct warehouse access.

Digital Media - The two components of our strategy are to increase our portfolio of content and expand the number of distribution channels.

Licensing – FAB does not directly sell or own the media kiosks. FAB primarily generates revenue from the sale of FAB Brand licenses, advertising and FAB membership cards.

Prior to 2010, the Company's business model consisted of brand licensing and agreements that allowed for the purchase and operation of kiosks under the FAB brand. After 2010, the Company only sold license agreements which were outside of Beijing. Collectively, these agreements from 2008-2013 are referred to generally as "licenses" and the parties who entered into the agreements are referred to as "licensees". Not all kiosks possess the capability of performing all functions noted below.

The Kiosks provide a variety of functions, and some provide multiple functions. The great majority of the kiosks generate revenue from the sale of advertising. Some kiosks are ATM style terminals where consumers can download content directly to their cell phones, memory sticks or other mobile storage devices. Others provide directions or other services or offer coupons or other goods for sale.

Subscription TV Services – We are planning to provide our copyright protected media content for distribution through pay TV terminals used in the home by Future TV subscribers. We are in the online testing stage in preparation for our formal rollout, expected in late 2014.

Podcasting - We provide a web based podcast distribution platform for podcast producers wanting to broadcast their audio or video shows to people worldwide, in most cases through RSS distribution. FAB's podcast hosting service accumulates and provides audience statistics as well as monetization services to help producers generate revenue.

### **Principal Offices**

Our principal executive offices consist of approximately 3,100 square feet of office space located at 5001 Baum Boulevard, Suite 770, Pittsburgh, Pennsylvania 15213. Our telephone number is (412) 621-0902. We also maintain two offices in Beijing, China. One is located at No. 22 Shijingshan Road, Shijingshan District, and the other is located at No. 51 Xirongxian Alley, Xicheng District. The telephone number is 86-10-68635287.

### **Research and Development**

During the calendar years ended December 31, 2013 and 2012, the Company spent \$302,361 and \$269,562, respectively, on research and development.

### **Necessary Material**

None.

### **Licenses**

- Internet Publishing License from China's General Administration of Press and Publication.
- Business Model License granted by China's Ministry of Commerce

### **Patents Pending**

None.

### **Environmental Compliance**

We do not believe that there are any material laws, rules or regulations regarding environmental concerns that are applicable to our present or intended business operations.

## **Governmental Regulations**

### **Wholly Foreign-owned Enterprises**

FAB's wholly-owned subsidiary, DGC, is deemed to be a "wholly foreign-owned enterprise." Wholly foreign-owned enterprises are governed by the *Law of the PRC Concerning Enterprises with Sole Foreign Investments* (which was promulgated in April 1986, as amended in October 2000, and its Implementation Regulations promulgated in December 1990, as amended in April 2001 (together the "Foreign Enterprises Law"). The establishment of a wholly foreign-owned enterprise has to be approved by the Ministry of Commerce of the PRC (or its local counterparts). A wholly foreign-owned enterprise must also obtain a business license from Administration for Industry and Commerce Authority before it can commence business.

A wholly foreign-owned enterprise is a limited liability company under the Foreign Enterprise Law. It is a legal person which may independently assume civil obligations, enjoy civil rights and has the right to own, use and dispose of property. It is required to have a registered capital contributed by the foreign investor(s). The liability of the foreign investor(s) is limited to the amount of registered capital contributed. A foreign investor may make its contributions by installments and the registered capital must be contributed within the period as approved by the Ministry of Commerce of the PRC (or its local counterparts) in accordance with relevant regulations. As a wholly-foreign-owned enterprise, DGC is subject to these regulations.

### **Regulations relating to Dividend Distribution**

Dividends generated after January 1, 2008 and distributed to DEI by DGC, its PRC subsidiary, are subject to withholding tax at a rate of 5%, provided that the Hong Kong based holding company is determined by the relevant PRC tax authorities to be a "non-resident enterprise" and holds at least 25% of the equity interest of its PRC subsidiary. DEI has not yet obtained the approval for a withholding tax rate of 5% from the local tax authority because DGC, FAB Media and FAB Digital, have not paid any dividends to DEI after they effectively became consolidated subsidiaries in March 2012. According to SAT Circular 601, a beneficial owner generally must be engaged in substantive business activities. An agent or conduit company will not be regarded as a beneficial owner and, therefore, will not qualify for treaty benefits. The conduit company normally refers to a company that is set up for the purpose of avoiding or reducing taxes or transferring or accumulating profits. In addition, as described above, DEI may be considered a PRC resident enterprise for PRC enterprise income tax purposes, in which case, dividends received by it, as the case may be, from the relevant PRC subsidiary would be exempt from the PRC withholding tax because such income is exempt as a PRC resident enterprise recipient. There remains uncertainty regarding the interpretation and implementation of the New EIT Law and its implementation rules. It is uncertain whether, if DEI is deemed a PRC resident enterprise, any dividends to be distributed by DEI to our non-PRC shareholders, would be subject to any PRC withholding tax.

### **Foreign Ownership Restrictions**

The Catalog for the Guidance of Foreign Investment Industries (the "Catalog") as promulgated and amended from time to time by the Ministry of Commerce and the National Development and Reform Commission, is the principal guide to foreign investors' investment activities in the PRC. The most updated version of the Catalog, which became effective in January 2012, divides the industries into three categories: encouraged ones, restricted ones and prohibited ones. The industries not listed in the Catalog fall within the scope of permitted ones.

For restricted industries, such as the distribution of audio-visual products operated by FAB Digital and FAB Media, and the consolidated affiliates of DEI, there are some limitations to the ownership and/or corporate structure of the foreign invested companies that operate in such industries. In addition, under the Administration of audio-visual Products which was promulgated by the State Council, the State implements a license system for the publication, production, reproduction, importation, wholesale, retail, and rental of audio-visual products. Any entity or individual, without a license, shall not be engaged in the publication, production, reproduction, importation, wholesale, retail or rental of audio-visual products. Any license or approval documents issued according to these Regulations shall not be assigned by means of rental, lending, sale or any other means. The consolidated affiliated entities of DEI have obtained Publication Operation Permits and License for operating the business of retailing audio-visual products.

### **Regulations on Value-Added Telecommunication Services**

In September 2000, the State Council promulgated the Telecommunications Regulations (the “Telecom Regulations”). The Telecom Regulations draw a distinction between “basic telecommunication services” and “value-added telecommunication services.” Internet content provision services (“ICP services”) are a subcategory of value-added telecommunications businesses. Under the Telecom Regulations, commercial operators of value-added telecommunications services must first obtain an operating license from the Ministry of Industry and Information Technology of the PRC (the “MIIT”) or its provincial level counterparts.

The State Council has issued the Administrative Measures on Internet Information Services (the “Internet Measures”). According to the Internet Measures, commercial ICP service operators must obtain an ICP license from the relevant government authorities before engaging in any commercial ICP operations within the PRC. The MIIT promulgated the Administrative Measures on Telecommunications Business Operating License (the “Telecom License Measures” which was revised by the MIIT. The Telecom License Measures set forth the types of licenses required to operate value-added telecommunications services and the qualifications and procedures for obtaining such licenses.

According to the *Administrative Rules for Foreign Investment in Telecommunications Enterprises* promulgated by the State Council, a foreign investor may hold up to 50% equity interest in a value-added telecommunications services operator in China and such foreign investor must have experiences in providing value-added telecommunications services overseas and maintain a good track record. To comply with the PRC regulations noted above, DEI operates value-added telecommunications services for the online sale of audio-visual products through the consolidated affiliated entity FAB Media and holds an ICP license.

### **Regulations Relating to Distribution of Audio-visual Products**

DEI is also subject to regulations relating to the distribution of audio-visual products. Under the Administrative Measures for the Publication Market which were promulgated by the General Administration of Press and Publication and any entity or individual engaging in the distribution of publications, including audio-visual products, must obtain an approval from the competent press and publication administrative authority and receive the Publication Operation Permit. The consolidated affiliated entities of DEI, FAB Media and FAB Digital have obtained Publication Operation Permits for the sale of publications.

### **Regulations on Internet Culture Activities**

The Ministry of Culture promulgated the Internet Culture Administration Tentative Measures, or the Internet Culture Measures. The Internet Culture Measures require ICP operators engaging in “Internet culture activities” to obtain a permit from the Ministry of Culture. The term “Internet culture activities” includes, among other things, online dissemination of Internet cultural products (such as audio-visual products, gaming products, performances of plays or programs, works of art and cartoons) and the production, reproduction, importation, sale (wholesale or retail), leasing and broadcasting of Internet cultural products. FAB Media has been granted an Internet culture business permit.

The Ministry of Culture issued Several Suggestions of the Ministry of Culture on the Development and Administration of the Internet Music, or the “Suggestions”. The Suggestions, among other things, reiterate the requirement for the Internet service provider to obtain an Internet culture business permit to carry on any business relating to Internet music products. In addition, foreign investors are prohibited from operating Internet culture businesses. However, the laws and regulations on Internet music products are still evolving, and there have not been any provisions stipulating whether or how music video will be regulated by the Suggestions.

The Ministry of Culture promulgated the Notice on Strengthening and Improving the Content Review of Online Music. According to this notice, only “Internet culture operating entities” approved by the Ministry of Culture may engage in the production, release, dissemination (including providing direct links to music products) and importation of online music products. The content of online music shall be reviews by or filed with the Ministry of Culture. Internet culture operating entities should establish a strict self-monitoring system of online music content and set up a special department in charge of such monitoring. DEI’s websites currently do not engage in the producing, broadcasting or transferring of Internet cultural products, but exhibit the products which are offered in the retail stores.

### **Regulation relating to Franchise**

Pursuant to *the Administrative Measures on Filings for Commercial Franchise* promulgated by the Ministry of Commerce in April 2007 and effective as of May 2007, franchisors are required to file with the MOFCOM for its cross-province franchising business. One of the preconditions for conducting a franchising business and making such filings is that franchisors should have at least two direct operating stores with an operation period of no less than 1 year. Legal consequences for such non-compliance include a fine up to RMB 10,000 or RMB 50,000 in worse circumstances. FAB Media has filed with the competent commercial authority of record and the file number is 0110100810900018.

### **Foreign Currency Exchange**

The principal regulation governing foreign currency exchange in the PRC is *the Regulations of the PRC on Foreign Exchange Administration* (the “Foreign Exchange Regulations”), as amended in August 2008. Under the Foreign Exchange Regulations and other relevant regulations and rules, Renminbi are freely convertible for current account transactions, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions. In order to convert Renminbi for capital account transactions, such as capital injections, loans, repatriation of investments and investments in securities outside the PRC, the prior approval of, or registration with, the State Administration of Foreign Exchange (the “SAFE”) or its competent local branches is required. DEI has not taken any funds outside China, and if they intend to do so in the future, they will make the proper registration with SAFE prior to such transaction.

In August 2008, the SAFE promulgated *the Circular on Operating Issues Concerning the Improvement of the Administration of Payment and Settlement of Foreign Currency Capital of Foreign-Invested Enterprises* (“Circular 142”), pursuant to which the registered capital of a foreign-invested company settled in Renminbi and converted from foreign currencies can only be used for purposes within the approved business scope and cannot be used for equity investments made by such foreign-invested company within the PRC, unless otherwise provided. In addition, a foreign-invested company may not change the use of its Renminbi-denominated registered capital without the SAFE’s or its competent local branch’s approval, and may not in any case use such capital to repay Renminbi-denominated loans if the proceeds of such loans have not been used within the permitted scope. Violations of Circular 142 could result in severe penalties, including heavy fines. In addition, the SAFE promulgated *the Notice on Relevant Issues Concerning Strengthening the Administration of Foreign Exchange Businesses* in November 2010, which requires the authenticity of settlement of the funds raised from offshore offerings to be closely examined and the settlement of funds should conform to their intended use as listed in the offering document. For the settlement of funds in excess of those intended by the offering document or for a purpose other than that listed in the offering document, a board of director’s resolution relating to the use of funds shall be submitted as a separate application document.

### **Investment in Offshore Special Purpose Vehicles**

In October 2005, the SAFE issued *the Notice on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents’ Corporate Financing and Roundtrip Investment through Offshore Special Purpose Vehicles* (the “Circular 75”), which became effective in November 2005. Under Circular 75, PRC residents are required to register with the local SAFE branch prior to establishing, or acquiring control of, an offshore company for the purpose of financing that offshore company with equity interests in, or assets of, an onshore enterprise. In addition, PRC residents are required to amend their registrations with the local SAFE branch after contributing equity interests in, or assets of, an onshore enterprise to the offshore company, or making any other material change in the capital of the offshore company. Furthermore, according to the relevant rules and regulations issued by the SAFE, the shareholders, beneficial owners and/or the PRC operating subsidiaries who apply for remedial SAFE registrations under the Circular 75 shall first be subject to various administrative sanctions, in accordance with the Foreign Currency Administration Regulations, before they can be granted a remedial SAFE registration.

Failure to comply with the registration procedures of Circular 75 may result in restrictions on the foreign exchange activities of the onshore company, including increases in its registered capital, payments of dividends and other distributions to its offshore parent or affiliate, and may also subject the relevant PRC residents and onshore entities to penalties under foreign exchange administration regulations. DEI has submitted the initial registrations under Circular 75.

### **Regulations relating to Labor Laws**

The principal labor laws and regulations in the PRC include *the PRC Labor Law*, *the PRC Labor Contract Law* and *the Implementation Regulations of the PRC Labor Contract Law*. Pursuant to *the PRC Labor Law* and *the PRC Labor Contract Law*, employers must enter into written labor contracts with employees. Employers must pay their employees’ wages equal to

or above local minimum wage standards, establish labor safety and workplace sanitation systems, comply with government labor rules and standards and provide employees with appropriate training regarding workplace safety. In addition, *the PRC Labor Contract Law* imposes more stringent requirements on employers with regard to, among others, severance payment and non-fixed-term employment contracts, time limits for probation periods, as well as the duration and the times that an employee can be placed on a fixed-term employment contract. Violations of *the PRC Labor Contract Law* and *the PRC Labor Law* may result in liabilities to employees and subject employer to administrative sanctions including fines or, in the case of serious violations, criminal liability. DEI and its subsidiaries are in compliance with all applicable laws and orders relating to employment and labor other than those laws.

The PRC regulatory authorities have passed a variety of laws and regulations regarding statutory social welfare benefits, including, among others, *the PRC Social Insurance Law* effective in July 2011, *the Regulations of Insurance for Occupational Injury*, *the Regulations of Insurance for Unemployment*, *the Provisional Insurance Measures for Maternal Employees*, and *the Interim Provisions on Registration of Social Insurance*. Pursuant to these laws and regulations, companies in China have to make sufficient contributions of statutory social welfare benefits for their employees, including medical care insurance, occupational injury insurance, unemployment insurance, maternity insurance, pension benefits and housing funds. Failure to comply with such laws and regulations may result in supplementary payments, surcharges or fines.

### **Regulations relating to Intellectual Properties**

China has enacted various laws and regulations relating to the protection of intellectual property rights, including copyrights, software, trademarks, patents, domain names and other forms of intellectual property. China is a signatory to some main international conventions on protection of intellectual property rights and became a member of the Agreement on Trade Related Aspects of Intellectual Property Rights upon its accession to the World Trade Organization.

#### ***Trademark***

In accordance with *the PRC Trademark Law*, the Trademark Office of the SAIC is responsible for the registration and administration of trademarks in China. The SAIC has established a Trademark Review and Adjudication Board for resolving trademark disputes.

China has adopted a “first-to-file” principle for trademarks. If two or more applicants apply for registration of identical or similar trademarks for the same or similar commodities, the application that was filed first will receive preliminary approval and will be publicly announced. For applications filed on the same day, the trademark that was first used will receive preliminary approval and will be publicly announced.

Registered trademarks remain valid for ten years from the date that registration is approved. A registrant may apply to renew a registration within six months prior to the expiration date of the registration. If the registrant fails to apply in a timely manner, a grace period of six additional months may be granted. If the registrant fails to apply before the grace period expires, the registered trademark will be deregistered. Renewed registrations remain valid for ten years. Under *the PRC Trademark Law*, a registered trademark may be transferred between parties upon execution of a transfer agreement and approval and publication by the Trademark Office of the SAIC. DEI has registered trademarks under the PRC Trademark Law.

#### ***Patent***

In accordance with the *PRC Patent Law*, the State Intellectual Property Office is responsible for administering patents in the PRC. The patent administration departments at the provincial or municipal level are responsible for administering patents within their respective jurisdictions.

Under the *PRC Patent Law*, patents are grouped into three categories: inventions, utility models and designs. The PRC patent system adopts a “first-to-file” principle, which means that, where more than one person files a patent application for the same invention, a patent will be granted to the person who filed the application first. In addition, the PRC requires absolute novelty in order for an invention to be patentable. Under this requirement, any relevant written or oral publication, demonstration or use prior to filing a patent application may prevent an invention from being patented in the PRC. Patents for inventions remain valid for twenty years, and patents for utility models and designs remain valid for ten years, in each case from the filing date of the patent application.

In accordance with the *PRC Patent Law*, a patent application or patent right may be transferred between parties upon execution of a written agreement between the parties, which becomes effective upon registration with the State Intellectual Property Office. DEI has received acceptance notices on 15 patents which were filed in October 2010.

### ***Copyright***

*The PRC Copyright Law*, set forth the basic legal system for the protection of copyright in the PRC. *The Regulations on Computer Software Protection* (“the Software Regulations”), and *the Measures on the Registration of Computer Software Copyright*, were formulated in accordance with *the PRC Copyright Law*. In accordance with the Software Regulations, a software copyright owner may apply for the registration of software at software registration organs recognized by the National Copyright Administration. A registration certificate may serve as preliminary proof of the copyright ownership of the registrant. A software copyright of a legal person remains valid for a period of fifty years from the date of publication of such copyright. DEI has registered copyright under the PRC Copyright Law.

### **Taxation**

#### ***Enterprise Income Tax***

In March 2007, the NPC promulgated *the PRC Enterprise Income Tax Law* (the “EIT Law”). The State Council promulgated *the Implementation Regulations to the PRC Enterprise Income Tax Law* in December 2012 (the “EIT Law Implementation Regulations”).

Under the EIT Law and the EIT Law Implementation Regulations, (i) PRC resident enterprises are generally subject to enterprise income tax at the rate of 25% on their worldwide income, (ii) non-PRC resident enterprises with presence in the PRC are generally subject to enterprise income tax at the rate of 25% on their income sourced from such presence in the PRC and (iii) non-PRC resident enterprises with no presence in the PRC are generally subject to enterprise income tax at the rate of 10% for their PRC-sourced income.

Under the EIT Law, enterprises organized under the laws of jurisdictions outside China with “*de facto* management bodies” that are located within China may be considered PRC resident enterprises and therefore be subject to PRC enterprise income tax at the rate of 25% on their worldwide income. The EIT Law Implementation Regulations define the term “*de facto* management body” as a management body that exercises full or substantial control and management authority over the production, operation, personnel, accounts and assets of an enterprise. The State Administration of Taxation (the “SAT”), issued *the Notice Regarding the Determination of Chinese-Controlled Offshore Incorporated Enterprises as PRC Tax Resident Enterprises on the Basis of De Facto Management Bodies* (the “Circular 82”).

Circular 82 provides specific criteria for determining whether the “*de facto* management body” of a Chinese-controlled offshore enterprise is located in China, which include the presence in the PRC of the following locations: (1) the location where senior management members responsible for an enterprise’s daily operations discharge their duties; (2) the location where financial and human resource decisions are made or approved by organizations or persons; (3) the location where the major assets and corporate documents are kept; and (4) the location where more than half (inclusive) of all directors with voting rights or senior management have their habitual residence.

The SAT issued *Administrative Measures of Enterprise Income Tax of Chinese-controlled Offshore Incorporated Resident Enterprises (Trial)* (the “Bulletin 45”), which became effective in September 2011, to provide further guidance on the implementation of Circular 82.

Bulletin 45 clarifies certain issues related to determining PRC resident enterprise status, post-determination administration and which competent tax authorities are responsible for determining for offshore incorporated PRC resident enterprise status. Bulletin 45 specifies that when provided with a copy of a Chinese tax resident determination certificate issued by the competent tax authorities from an offshore incorporated PRC resident enterprise, the payer should not withhold 10% income tax when paying PRC-sourced dividends, interest and royalties to the offshore incorporated PRC resident enterprise.



Although Circular 82 applies only to offshore enterprises controlled by PRC enterprises or PRC corporate groups and not those controlled by PRC individuals, the determining criteria set forth in Circular 82 may reflect the SAT's general position on how the "de facto management body" test should be applied in determining the tax residency status of offshore enterprises, regardless of whether they are controlled by PRC enterprises or individuals or foreign enterprises.

There are currently no detailed rules or precedents governing the procedures and specific criteria for determining whether a given entity constitutes a "de facto management body," and a final confirmation by the SAT as to the "residency" status of offshore enterprises is generally necessary. Therefore, it remains unclear whether the PRC tax authorities would classify DEI as a PRC resident enterprise. Because substantially all of its operations and senior management are located within the PRC and are expected to remain so for the foreseeable future, DEI may be considered a PRC resident enterprise for enterprise income tax purposes and therefore subject to the PRC enterprise income tax at the rate of 25% on its worldwide income. If DEI were treated as a PRC resident enterprise, although under the EIT Law and the EIT Law Implementing Regulations dividends paid to DEI from its PRC subsidiary, it should qualify as tax-exempt income, there is no assurance that DEI would enjoy such tax-exempt treatment on dividends paid to it from its PRC subsidiary as offshore incorporated PRC resident enterprises controlled by PRC enterprises or PRC corporate groups enjoy under Bulletin 45.

In addition, the EIT Law Implementation Regulations provide that, (i) if an enterprise that distributes dividends is domiciled in the PRC, or (ii) if gains are realized from transferring equity interests of enterprises domiciled in the PRC, then such dividends or gains are treated as PRC-sourced income. It is not yet clear how the term "domicile" will be interpreted under the EIT Law, and it may be interpreted as the jurisdiction where an enterprise is a tax resident. As a result, if DEI were deemed to be a PRC resident enterprise, any dividends that DEI pays to its non-resident enterprise shareholders, as well as gains realized by such shareholders from the transfer of the Shares, may be regarded as PRC-sourced income and thus subject to a 10% PRC tax, unless a reduced rate is provided under any applicable tax treaty.

Under the *PRC Individual Income Tax Law* (the "IITL"), if DEI were treated as a PRC resident enterprise, it is possible that non-resident individual investors may be subject to PRC individual income tax at a rate of 20% on any dividends paid to such investors and any capital gains realized from the transfer of the Shares if such dividends or capital gains are deemed income derived from sources within the PRC, unless such individuals qualify for a lower rate under a tax treaty. A non-resident individual is an individual who has no domicile in the PRC and does not stay within the PRC or has stayed within the PRC for less than one year. Pursuant to the IITL and its implementation rules, for purposes of the PRC capital gains tax, the taxable income will be based on the total income obtained from the transfer of the Shares minus all the costs and expenses that are permitted under PRC tax laws to be deducted from the income.

In connection with the EIT Law, the Ministry of Finance (the "MOF"), and the SAT jointly issued, *the Notice on Issues Concerning Process of Enterprise Income Tax in Enterprise Restructuring Business* (the "Circular 59"). In December 2009, the SAT issued *the Notice Concerning the Strengthening of Enterprise Income Tax Administration with Respect to Equity Transfers by Non-resident Enterprises* (the "Circular 698"). By promulgating and implementing these circulars, the PRC tax authorities have enhanced their scrutiny over the direct or indirect transfer of equity interests in a PRC resident enterprise by a non-PRC resident enterprise. The PRC tax authorities have the discretion under Circular 698 to make adjustments to the taxable capital gains based on the difference between the fair value of the equity interests transferred and the cost of investment.

Under Circular 698, if a non-resident enterprise transfers the equity interests of a PRC resident enterprise indirectly via disposing of the equity interests of an overseas holding company other than through public markets, such as the ASX where DEI was expected to be listed (the "Indirect Transfer") and such overseas holding company is located in a tax jurisdiction that: (i) has an effective tax rate less than 12.5% or (ii) does not tax foreign income of its residents, the foreign investor is required to report this Indirect Transfer to the competent PRC tax authorities. Using a "substance over form" principle, the PRC tax authorities may disregard the existence of the overseas holding company if it lacks a reasonable commercial purpose and was established for the purpose of avoiding PRC tax. As a result, gains derived by a shareholder from such Indirect Transfer may be subject to PRC tax at the rate of up to 10%.

### ***Enterprise Income Tax Preference***

The EIT Law and its implementation rules permit certain "high and new technology enterprises strongly supported by the state" that hold independent ownership of core intellectual property and simultaneously meet a list of other criteria, financial or non-financial, as stipulated in the implementation rules and other regulations, to enjoy a reduced 15% enterprise

income tax rate subject to certain new qualification criteria. The State Administration of Taxation, the Ministry of Science and Technology and the Ministry of Finance jointly issued the Administrative Rules for the Certification of High and New Technology Enterprises delineating the specific criteria and procedures for the “high and new technology enterprises”.

FAB Digital was recognized by the provincial level Science and Technology Commission, Finance Bureau, and State and Local Tax Bureaus as “high and new technology enterprise”, which recognition is valid for 3 years. Therefore, FAB Digital is entitled to the preferential enterprise income tax rate of 15%. FAB cannot assure you that FAB Digital will continue to be recognized as “high and new technology enterprise” or be able to renew this qualification when the term expires, and thus continue to be entitled to the preferential enterprise income tax rate of 15% or any other preferential enterprise income tax treatment.

### ***Value Added Tax***

The Provisional Regulations of the PRC concerning Value Added Tax were promulgated by the State Council. Value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

Value added tax payable in the PRC is charged on an aggregated basis at a rate of 13% or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided but excluding, in respect of both goods and services, any amount paid in respect of value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year.

### **Employees**

Currently, Libsyn has 18 full time employees and 5 part time employees who spend a significant amount of their time working in our Podcast hosting operations.

Currently, DEI has 170 full time employees, and no part time employees who spend their time running the media business in China.

### **Item 1A. Risk Factors.**

#### **Risks Relating to Our Business**

Our present and intended business operations are highly speculative and involve substantial risks. Only investors who can bear the risk of losing their entire investment should consider buying our shares. Among the risk factors that you should consider are the following:

#### **If we do not maintain and develop our brand, we may not be able to maintain and grow our customers and clients.**

It is critical for us to maintain and develop our brands so as to effectively expand our customer base and our revenues. We believe that the importance of brand recognition will increase as the middle class grows in China. In order to attract and retain customers, we may need to substantially increase our expenditures for creating and maintaining brand loyalty.

Our success in promoting and enhancing our brands, as well as our ability to remain competitive, will also depend on our success in offering high quality copyright protected content. If we fail to promote our brands successfully or if customers do not perceive our content and services to be of high quality, we may not be able to continue growing our business and attracting customers.

#### **Our strategy of acquiring complementary assets, technologies and businesses may fail and result in equity or earnings dilution.**

As a component of our growth strategy, we intend to actively identify and acquire assets, technologies and businesses that are complementary to our existing businesses. Our acquisitions could result in the use of substantial amounts of cash, potentially dilutive issuances of equity securities, significant impairment losses related to goodwill or amortization expenses

related to intangible assets and exposure to undisclosed or potential liabilities of acquired companies. Any acquisition we decide to pursue may be subject to the approval of the relevant PRC governmental authorities, as well as any applicable PRC rules and regulations. Considering the fast changing legal environment, our acquisition may be subject to the government's further scrutiny and the acquisition structures we use may be found to be inappropriate.

**Acquisitions and/or strategic alliances may have an adverse effect on DEI's ability to manage its business.**

DEI may acquire technologies, businesses or assets that are complementary to its business and/or enter into strategic alliances in order to leverage its position in the Chinese market and expand its business domestically and internationally. Acquisitions or strategic alliances would expose DEI to potential risks, including risks associated with the integration of new technologies, businesses and personnel, unforeseen or hidden liabilities, the diversion of management attention and resources from its existing business, and the inability to generate sufficient revenues to offset the costs and expenses of acquisitions or strategic alliances. Any difficulties encountered in the acquisition and strategic alliance process may have an adverse effect on DEI's ability to manage its business. In addition, acquired businesses may not perform to DEI's expectations for various reasons, including the loss of key personnel or key clients, or its strategic focus may change. As a result, DEI may not realize the benefits it anticipates. If DEI fails to integrate acquired technologies, businesses and assets or realize the expected benefits, it may not receive a return on its investment and its transaction costs for such acquisitions, and its business and operations may be adversely affected.

**If DEI is unable adequately to protect its intellectual property rights, its businesses may be materially adversely affected.**

DEI's businesses depend in part on intellectual property. The protection of intellectual property rights and brands in the PRC may not be as effective as those in the United States or other countries. The steps that DEI has taken to protect its intellectual property may not be effective at preventing its misappropriation. Any litigation that is necessary to protect these rights may require significant expense and time.

**DEI's business could suffer if it does not successfully manage its current and future growth.**

DEI has experienced a period of rapid growth and expansion that has placed, and will continue to place, strain on its management personnel, systems and resources. To accommodate the growth pursuant to its strategies, DEI anticipates that it will need to implement a variety of new and upgraded operational and financial systems, including online payment systems and related security systems, procedures and controls, and the improvement of accounting and other internal control and management systems, all of which require substantial management effort and financial resources. DEI will also need to continue to expand, train, manage and motivate its workforce, and manage its relationships with its distributors, third-party service providers and customer base. All of these endeavors will require substantial management effort and skill and the incurrence of additional expenditures. DEI cannot assure that it will be able to efficiently or effectively implement its growth strategies and manage the growth of its operations, and any failure to do so may limit its future growth and hamper its business strategy.

**We are subject to the risks associated with operating in an evolving market.**

As a company with a major subsidiary operating in the rapidly evolving PRC market, we face numerous risks and uncertainties. Some of these risks relate to our ability to:

- attract customers with copyright protected content and the products we offer;
- maintain and attract customers;
- increase the revenues derived from our fee-based memberships and products we offer;
- maintain and increase the revenue derived from advertising;
- attract and retain qualified personnel.

**There are risks inherent to our subsidiary, DEI's operations that could significantly impact its ability to continue to execute our business plans and/or generate revenues and profits.**

DEI faces business risks regarding the following:

- The ability to secure necessary materials to distribute products;
- The ability to secure licenses and distribution rights for copyrighted products;
- The ability to secure the necessary licenses from the Chinese government to operate a high-tech business;
- The ability to attract and retain highly skilled employees to develop software for its business;
- Competition with pirated or copyright infringing products and the Company's ability to compete effectively on price with illegal content;
- DEI relies on large gatherings of people to promote its business and sell music and other products. DEI must be able to secure growth gathering permits or its revenues may be negatively impacted.

**We face intense competition which could reduce our market share and adversely affect our financial performance.**

There are many companies that distribute online content targeting Chinese Internet users. We compete with distributors of content over the Internet, including content sites, Web directories, search engines and Internet service providers. These sites compete with us for customers and advertising dollars. The Internet market in China is rapidly evolving. Competition is intense and has increased significantly, because there are no substantial barriers to entry in our market.

In addition, we face increasing numbers of newly-emerged competitors or existing competitors who compete with us by expanding their businesses into new areas.

We compete with our peers and competitors in China primarily on the following basis:

- technological advancements;
- brand recognition;
- strategic relationships;
- quality of services;
- effectiveness of sales and marketing efforts;
- talented staff; and
- pricing.

Our competitors may have certain competitive advantages over us including:

- greater brand recognition among Internet users;
- better products and services;
- larger customer base;
- more extensive and well developed marketing and sales networks; and
- substantially greater financial and technical resources.

**Our international operations are subject to additional risks which could harm our business, operating results, and financial condition.**

There are risks inherent in doing business internationally including:

- trade barriers and changes in trade regulations;
- difficulties in developing, staffing, and simultaneously managing foreign operations as a result of distance, language, and cultural differences;
- stringent local labor laws and regulations;
- longer payment cycles;
- credit risk and higher levels of payment fraud;
- restrictions on foreign ownership and investments, and stringent foreign exchange controls that might prevent us from repatriating cash earned in countries outside the U.S.;
- political or social unrest, economic instability, repression, or human rights issues;
- geopolitical events, including acts of war and terrorism;
- compliance with U.S. laws such as the Foreign Corrupt Practices Act, and local laws prohibiting bribery and corrupt payments to government officials;
- antitrust and competition regulations;
- laws, regulations, licensing requirements, and business practices that favor local competitors or prohibit foreign ownership or investments;

- different employee/employer relationships, existence of workers' councils and labor unions, and other challenges caused by distance, language, and cultural differences, making it harder to do business in certain jurisdictions.
- different or more stringent user protection, content, data protection, privacy and other laws; and
- risks related to other government regulations or required compliance with local laws.

**We expect in the future to derive a majority of our revenues from the provision of audio and video products through digital platforms, which is particularly sensitive to changes in economic conditions and people's consuming habits.**

Demand for audio and video products is particularly sensitive to changes in general economic conditions, and sales typically decrease during periods of economic downturn. Customers may reduce their spending for these products in our stores for a number of reasons, including:

- a general decline in economic conditions;
- a shift in business strategy by our wholesale customers
- a decision to shift material products expenditures to online content;
- a decline in audio and video products spending in general; or
- a decrease in demand for audio and video products in general and for our services in particular would materially and adversely affect our ability to generate revenue from our wholesale and retail business, and could affect our financial condition and results of operations.

Since the popularity of online content provision, we have experienced difficult conditions. In addition, in early March 2012, China pared its economic growth target to 7.5% from an 8% goal that had been in place since 2005. As a result of such economic downturns, growth in consumer spending in China slowed which resulted in a corresponding slowdown in advertising spending growth. If there is deterioration in the economic condition, our revenues, net income and results of operations could be materially adversely affected.

**We derived a significant portion of our cash from the sale of FAB brand licenses, which is sensitive to changes in economic conditions and people's consuming habits.**

Demand for our business model and audio and video products is particularly sensitive to changes in general economic conditions, and changes with the growth of the internet. The length of our license is for a period of 5 years with the cash payment received at the beginning of the agreement. As the internet grows, the demand for our license and related business model could decline and result in lower revenue and cash generation. As user preferences change and the internet becomes more prevalent, fewer licenses may be sold, and we may deem the business to no longer be feasible or result in a necessity to change our business strategy. There can be no assurance the level of license sales will remain consistent with previous results.

**If we need additional capital and are not able to raise it, our liquidity and financial position could be adversely affected.**

We believe that our current cash and cash equivalents and cash flow from operations will be sufficient to meet our anticipated cash needs including working capital and capital expenditures, for the foreseeable future. We may, however, require additional cash resources due to a change in business conditions or other future developments. We may seek to sell additional equity and/or debt securities or obtain a credit facility. The sale of convertible debt securities or additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness could result in increased debt service obligations and could result in operating and financing covenants that could restrict our operations and liquidity.

Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties, including:

- investors' perception of, and demand for, securities of alternative media companies;
- conditions of the U.S. and other capital markets in which we may seek to raise funds;
- our future results of operations, financial condition and cash flows;
- PRC governmental regulation of foreign investment in licensing business companies in China;
- economic, political and other conditions in China; and
- PRC governmental policies relating to foreign currency borrowings.

We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all. Any failure by us to raise additional funds on terms favorable to us could have a material adverse effect on our liquidity and financial condition.

**There are risks associated with DEI's business structure.**

DEI operates its businesses in China through a VIE with FAB Media and its subsidiaries. The contractual arrangement with FAB Media, and their respective shareholders provide DEI with effective control over these companies. As a result of these contractual arrangements, DEI is considered to be the primary beneficiary of FAB Media and accordingly, DEI consolidates the results of operations, assets and liabilities of FAB Media and its subsidiaries in its financial statements. While this is the traditional legal structure for foreign corporations to control businesses in China, these contractual arrangements may not be as effective in providing DEI with control over FAB Media and its subsidiaries as direct ownership of these companies. In addition, FAB Media and its subsidiaries or their respective shareholders may breach the contractual arrangements. In any such event, DEI would have to rely on legal remedies under PRC law. These remedies may not always be effective, particularly in light of uncertainties in the PRC legal system.

The VIE is jointly owned by individuals, including our Chairman. Conflicts of interest between these individuals' role as shareholders of the VIE and their duties to DEI may arise. In addition, these individuals are also directors and executive officers of the VIE. PRC laws provide that a director or certain member of senior management owes a fiduciary duty to the company he directs or manages. These individuals must therefore act in good faith and in the best interests of the relevant VIE and must not use their respective positions for personal gain. These laws do not require them to consider best interests of DEI when making decisions as a director or member of management of the relevant VIE. Conflicts may arise between these individuals' fiduciary duties as directors and officers of the VIE and DEI. We cannot assure you that when conflicts of interest arise, these individuals will act in the best interests of the Company or DEI or those conflicts of interest will be resolved in favor of the Company or DEI.

In addition, these individuals may breach or cause the VIE to breach or refuse to renew the existing contractual arrangements that allow DEI to effectively control the VIE and receive economic benefits from them. If the Company cannot resolve any conflicts of interest or disputes between DEI and the shareholders of the VIE, the Company would have to rely on legal proceedings, which could result in disruption of the business of DEI, and there would be substantial uncertainty as to the outcome of any such legal proceedings.

If we are unable to enforce these contractual arrangements, or if we suffer significant delay or other obstacles in the process of enforcing these contractual arrangements, we may not be able to have the power to direct the activities that most significantly affect the economic performance of our consolidated entities, we may lose control over the assets owned by our consolidated entities, including our brand name, and retail and wholesale businesses. As a result, our ability to conduct our business may be materially and adversely affected, and we may not be able to consolidate the financial results of the relevant entities into our consolidated financial statements in accordance with U.S. GAAP, which may materially and adversely affect our results of operations and damage our reputation.

DEI believes the ownership structure is in compliance with all existing PRC laws and regulations, and the VIE Contract is binding and will not result in any violation of PRC laws or regulations currently in effect. The Company cannot assure you that the PRC regulatory authorities will ultimately take a view that is consistent with DEI. If DEI is found to be in violation of any existing or future PRC laws or regulations, or fails to obtain or maintain any of the required permits or approvals, the relevant regulatory authorities would have broad discretion in dealing with such violation, including levying fines, confiscating of income, revoking DEI's business licenses or operating licenses, requiring the Company to restructure the relevant ownership structure or operations, and requiring DEI to discontinue all or any portion of its business. Any of these actions could cause significant disruption to DEI's business operations.

**DEI is dependent upon its existing management, its key development personnel and its qualified technical personnel, and its business may be severely disrupted if DEI loses their services.**

The future success of DEI depends substantially on the continued services of its executives and its key development personnel, such as Chairman, Zhang Hongcheng, who has been instrumental in the development of the FAB business. If one or more of the key personnel were unable or unwilling to continue in their present positions, DEI might not be able to replace them easily or at all. In addition, if any of the key employees joins a competitor or forms a competing company, DEI may lose know-how, key professionals and staff members as well as suppliers. These key employees could develop and operate a business that could compete with and take customers away from DEI's existing and future customers. Each of these key

personnel has entered into an employment agreement with DEI, which contains non-competition provisions. However, if any dispute arises between the key employees and DEI, these non-competition provisions may not be enforceable in China.

**Changes in the economic and political policies of the PRC could materially and adversely affect the DEI business.**

Through the VIE, DEI conducts substantially all of its business operations in the PRC. As a result, its business, financial condition, results of operations and business prospects depend largely on economic and political developments in the PRC. China's economy differs from the economies of most developed countries in many respects, including the amount of government involvement in the economy, the general level of economic development, growth rates and control of foreign exchange and the allocation of resources. Although the economy of the PRC has experienced significant growth in recent decades, this growth has remained uneven across different periods, regions and among various economic sectors. The PRC government has implemented various measures to encourage economic development and guides the allocation of resources. It also exercises significant control over China's economic growth through strategically allocating resources, controlling the payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. The PRC government's future actions and policies may materially affect the Chinese economy and may have a material adverse effect on DEI's business.

**Our disclosure controls and procedures are not effective to ensure accurate and timely reporting and we have identified a material weakness in our internal control over financial reporting, and our business and stock price may be adversely affected if we do not adequately address those weaknesses or if we have other material weaknesses or significant deficiencies in our disclosure controls and procedures or internal control over financial reporting.**

As a result of our determination that one of our VIE's conducted a \$16.3 million bond offering in China in 2013 that was not reflected in the Company's interim financial statements as filed with the Commission, our management has concluded that we did not maintain effective internal controls to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and form as of June 30, September 30, and December 31, 2013. In particular, we had to restate our financial information for the second and third quarters of 2013 as a result of our failing to accrue interest expense associated with the bonds, the existence of the bonds as a consolidated liability and the receipt of the proceeds of the offering.

The existence of these or one or more other material weaknesses or significant deficiencies could result in errors in our financial statements, and substantial costs and resources may be required to rectify any internal control deficiencies. If we cannot produce reliable financial reports, investors could lose confidence in our reported financial information, the market price of our stock could decline significantly, we may be unable to obtain additional financing to operate and expand our business, and our business and financial condition could be harmed.

**We may be required to record a significant charge to earnings as we are required to reassess our goodwill or other intangible assets arising from acquisitions.**

We are required under U.S. GAAP to review our intangible assets, including goodwill for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment annually or more frequently if facts and circumstances warrant a review. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization and slower or declining growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined.

**Foreign Currency Exchange Rate Risk**

While our reporting currency is the U.S. dollar, the majority of our revenues and costs are denominated in RMB and a significant portion of our assets and liabilities are denominated in RMB. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be affected by fluctuations in the exchange rate between the U.S. dollar and the RMB. If the RMB depreciates against the U.S. dollar, the value of our RMB revenues and assets as expressed in our U.S.

dollar financial statements will decline. We do not hold any derivative or other financial instruments that expose us to substantial market risk.

To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure. Accordingly, we may incur economic losses in the future due to foreign exchange rate fluctuations, which could have a negative impact on our financial condition and results of operations.

**The telecommunications infrastructure in China, which is not as well developed as in the United States, may limit our growth.**

The telecommunications infrastructure in China is not well developed. Our internet growth may depend on the PRC government and state-owned enterprises establishing and maintaining a reliable Internet and telecommunications infrastructure to reach a broader base of Internet users in China. The Internet infrastructure, standards, protocols and complementary products, services and facilities necessary to support the demands associated with continued internet growth may not be developed on a timely basis or at all by the PRC government and state-owned enterprises.

**To the extent we may be unable to scale our systems to meet the increasing PRC Internet population, we will be unable to expand our online customers and increase our attractiveness to advertisers and merchants.**

As internet volume and traffic increase in China, we may not be able to scale our systems proportionately. To the extent we do not successfully address our capacity constraints, our operations may be severely disrupted, and we may not be able to expand our customer base and increase our attractiveness to advertisers and merchants. Even if we scale our systems proportionately, any unforeseen increase in traffic may disrupt our operations and make it difficult for our customers to visit our websites, or even cause customers to be unable to access our websites at all, which could result in a loss of customers.

**We face a higher risk of failure because we cannot accurately forecast our future revenues and operating results.**

The rapidly changing nature of the markets in which we compete makes it difficult to accurately forecast our revenues and operating results. Furthermore, we expect our revenues and operating results to fluctuate in the future due to a number of factors, including the following:

- the timing of sales of our products and services;
  - the timing of product implementation, particularly large design projects;
  - unexpected delays in introducing new products and services;
  - increased expenses, whether related to sales and marketing, product development, or administration;
  - the mix of product license and services revenue; and
  - costs related to possible acquisitions of technology or businesses.
- Change in business strategy and direction

**We face a higher risk of failure because the podcasting media service businesses are in their infancy.**

We face the difficulties frequently encountered by companies in the early stage of development in new and evolving markets. These potential difficulties include the following:

- substantial delays and expenses related to testing and developing of our new products;
- successfully establishing podcasting as a large-scale advertising medium;
- marketing and distribution problems with new and existing products and technologies;
- we are at the mercy of App Store providers approval process who control if we can sell our App through their stores;
- competition from larger and more established companies;
- delays in reaching our marketing goals;
- difficulty in recruiting qualified employees for management and other positions;
- our lack of sufficient customers, revenues and cash flow; and
- our limited financial resources.



We may continue to face these and other difficulties in the future. Some of these problems may be beyond our control. If we are unable to successfully address them, our business will suffer.

**If we do not achieve the brand recognition necessary to succeed in the podcasting and media services markets, we may not be able to compete.**

We must build our Libsyn brand to gain market acceptance for our podcasting services, and media services and tools. We believe that our long-term success will require that we obtain significant market share for our products and services before other competitors enter the market. We must spend large amounts on product development, strategic relationships and marketing initiatives in order to establish brand awareness. We cannot be certain that we will have enough resources to build our brand and to obtain commercial acceptance of our products and services. If we do not gain market acceptance for our podcasting services, as a large-scale advertising medium, and related media services, we may not be able to compete effectively.

**Our expansion plans may not be cost-effective.**

We have pursued, and may continue to pursue, strategic alliances with new or complementary businesses in an effort to enter into new business areas, diversify our sources of revenue and expand our products and services. If we pursue strategic alliances with new or complementary businesses, we may not be able to expand our product or service offerings and related operations in a cost-effective or timely way. We may experience increased costs, delays and diversions of management's attention when beginning any new businesses or services. Also, any new business or service that users do not favorably receive could damage our reputation and brand name in the market place. We also cannot be certain that we will obtain enough revenues from any expanded products or services to offset related costs. Any expansion of our operations may require additional expenses. These efforts may strain our management, financial and operational resources.

**Our limited resources may make it harder for us to manage growth.**

We have a limited basis upon which to evaluate our systems' ability to handle controlled or full commercial availability of our products and services. We may expand our operations significantly in the near future, and we will have to expand further to address the anticipated growth in our user base and market opportunities. To manage the expected growth of operations and personnel, we will need to improve existing systems, and implement new systems, procedures and controls. In addition, we will need to expand, train and manage an increasing employee base. We will also need to expand our finance, administrative and operations staff. We may not be able to effectively manage this growth. Our planned expansion in the near future will place a significant strain on our managerial, operational and financial resources. Our planned personnel, systems, procedures and controls may be inadequate to support our future operations. If we cannot manage growth effectively or if we experience disruptions during our expansion, the expansion may not be cost-effective.

**We have a history of losses and we may never achieve profitability.**

FAB's net income reported to common stockholders was \$20.7million for the year end December 31, 2013. FAB's net loss available to common stockholders was \$4,004,225, or \$0.34 per share, for the year ended December 31, 2012. Even though FAB reported a profit during 2013, because we need to establish our brand and services, we expect to incur increasing sales and marketing, product development and administrative expenses, and, as a result, we will need to generate significant revenues to maintain profitability. We cannot assure you that we will ever be able to maintain revenue and profitability.

**If producers have to pay additional licensing fees, we may not be able to maintain and grow our revenue for our podcasting business.**

Personal Audio LLC ("PA") has asserted a Podcast Patent against several Media Companies and Networks including Libsyn's producers. PA has filed suit in the US District Court for the Eastern District of Texas for infringement of its U.S. 8,112,504 patent, "The Podcasting Patent". PA is also actively seeking licensing of its podcast technology from individual Media Producers and Networks. Electronic Frontier Foundation (the "EFF") is assisting producers in responding to these matters. The EFF, founded in 1990, has championed the public interest in every critical battle related to digital rights and freedoms primarily through bringing and defending lawsuits in the courts. Should PA be successful in its lawsuits against producers and/or their efforts of licensing their technology, it could have a significant effect on the number of producers that

continue to produce podcasts. This could have an adverse effect on the revenue generated by Libsyn and we may not be able to maintain the level of revenue sufficient to exceed our expenses.

**If we do not respond effectively to technological change, our products and services could become obsolete.**

The development of our products and services and other technology entails significant technical and business risks. To remain competitive, we must continue to improve our products' responsiveness, functionality and features.

High technology industries are characterized by:

- rapid technological change;
- changes in user and customer requirements and preferences;
- frequent new product and services introductions embodying new technologies; and
- the emergence of new industry standards and practices.

The evolving nature of the Internet could render our existing technology and systems obsolete. Our success will depend, in part, on our ability to:

- license or acquire leading technologies useful in our business;
- develop new services and technologies that address our users' increasingly sophisticated and varied needs; and
- respond to technological advances and emerging industry and regulatory standards and practices in a cost-effective and timely way.

Future advances in technology may not be beneficial to, or compatible with, our business. Furthermore, we may not use new technologies effectively or adapt our technology and systems to user requirements or emerging industry standards in a timely way. In order to stay technologically competitive, we may have to spend large amounts of money and time. If we do not adapt to changing market conditions or user requirements in a timely way, our business, financial condition and results of operations could be seriously harmed.

**If we fail to develop new products, or if we incur unexpected expenses or delays in product development, we may lose our competitive position.**

Although we currently have fully developed products available for sale, we are also developing various products and technologies that we will rely on to remain competitive. Due to the risks in developing new products and technologies, limited financing, competition, obsolescence, loss of key personnel and other factors, we may fail to develop these technologies and products, or we may experience lengthy and costly delays in doing so. Although we may be able to license some of our technologies in their current stage of development, we cannot assure you that we will be able to do so.

**Changes in the app approval policies of an App Store could have an adverse effect on the business plans of Libsyn, including revenues.**

Our Podcast Apps for sale in the most popular App Stores including Apple, Windows, Amazon and Verizon are subject to approval by each marketplace. Throughout the submission process, some Apps have not been approved for sale in the marketplaces and may not be approved in the future because they do not comply with App Store Review Guidelines.

The App stores with which Libsyn currently sells its Apps, (Apple App Store, Windows 8, Windows Phone 8, Verizon and Amazon Appstore), have complete control over the approval of each App submitted to their store. The policies for the App approval process are normally very broad, and subject to interpretation and frequent changes by each App store.

In the past, Libsyn has received approval for Apps with streaming video and then subsequently has had Apps rejected for including streaming video. On the other hand, some App Stores have approved Apps with streaming video without any hesitation.

Apple has rejected individual podcast Apps because they do not want thousands of individual podcast Apps in the App store under one developer account, and then subsequently approved podcast Apps when submitted under a podcast producer's own developer account. If Apple were to enforce its policy to disallow podcast Apps to be accepted under

Libsyn's developer account or under a podcaster's individual developer account, it could have an adverse impact on future business plans of Libsyn, including revenues.

The approval of Apps, which cannot be guaranteed, is subject to the App Stores' review personnel, their Management and the overall store and company policy, which are subject to change at any time. The change in policy and rejection of Apps for approval by any one or all of the App Stores could have an adverse impact on future business plans of Libsyn, including revenues.

**If we lose our key U.S. personnel or are unable to hire additional U.S. personnel, we will have trouble growing our business.**

We depend to a large extent on the abilities of our key U.S. management and technical personnel, in particular Christopher J. Spencer, our Chief Executive Officer and President. The loss of any key employee or our inability to attract or retain other qualified employees could seriously impair our results of operations and financial condition.

Our future success depends on our ability to attract, retain and motivate highly skilled technical, marketing, management, accounting and administrative personnel. We plan to hire additional personnel in all areas of our business as we grow. Competition for qualified personnel is intense. As a result, we may be unable to attract and retain qualified personnel. We may also be unable to retain the employees that we currently employ or to attract additional technical personnel. The failure to retain and attract the necessary personnel could seriously harm our business, financial condition and results of operations.

**System and online security failures could harm our business and operating results.**

The operation of our business depends on the efficient and uninterrupted operation of our computer and communications hardware systems. Our systems and operations are vulnerable to damage or interruption from many sources, including fire, flood, power loss, telecommunications failure, break-ins, earthquakes and similar events. Our servers are also vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. Any substantial interruptions in the future could result in the loss of data and could destroy our ability to generate revenues from operations.

The secure transmission of confidential information over public networks is a significant barrier to electronic commerce and communications. Anyone who can circumvent our security measures could misappropriate confidential information or cause interruptions in our operations. We may have to spend large amounts of money and other resources to protect against potential security breaches or to alleviate problems caused by any breach.

**Our operating results could be impaired if we become subject to burdensome government regulation and legal uncertainties.**

We are not currently subject to direct regulation by any domestic or foreign governmental agency, other than regulations applicable to businesses generally. However, due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may be adopted with respect to the Internet, relating to:

- user privacy;
- pricing;
- content;
- copyrights;
- distribution; and
- characteristics and quality of products and services.

The adoption of any additional laws or regulations may decrease the expansion of the Internet. A decline in the growth of the Internet could decrease demand for our products and services and increase our cost of doing business. Moreover, the applicability of existing laws to the Internet is uncertain with regard to many issues, including property ownership, export of specialized technology, libel and personal privacy. Our business, financial condition and results of operations could be seriously harmed by any new legislation or regulation. The application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or the application of existing laws and regulations to the Internet and other online services could also harm our business.

## **Risks Related to China's Regulatory Environment**

### **Uncertainties relating to the legal system of the PRC may have a material adverse effect on FAB.**

China has not yet developed a fully integrated legal system and recently enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations continue to evolve and the limited number and non-binding nature of published decisions concerning them, their interpretation and enforcement involves uncertainties. In addition, the Chinese legal system is based partly on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, DEI may not be aware of its violation of these policies and rules until sometime after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

### **Political, economic and social policies of the PRC government could affect our business.**

Substantially all of our business, operating assets, fixed assets and operations are located in China, and substantially all of our revenues are derived from our operations in China. Accordingly, our business may be adversely affected by changes in political, economic or social conditions in China, adjustments in PRC government policies or changes in laws and regulations.

The economy of China differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development in a number of respects, including:

- structure;
- level of government involvement;
- level of development;
- level of capital reinvestment;
- growth rate;
- control of foreign exchange; and
- methods of allocating resources.

China has been primarily a planned economy subject to a system of macroeconomic management. Although the PRC government still owns a significant portion of the productive assets in China, economic reform policies have emphasized decentralization, autonomous enterprises and the utilization of market mechanisms. We cannot predict the future effects of the economic reform and macroeconomic measures adopted by the PRC government on our business or results of operations. Furthermore, the PRC government began to focus more attention on social issues in recent years and has promulgated or may promulgate additional laws or regulations in this area, which could affect our business in China. For example, the PRC government issued the *Employment Contract Law*, effective January 1, 2008, providing increased employment protection to employees in China, which could cause us to incur additional staff costs in the future.

### **The PRC legal system embodies uncertainties which could limit the legal protections available to us, or could lead to penalties on us.**

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. The PRC government promulgates a comprehensive system of laws and regulations governing economic matters in general. Our subsidiaries and VIE are incorporated in China and subject to all applicable Chinese laws and regulations. Because of the relatively short period for enacting such a comprehensive legal system, it is possible that the laws, regulations and legal requirements are relatively recent, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us and other foreign investors. Such uncertainties may also make it easier for others to infringe our intellectual property without significant cost, and new entrants to the market may tend to use gray areas to compete with us. In addition, uncertainties in the PRC legal system may lead to penalties being imposed on us because of a difference in interpretation of the applicable law between the relevant governmental authority and us. We cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws.

**In order to comply with PRC regulatory requirements, we operate our main business through a company with which we have contractual relationship but in which we do not have an actual ownership interest. If our current ownership**

**structure is found to be in violation of current or future PRC laws, rules or regulations regarding the legality of foreign investment in the PRC Internet sector, we could be subject to severe penalties.**

Various regulations in the PRC restrict or prohibit wholly foreign owned enterprises (“WFOEs”), such as DGC, from operating in specified industries such as Internet information, wireless, Internet access, and certain other industries. In order to comply with PRC regulatory requirements, we conduct our business operations solely in the PRC through our indirect wholly-owned subsidiaries and VIE that is incorporated in the PRC and owned by certain of our employees.

We believe that our current ownership structure complies with all existing PRC laws, rules and regulations. However, considering the substantial uncertainties regarding the interpretation of current PRC Internet laws and regulations, we cannot be sure that the PRC government would view our current ownership structure to be in compliance with PRC laws, rules and regulations. Accordingly, it is possible that the relevant PRC authorities could, at any time, assert that any portion or all of our PRC subsidiaries’ and VIE’s existing or future ownership structure and businesses violate existing or future PRC laws, regulations or policies. It is also possible that new laws or regulations governing our PRC business sector that have been adopted or may be adopted in the future will prohibit or restrict foreign investment in, or other aspects of, any of our PRC subsidiaries’ and VIE’s current or proposed businesses and operations. In addition, any such new laws and regulations may be retroactively applicable to us and our PRC subsidiaries and VIE.

If we or any of our PRC subsidiaries and VIE were found to be in violation of any existing or future PRC laws or regulations, the relevant PRC authorities would have broad discretion in dealing with such violations, including, without limitation, the following:

- levying fines;
- confiscating our income;
- revoking our licenses;
- shutting down our servers and/or blocking our websites;
- requiring us to restructure our ownership structure or operations; and
- requiring us to discontinue any portion or all of its Internet and value-added telecommunication businesses.

**We depend upon contractual arrangements with our VIE for the success of our business and these arrangements may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.**

Because we conduct our operations mainly in the PRC, and are restricted or prohibited by the PRC government from owning operations in the PRC, we are dependent on our VIE in which we have no direct ownership interest, to provide those services through contractual agreements between the parties. These arrangements may not be as effective in providing control over our operations as direct ownership of these businesses. For example, our subsidiaries and VIE could fail to take actions required for our business, such as entering into content contracts with potential content suppliers. If the VIE fails to perform their obligations under these agreements, we may have to rely on legal remedies under PRC law. We cannot assure you that such remedies under PRC law would be effective or sufficient.

**The contractual arrangements between our subsidiaries and our VIE may result in adverse tax consequences.**

PRC laws and regulations emphasize the requirement of an arm’s length basis for transfer pricing arrangements between related parties. The laws and regulations also require enterprises with related party transactions to prepare transfer pricing documentation to demonstrate the basis for determining pricing, the computation methodology and detailed explanations. Related party arrangements and transactions may be subject to challenge or tax inspection by PRC tax authorities.

Under a tax inspection, if our transfer pricing arrangements between the China-based subsidiaries and VIE are judged as tax avoidance, or related documentation does not meet the requirements, our China-based subsidiaries and VIE may be subject to material adverse tax consequences, such as transfer pricing adjustment. A transfer pricing adjustment could result in a reduction, for PRC tax purposes, of adjustments recorded by VIE, which could adversely affect us by (i) increasing VIE’s tax liabilities without reducing our subsidiaries’ tax liabilities, which could further result in interest being levied to us for unpaid taxes; or (ii) limiting the ability of our PRC companies to maintain preferential tax treatment and other financial incentives.

**Possible increased scrutiny by Chinese authorities of the VIE structure used by us and various other Chinese companies publicly-traded in the United States appear to have created concern among investors, and such reports may cause the price of our common stock to drop in the future.**

In the past, various prominent Western news outlets have reported that the PRC Ministry of Commerce and the China Securities Regulatory Commission, among other Chinese regulatory authorities, may be considering increased scrutiny or enhanced regulation of Chinese companies that use VIE structures as a means of complying with Chinese laws prohibiting or restricting foreign ownership of certain businesses in China. Some news reports have also sought to draw a connection between recent widely reported accounting issues at certain Chinese companies and the use of VIE structures. Such news reports appear to have had the effect of causing significant drops in the market prices of the shares of several Chinese companies that are publicly-traded in the United States. If any such Chinese regulatory authorities were to increase scrutiny of VIE structures or adopt regulations specifically governing their use, any such scrutiny may have a material adverse impact on us or cause us to change our existing operational structure. It is possible that there will be increased scrutiny or enhanced regulation in the future. Any of such circumstances could lead to further loss of investor confidence in Chinese focused companies such as ours and cause fluctuations in the market prices of our common stock and, if such prices were to drop sharply, could subject us to additional shareholder litigation, which could cause the price for our shares to drop further.

**Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.**

We regard our copyrights, trademarks, trade secrets and other intellectual property as critical to our success. Unauthorized use of our intellectual property by third parties may adversely affect our business and reputation. We rely on trademark and copyright law, trade secret protection and confidentiality agreements with our employees, customers, business partners and others to protect our intellectual property rights. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without authorization. Under the *Patent Law of the PRC* promulgated by the NPC Standing Committee, the State Council's Patent Administration Department may grant a compulsory license to individuals or entities to use our patent, if our exploitation of the patent has been determined to violate the antitrust laws. Furthermore, the validity, enforceability and scope of protection of intellectual property in Internet-related industries are uncertain and still evolving. In particular, the laws of the PRC and certain other countries are uncertain or do not protect intellectual property rights to the same extent as do the laws of the United States. Moreover, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Future litigation could result in substantial costs and diversion of resources.

**Regulations relating to offshore investment activities by PRC residents may limit our ability to acquire PRC companies and could adversely affect our business.**

The SAFE promulgated the *Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment Through Offshore Special Purpose Vehicles (or the "Circular 75")*, the SAFE and has further issued a series of implementation guidance, including the most recent the *Notice of SAFE on Printing and Distributing the Implementing Rules for the Administration of Foreign Exchange in Fund-Raising and Round-trip Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies (or the "Circular 19")*, which came into effect on July 1, 2011. These regulations state that if PRC residents use assets or equity interests in their PRC entities as capital contributions to establish offshore companies or inject assets or equity interests of their PRC entities into offshore companies to raise capital overseas, they must register with local SAFE branches with respect to their overseas investments in offshore companies. They must also file amendments to their registrations if their offshore companies experience material events involving capital variation, such as changes in share capital, share transfers, mergers and acquisitions, spin-off transactions, long-term equity or debt investments or uses of assets in China to guarantee offshore obligations. Under these regulations, their failure to comply with the registration procedures set forth in such regulation may result in restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on the capital inflow from the offshore entity to the PRC entity.

We have requested DEI and its shareholders, who are PRC residents to make the necessary applications, filings and amendments as required under Circular 75 and other related rules. We and DEI attempt to comply, and to ensure that our shareholders who are subject to these rules comply with the relevant requirements. However, we cannot provide any assurances that all of our shareholders, and all of DEI's shareholders, who are PRC residents will comply with our and DEI's requests to make or obtain any applicable registrations or comply with other requirements required by Circular 75 or other

related rules. Any future failure by any of our shareholders or of DEI's shareholders who is a PRC resident, or controlled by a PRC resident, to comply with relevant requirements under these regulations could subject us or DEI to fines or sanctions imposed by the PRC government, including restrictions on our subsidiaries' ability to pay dividends or make distributions to us and our ability to increase our investment in these subsidiaries.

**We may be subject to fines and legal sanctions if we or our employees who are PRC citizens fail to comply with PRC regulations relating to employee stock options granted by overseas listed companies to PRC citizens.**

The PBOC issued the *Administration Measures on Individual Foreign Exchange Control*, and its Implementation Rules were issued by the SAFE. Under these regulations, all of the foreign exchange transactions involving an employee share incentive plan, share option plan or similar plan participated in by PRC citizens may be conducted only with the approval from the SAFE or its authorized branch. The SAFE promulgated the *Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas Listed Company* (or the "Stock Option Rule"). Under the Stock Option Rule, PRC citizens who are granted stock options or restricted share units or issued restricted shares by an overseas publicly listed company are required, through a PRC agent or PRC subsidiary of such overseas publicly listed company, to register with the SAFE or its authorized branch and to comply with a series of other procedures and requirements. We and the PRC employees of DEI and those who have been granted stock options or restricted share units, or issued restricted shares, are subject to the Stock Option Rule. If we, DEI or the PRC employees of DEI and those who hold options, restricted share units or restricted shares fail to comply with these registration or other procedural requirements, we, DEI and/or such employees may be subject to fines and other legal sanctions.

**Dividends we receive from our operating subsidiaries located in the PRC are subject to PRC withholding tax.**

The New CIT Law imposes, among other things, that a maximum withholding tax rate of 20% may be applicable to dividends payable to non-PRC investors that are "non-resident enterprises," to the extent that such dividends are derived from sources within the PRC, and the State Council has reduced such rate to 10% through the *Implementing Regulations for the PRC Corporate Income Tax Law*. A lower withholding tax rate will be applied if there is a tax treaty arrangement between China and the jurisdiction of the foreign holding companies, such as Hong Kong. Our China-based subsidiaries are invested by immediate foreign holding companies in Hong Kong. All of these foreign-invested enterprises are subjected to the withholding tax.

Under the *Arrangement Between the PRC and the Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital* (or "China-HK Tax Arrangement"), the dividend withholding tax rate may be reduced to 5%, if a Hong Kong resident enterprise is considered a non-PRC resident enterprise and holds at least 25% of the equity interests in the PRC enterprise distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong resident enterprise is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividends may remain subject to withholding tax at a rate of 10%. The PRC State Administration of Taxation issued a *Notice on How to Understand and Determine the Beneficial Owners in Tax Agreement* (or "Circular 601"), which provides guidance on determining whether an enterprise is a "beneficial owner" under China's tax treaties and tax arrangements. Circular 601 provides that, in order to be a beneficial owner, an entity generally must be engaged in substantive business activities. It also sets forth a list of factors, the existence of which generally does not provide support that the treaty resident is a beneficial owner. An agent or conduit company, which refers to a company that is set up for the purpose of avoiding or reducing taxes or transferring or accumulating profits, will not be regarded as a beneficial owner and, therefore, will not qualify for treaty benefits such as preferential dividend withholding tax rates. If our Hong Kong subsidiary is, in the light of Circular 601, considered to be a non-beneficial owner for purpose of the China-HK Tax Arrangement, any dividends paid to it by any of our PRC subsidiaries would not qualify for the preferential dividend withholding tax rate of 5%, but rather would be subject to the usual rate of 10%.

**We may be deemed a PRC resident enterprise under the CIT Law and be subject to PRC taxation on our worldwide income.**

The New CIT Law provides that enterprises established outside of China whose "de facto management bodies" are located within China are considered "resident enterprises" and are generally subject to the uniform 25% enterprise income tax rate on their worldwide income (including dividend income received from subsidiaries). Under the *Implementing Regulations for the Corporate Income Tax Law*, "de facto management body" is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and

treasury, and acquisition and disposition of properties and other assets of an enterprise. Although substantially all of our operational management is currently based in the PRC, it is unclear whether PRC tax authorities would require (or permit) us to be treated as a PRC-resident enterprise. If we were treated as a resident enterprise for PRC tax purposes, we will be subject to PRC tax on our worldwide income at the 25% uniform tax rate, which could have an impact on our effective tax rate and an adverse effect on our net income and the results of operations, although dividends distributed from our PRC subsidiaries to us could be exempted from Chinese dividend withholding tax, since such income is exempted under the New CIT Law for PRC-resident recipients.

### **There Are Substantial Risks Related to Our Common Stock and Management's Percentage of Ownership of Our Common Stock**

#### **Trading in our Common Stock was halted by NYSE MKT on November 21, 2013 and there can be no assurance when or if such trading will resume, and if it resumes, whether our Common Stock will be a "Penny Stock" under SEC Regulations**

We were notified on November 21, 2013 that the NYSE MKT had instituted a trading halt in our common stock, pending receipt of further information, as a result of allegations contained in various short-seller publications issued in November 2013. We subsequently received an information request from NYSE MKT and on April 28, 2014 received a notice from NYSE MKT that the staff of the NYSE MKT intends to strike our common stock from listing. We have appealed the staff's determination in this regard to the Exchange Listing Qualifications Panel and a hearing to review the staff's decision has been scheduled for July 16, 2014. There can be no assurance that the Exchange Listing Qualifications Panel will overturn the staff's determination or that NYSE MKT will permit resumption of trading of our common stock. You should be aware that our common stock may not resume trading until it is "released" to the Pink Sheets in the Over-the-Counter market following delisting from the NYSE MKT.

If our common stock were removed from listing with the NYSE MKT, we may be subject to the so-called "penny stock" rules. The SEC has adopted regulations that define a "penny stock" to be any equity security that has a market price per share of less than US\$5.00, subject to certain exceptions, such as any securities listed on a national securities exchange. For any transaction involving a "penny stock," unless exempt, the rules impose additional sales practice requirements on broker-dealers, subject to certain exceptions. If our common stock were delisted and determined to be a "penny stock," a broker-dealer may find it more difficult to trade our common stock and an investor may find it more difficult to acquire or dispose of our common stocks on the secondary market. Investors in penny stocks should be prepared for the possibility that they may lose their whole investment.

#### **Techniques employed by manipulative short sellers in Chinese small cap stocks may drive down the market price of our common stock.**

Short selling is the practice of selling securities that the seller does not own but rather has, supposedly, borrowed from a third party with the intention of buying identical securities back at a later date to return to the lender. The short seller hopes to profit from a decline in the value of the securities between the sale of the borrowed securities and the purchase of the replacement shares, as the short seller expects to pay less in that purchase than it received in the sale. As it is therefore in the short seller's best interests for the price of the stock to decline, many short sellers (sometime known as "disclosed shorts") publish, or arrange for the publication of, negative opinions regarding the relevant issuer and its business prospects in order to create negative market momentum and generate profits for themselves after selling a stock short. While traditionally these disclosed shorts were limited in their ability to access mainstream business media or to otherwise create negative market rumors, the rise of the Internet and technological advancements regarding document creation, videotaping and publication by weblog ("blogging") have allowed many disclosed shorts to publicly attack a company's credibility, strategy and veracity by means of so-called research reports that mimic the type of investment analysis performed by large Wall Street firm and independent research analysts. These short attacks have, in the past, led to selling of shares in the market, on occasion in large scale and broad base. Issuers with business operations based in China and who have limited trading volumes and are susceptible to higher volatility levels than U.S. domestic large-cap stock, and can be particularly vulnerable to such short attacks.

These short seller publications are not regulated by any governmental, self-regulatory organization or other official authority in the U.S., are not subject to the certification requirements imposed by the Securities and Exchange Commission in Regulation AC (Regulation Analyst Certification) and, accordingly, the opinions they express may be based on distortions of



actual facts or, in some cases, fabrications of facts. In light of limited risks involved in publishing such information, and the enormous profit that can be made from running just one successful short attack, unless the short sellers become subject to significant penalties, it is more likely than not that disclosed shorts will continue to issue such reports.

While we intend to strongly defend our public filings against any such short seller attacks, often times we are constrained, either by principles of freedom of speech, applicable state law (often called “Anti-SLAPP statutes”), or issues of commercial confidentiality, in the manner in which we can proceed against the relevant short seller. You should be aware that in light of the relative freedom to operate that such persons enjoy - oftentimes blogging from outside the U.S. with little or no assets or identity requirements - should we be targeted for such an attack, our stock will likely suffer from a temporary, or possibly long term, decline in market price should the rumors created not be dismissed by market participants.

In November and December of 2013, there were reports published by the Seeking Alpha website, analysts, and other web-based publishers that contained misleading statements about us. Although we have responded to certain of the allegations contained in these reports in a press releases dated December 10, 2013, there are predictions that there will continue to be more short seller attacks against Chinese companies. On March 5, 2014, the Company announced that Loeb and Loeb, LLP (“Loeb”) had been engaged by the Board of Directors to investigate allegations regarding the Company raised in previously published reports and that Loeb had engaged FTI Consulting Inc. and FTI Investigations LLC (collectively “FTI”) to provide independent investigation support. As of date of the filing of this report, the investigation conducted by Loeb and FTI is still underway. The Company believes these allegations are without merit and has vowed full cooperation with the investigation.

**We may suffer significant loss of operating capital related to the class action lawsuit and our management, financial condition and results of operations could be seriously harmed.**

In November and December 2013, three putative class action lawsuits were filed in the federal court for the Southern District of New York against FAB Universal Corp., its CEO and its CFO. The actions are: *Simmons v. Spencer et al.* (1:13-cv-08216-RWS, filed 11/18/13), *Stubblefield v. Fab Universal Corp. et al.* (1:13-cv-08499-RWS, filed 11/27/13), and *Cox v. Fab Universal Corp. et al.* (1:13-cv-08716-RWS, filed 12/09/13). According to the complaints, defendants made false and/or misleading statements and failed to disclose material adverse facts about FAB’s business, operations, prospects and performance. Plaintiffs allege that defendants overstated the number of kiosks that FAB had deployed. FAB’s kiosks are “inundated with pirated digital entertainment content,” and the company’s Chinese subsidiary issued RMB 100 million (\$16.4 million) worth of bonds to Chinese investors that are not reflected in the Company’s publicly disclosed financial statements. Based on the foregoing, plaintiffs assert causes of action for violation of Sections 10(b) and 20(a) of the securities Exchange Act of 1934. Plaintiffs seek unspecified compensatory damages, recessionary damages, fees and costs.

In February 2014, two derivative actions were filed in the federal court for the Southern District of New York against its CEO, CFO and board of directors. The suits are *Thorbjonsen v. Spencer et al.* (1:14-cv-00687-UA, filed 02/03/14) and *Rowekamp v. Spencer et al.* (1:14-cv-01114-RWS, filed 02/21/14). Plaintiffs in the derivative action claim, on behalf of FAB Universal that Defendants breached their fiduciary duties of loyalty, due care, good faith, independence, candor and full disclosure to shareholders; misappropriated material, non-public information of FAB Universal, and violated of Section 14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 promulgated there under.

**Due to the instability in our common stock price, you may not be able to sell your shares at a profit.**

Prior to the imposition of a trading halt by the NYSE MKT, the public market for our common stock was limited and volatile. As with the market for many other companies in new and emerging industries, any market price for our shares is likely to continue to be very volatile. In addition, the other risk factors disclosed in this Form 10-K may significantly affect our stock price. The historical volatility of our stock price may make it more difficult for you to resell shares when you want at prices you find attractive.

In addition, the stock market in general and the market for Internet and technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of these companies. These broad market and industry factors may reduce our stock price, regardless of our operating performance.

**DEI designees may acquire a controlling interest in the Company.**

If DEI meets the Corporate Governance Objectives as defined in the Share Exchange Agreement by which the Company acquired DEI, and the DEI designees convert all the Preferred Stock into shares of our common stock, they will own 78% of our total issued and outstanding common shares. If these events occur, this means that the DEI designees will have the right to make key decisions regarding the Company's future.

**The resale of our common stock by DEI's former stockholders may negatively affect the market price of such stock.**

Both the Initial Shares issued to the DEI stockholders under the terms of the Share Exchange Agreement and the shares of common stock to be issued upon conversion of the Preferred Stock will be "unregistered" and "restricted" securities within the meaning of Rule 144 of the SEC. In addition, certain of the shares to be issued under the Agreement will have "piggyback" registration rights that will permit the registration for resale of such shares. Upon the effectiveness of any registration statement relating thereto and/or the expiration of the six-month holding period mandated by Rule 144 (and, with respect to the Lock-up Shares as defined in the Share Exchange Agreement, the expiration of the lock-up period applicable thereto), these shares may be sold into any market that then exists for our shares of common stock. Such sales may have a significant depressive effect upon the price thereof.

**We may suffer currency exchange losses if the RMB depreciates relative to the U.S. Dollar.**

Revenue generated and expenses incurred by international subsidiaries and equity method investees are often denominated in the currencies of the local countries. As a result, consolidated U.S. dollar financial statements are subject to fluctuations due to changes in exchange rates as the financial results of international subsidiaries and equity method investees are translated from local currencies into U.S. dollars.

Our reporting currency is the U.S. Dollar. However, substantially all of our revenues are denominated in RMB. China reformed its exchange rate regime by establishing a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The RMB is no longer pegged to the U.S. dollar and the exchange rate will have some flexibility. Hence, considering the floating exchange rate regime, if the RMB depreciates relative to the U.S. Dollar, our revenues as expressed in our U.S. Dollar financial statements will decline in value. The PBOC announced a policy to expand the maximum daily floating range of RMB trading prices against the U.S. dollar in the inter-bank spot foreign exchange market from 0.3% to 0.5%. While the international reactions to the RMB revaluation and widening of the RMB's daily trading band have generally been positive, with the increased floating range of the RMB's value against foreign currencies, the RMB may appreciate or depreciate significantly in value against the U.S. dollar or other foreign currencies in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued. On June 19, 2010, the PBOC announced that it has decided to proceed further with the reform of the RMB exchange rate regime to enhance the flexibility of the RMB exchange rate and that emphasis would be placed on reflecting market supply and demand with reference to a basket of currencies. While so indicating its intention to make the RMB's exchange rate more flexible, the PBOC ruled out any sharp fluctuations in the currency or a one-off adjustment. In addition, there are very limited hedging transactions available in China to reduce our exposure to exchange rate fluctuations. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure, if at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into U.S. Dollars.

**Item 1B. Unresolved Staff Comments.**

Not applicable to smaller reporting companies.

**Item 2. Properties.**

FAB's corporate offices are located at 5001 Baum Blvd., Suite 770, Pittsburgh, PA 15213. They consist of approximately 3,100 square feet of space, which is rented for \$4,589 per month. The lease is currently on a month to month basis. FAB continues to maintain a sound business relationship with the landlord. Even though each party may exit the lease with a 30 day written notice, Management does not foresee a significant risk, as the Company has been leasing the office space for the past three years on a month to month basis. We also maintain two offices in Beijing, China. One is located at No. 22 Shijingshan Road, Shijingshan District, and the other is located at No. 51 Xirongxian Alley, Xicheng District. The telephone number is 86-10-68635287. We lease a 30,000 sq. ft. retail store in the Joy City shopping mall for an average

monthly amount of approximately \$50,414 through March 2016, and a 20,000 square foot entertainment superstore in SoShow shopping district for \$48,476 per month through May 2017.

### **Item 3. Legal Proceedings.**

FAB is involved in routine legal and administrative proceedings and claims of various types. We have no material pending legal or administrative proceedings, other than as discussed below or ordinary routine litigation incidental to our business, to which we or any of our subsidiaries are a party or of which any property is the subject. While any proceeding or claim contains an element of uncertainty, management does not expect that any such proceeding or claim will have a material adverse effect on our results of operations or financial position.

In November and December 2013, three putative class action lawsuits were filed in the federal court for the Southern District of New York against FAB Universal Corp., its CEO and its CFO. The actions are: *Simmons v. Spencer et al.* (1:13-cv-08216-RWS, filed 11/18/13), *Stubblefield v. Fab Universal Corp. et al.* (1:13-cv-08499-RWS, filed 11/27/13), and *Cox v. Fab Universal Corp. et al.* (1:13-cv-08716-RWS, filed 12/09/13). According to the complaints, defendants made false and/or misleading statements and failed to disclose material adverse facts about FAB's business, operations, prospects and performance. Plaintiffs allege that defendants overstated the number of kiosks that FAB had deployed. FAB's kiosks are "inundated with pirated digital entertainment content," and the company's Chinese subsidiary issued RMB 100 million (\$16.4 million) worth of bonds to Chinese investors that are not reflected in the Company's publicly disclosed financial statements. Based on the foregoing, plaintiffs assert causes of action for violation of Sections 10(b) and 20(a) of the securities Exchange Act of 1934. Plaintiffs seek unspecified compensatory damages, recessionary damages, fees and costs.

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We believe this complaint is without merit and plan to defend ourselves vigorously. Failure by us to obtain a favorable resolution of the claims set forth in the complaint could have a material adverse effect on our business, results of operations and financial condition. Currently, the amount of such material adverse effect cannot be reasonably estimated, and no provision or liability has been recorded for these claims as of December 31, 2013. The costs associated with defending and resolving the complaint and ultimate outcome cannot be predicted. These matters are subject to inherent uncertainties and the actual cost, as well as the distraction from the conduct of our business, will depend upon many unknown factors and management's view of these may change in the future.

In 2009, West Chang'an Avenue Development Co., Ltd ("landlord") filed a lawsuit against FAB Media for unpaid rent and other payments due the landlord. The court ruled in favor of the plaintiff, and with this ruling the two parties reached a settlement, which included the implementation of the Lease Agreement commencing January 1, 2010. The ruling was that FAB pay rent in arrears, penalty and property fees totaling RMB 2 million (\$0.32million USD). The landlord then filed a claim against the Company for rent in arrears.

The Company appealed the decision, and the result was the court overturned the decision and remanded the case. However, after a retrial, the court ruled in favor of the plaintiff, and the company had to vacate the leased space, pay off the rent, property fees and penalty, totaling about RMB 5.9 million (\$0.95 million USD).

The case went through second trial, and the retrial procedure did not change the verdict. Payment plus interest on the debt of period, the amount payable rose to RMB 7 million (\$1.1 million USD). On May 23, 2014, the court ruled in favor of the plaintiff and the judgment for rent in arrears and penalty is RMB \$7.5 million (\$1.2million USD). The judgment has been in force, and has entered into the implementation procedure. The Company has to fulfill the payment in an amount of approximately RMB \$7.5 million (\$1.2million USD).

### **Item 4. Mine Safety Disclosures**

Not applicable

## PART II

### Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

As of June 26, 2014, [20,805,860] shares of our common stock were outstanding and the last reported sales price for our common stock on the NYSE MKT on November 21, 2013 was \$3.07 per share. We were notified on November 21, 2013 that the NYSE MKT had instituted a trading halt in our common stock, pending receipt of further information, as a result of allegations contained in various short-seller publications issued in November 2013. We subsequently received an information request from NYSE MKT and on April 28, 2014 received a notice from NYSE MKT that the staff of the NYSE MKT intends to strike our common stock from listing. We have appealed the staff’s determination in this regard to the Exchange Listing Qualifications Panel and a hearing to review the staff’s decision has been scheduled for July 16, 2014.

We have approximately 7,000 stockholders. This figure includes an indeterminate number of stockholders who hold their shares in “street name”.

Our common stock began trading on the NYSE MKT under the symbol “FU” on October 9, 2012. Prior to that, our common stock was traded on the NYSE MKT under the symbol “WZE”.

The quarterly high and low sales prices for our shares of common stock for the last two years are as follows:

	<u>Low</u>	<u>High</u>
<u>Fiscal Year 2013</u>		
Fourth quarter (through Nov. 21)	\$ 3.05	\$ 7.83
Third quarter	\$ 3.25	\$ 11.48
Second quarter	\$ 3.12	\$ 4.65
First quarter	\$ 2.98	\$ 4.39
<u>Fiscal Year 2012</u>		
Fourth quarter	\$ 2.31	\$ 5.30
Third quarter	\$ 1.90	\$ 5.70
Second quarter	\$ 1.91	\$ 3.45
First quarter	\$ 1.32	\$ 3.00

We have not declared any cash dividends on our common stock, and do not intend to declare dividends in the foreseeable future. Management intends to use all available funds for the development of our plan of operation. There are no material restrictions limiting, or that are likely to limit, our ability to pay dividends on our common stock.

#### Equity Compensation Plan Information

The following information is provided as of December 31, 2013:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights <u>(a)</u>	Weighted average exercise price of outstanding options, warrants and rights <u>(b)</u>	Number of securities remaining available for future issuance under equity compensation plans excluding securities reflected in column (a) <u>(c)</u>
Equity compensation plans approved by stockholders	-	-	4,788,967
Equity compensation plans not approved by stockholders	-	-	-

Total	-	-	4,788,967
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Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities.

We have not issued any restricted shares of common stock during the calendar years ended December 31, 2013 and 2012, that have not already been disclosed in our Quarterly Reports on Form 10-Q, Form 10-Q/A1 and/or Current Reports on Form 8-K.

During the quarterly period ended December 31, 2013, we did not receive any proceeds from the exercise of warrants for which the underlying shares were registered with the Securities and Exchange Commission.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers.

Not applicable.

**Item 6. Selected Financial Data**

The following selected financial data are derived from our consolidated financial statements. You should review this information in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7 of this report and the historical financial statements and related notes this report contains.

<b>(in thousands, except per share data)</b>	<b>Year ended December 31,</b>				
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>OPERATING DATA:</b>					
Total revenue	\$ 110,873	\$ 27,459	\$ 3,114	\$ 5,540	\$ 5,194
Net income (loss) from continuing operations	20,653	(4,183)	(9,488)	(4,110)	(6,509)
Net income (loss) available to common stockholders	20,653	(4,004)	(9,980)	(4,110)	(6,509)
Basic and diluted net income (loss) per common share	0.99	(0.34)	(1.31)	(0.76)	(1.56)

<b>(in thousands)</b>	<b>As of December 31,</b>				
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>BALANCE SHEET DATA:</b>					
Working capital	\$ 76,091	\$ 11,284	\$ 1,063	\$ (1,335)	\$ (1,255)
Net property, plant and equipment	16,574	16,721	32	79	129
Intangible assets & goodwill	85,996	88,529	11,484	20,460	20,538
Total assets	240,833	167,795	14,783	21,355	22,005
<b>Long-term liabilities:</b>					
Long-term debt	16,518	39	0	0	0
Other	27,677	10,398	0	0	0
Total long-term liabilities	44,195	10,437	0	0	0
Total stockholders’ equity	159,787	133,930	13,776	19,208	19,416

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion and analysis should be read in conjunction with the information set forth under the caption entitled “Item 6. Selected Financial Data” and the consolidated financial statements and related notes included in this Form 10-K.

**Safe Harbor Statement.**

Statements made in this Form 10-K which are not purely historical are forward-looking statements with respect to the goals, plan objectives, intentions, expectations, financial condition, results of operations, future performance and business of FAB, including, without limitation, (i) our ability to gain a larger share of the distribution of Chinese copyright protected media content and podcast hosting and distribution industries, our ability to continue to develop products acceptable to that

industry, our ability to retain our business relationships, and our ability to raise capital and the growth of the FAB brand, and (ii) statements preceded by, followed by or that include the words "may", "would", "could", "should", "expects", "projects", "anticipates", "believes", "estimates", "plans", "intends", "targets" or similar expressions.

Forward-looking statements involve inherent risks and uncertainties, and important factors (many of which are beyond FAB's control) that could cause actual results to differ materially from those set forth in the forward-looking statements, including the following, in addition to those contained in our reports on file with the SEC: general economic or industry conditions, nationally and/or in the communities in which FAB conducts business, changes in the interest rate environment, legislation or regulatory requirements, conditions of the securities markets, changes in the industries in which we operate, the development of products that may be superior to the products offered by FAB, demand for financial services, competition, changes in the quality or composition of FAB's products, our ability to develop new products, our ability to raise capital, changes in accounting principles, policies or guidelines, financial or political instability, acts of war or terrorism, other economic, competitive, governmental, regulatory and technical factors affecting FAB's operations, products, services and prices.

Accordingly, results actually achieved may differ materially from expected results in these statements. Forward-looking statements speak only as of the date they are made. FAB does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of such statements.

## **Company Overview**

Below is an update of our entire business, from our wholly-owned subsidiary, Digital Entertainment International Ltd. ("DEI") to our media business of podcast services, apps and premium subscriptions. We believe our business of selling and distributing copyright protected media and content in China from digital platforms will grow and generate profits due to the brand recognition of FAB in China as well as the continued support of the government for copyright protection in China. We believe our Media business will also continue to grow and generate profits due to the size of our podcast operations, our market leadership position, our presence in iTunes and the monetization of the content we distribute through our publishing platform, advertising, sale of Apps and paid subscriptions for content. The network growth of our media operation has occurred faster than initially expected, and it is management's opinion that we are seeing the flow of quality content coming to the Internet increase and audiences showing increased interest in the medium. FAB Universal believes that our network and relevance in our industry will continue to grow and that we are positioned to be one of the leading companies in the podcast monetization business. Our business is broken into three segments: Retail, Wholesale and Digital (FAB Licensing/Podcasting/ Subscription TV). In September 2013, FAB entered into an agreement with Future TV Co. Ltd. to distribute its copyright protected media content through pay TV terminals used in the home by Future TV's subscribers.

### **Retail**

FAB has conducted the retail business through its flagship stores since 2003. We currently operate a 30,000 sq. ft. store in the prestigious Joy City shopping mall and an entertainment superstore in SoShow. Each store has over 20,000 square feet in size and carries the largest selection of copyright protected audio and video products in China, including CDs, VCDs, DVDs, blu-rays, books, magazines and portable electronic devices. The flagship stores are recognized by many Chinese consumers as the right place to buy copyright protected products.

The 20,000 square foot entertainment superstore is located in the Beijing shopping district of SoShow. The store is designed to satisfy the tastes of a swiftly emerging middle class with maturing entertainment expectations. FAB's SoShow store provides Beijing shoppers with its first audio-video "hypermarket." As a preferred venue for product announcements, publishing parties, studio releases, author readings, movie showings, live promotional performances and concerts, FAB's SoShow outlet is one of China's first ultra-modern entertainment destination for music lovers, film buffs, game enthusiasts, and early electronic adopters.

The SoShow flagship store offers many new electronic digital products and mobile storage devices while serving as a center for the 5C download supermarket of traditional copyright protected audio-video products. Consumers can download movies, songs, games, e-books and applications to mobile storage devices through the intelligent 5C Kiosk. Additionally, the

5C download supermarket also offers coupon printing, self-service payments, membership points checking, map searching and other consumer functions.

The Joy City Flagship store, located in the core area in Xidan, Beijing, has superior geographic advantages. In the fourth quarter of 2013 the Joy City store was remodeled, and reopened in the middle of December, 2013. After the remodeling, FAB has increased various kinds of digital facilities, such as electric display screens, enhancing functions of social networks and digitalizing promotional tools.

As the Company gradually transitions the stores to dedicate a larger portion of each store to digital services, as well as a move to selling higher margin products, we anticipate a decrease in revenue within our stores. This store transformation away from selling mostly traditional audio and video products to individualized items such as covers for mobile devices, and electronics combined with digital experience is anticipated to be a temporary reduction in revenue. Also, our plans are to open a third store during the third quarter of 2014 in Beijing.

### **Wholesale**

FAB wholesale distribution provides audio-video products such as compact discs, video compact discs and digital video discs as well as books and magazines to audio-video products retailers. FAB distributes these media products to over 80 customers including Sohu, Dangdang and Century Outstanding Information Technology Company, a subsidiary of Amazon.com. FAB's wholesale business caters to three types of customers: large retail stores, FAB license stores and small wholesale/resellers. Customers place orders by telephone, through the internet or in-person and fulfillment is handled by FAB's vehicle fleet or through direct warehouse access.

The ecommerce business is growing much faster than originally anticipate in China. With this change, many of our retailers are going to transition their retail stores similar to the changes we have made with our retail stores. With our customers move away from the traditional hard goods of audio and video, the outlook for 2014 would be that revenue generated by our Wholesale business will experience a decrease throughout 2014.

### **Digital**

#### Licensing and Media

The twin components of our strategy are to increase our portfolio of content and expand the number of distribution channels. During 2013, we signed seven copyright licensing agreements with several well-known distributors for additional content. Many of these distributors have long-term cooperation agreements with over 80 independent film producers in the United States. The terms of these agreements range from one to ten years and some are revenue sharing based agreements. This content is expected to be distributed across multiple distribution channels, primarily through digital platforms, thereby leveraging our cost of acquisition.

Through these agreements, we obtained the right to distribute an additional 500 songs, 800 hours of TV series, 100 hours of documentaries and over 1,500 movies, of which over 70% were produced in countries outside of China including Million Dollar Baby, Crouching Tiger Hidden Dragon, Roman Holiday and other popular Oscar, Cannes and Golden Globe winners and nominees. In addition we signed a copyright licensing agreement with the Universal Audio Publishing House to purchase this Chinese company's highly regarded unique music teaching courses. These music teaching courses are very popular in China and are divided into 71 sets with more than 1,000 curricula delivered by well-known teachers from China's Central Conservatory of Music. We also signed an agreement to distribute over 300 hours of South Korean variety shows with the Seoul Broadcasting System.

With our established media, new distribution opportunities and entertainment distribution platform and the power of the FAB brand we believe that we have the fundamentals in place to continue to drive growth as we increase our content offerings across an expanding number of distributions channels. In order to distribute content over mobile phones and the internet, the Chinese Government requires an internet publishing license which is granted by the General Administration of Press and Publication, the National Agency of Radio, Film and Television. FAB was granted a license by China's Ministry of Commerce to license its business model.

FAB has grown its business through its licensing and regional agent programs and has sold 17,944 brand licenses, which allows the licensees to use FAB's brand on the kiosks.

FAB generates revenues from the sale of FAB Brand licenses, as well as advertising, and FAB membership card sales.

FAB, to date, has sold 40 Regional Agent licenses. The Regional Agent pays an upfront fee of RMB 1,200,000, and a deposit of RMB 100,000. The license fee is non-refundable after 7 days and the contract period is five years. The Regional Agent is responsible for selling the individual licenses in each of their locations and for the development of the business with each licensee.

For each kiosk licensed outside of Beijing, the Licensee pays an upfront RMB 30,000 license fee upon signing the contract. The license fee is non-refundable after three days. The total contract period is five years. FAB pays 20% of each single license fee received (20% of RMB 30,000 = RMB 6,000) to the Regional Agent. The Licensee looks to the Regional Agent for assistance with acquisition of the kiosk, maintenance and operation of the kiosk, and development of the business.

FAB obtained an Internet Publishing License by China's General Administration of Press and Publication, the national agency of radio, film and television. This license grants FAB Universal the right to distribute both its exclusive and acquired copyright protected audio and video digital content over the Internet and mobile phone networks.

#### FAB Membership – Beijing Only

In order to retain customers and increase cross-sales, FAB launched its client retention program, the FAB membership program, in 2008. This program entitles customers to download digital content from FAB. The membership provides bonus points for member's purchasing products in any of the flagship stores. The bonus points can be exchanged for non-cash gifts.

#### **Cross-Platform Video Operation**

The use of digital consumption channels for media in China is growing more rapidly than anticipated. With this change we will transition our business more quickly than previously thought to provide digital content for consumption across multiple channels. This transition will take place starting in 2014.

The Cross-Platform Video Operation business will generate revenue from the distribution of FAB copyright-protected content across various digital platforms. These platforms include digital TV, IPTV, Smart TV, OTT, mobile and the Internet. Initial targets for partners for these platforms will be those with large, existing consumer bases.

#### **Content**

FAB has purchased the licenses or has the rights to distribute and broadcast movies, TV shows, and educational programming. FAB will continue to acquire the rights to this type content in 2014.

The distribution of this content will be through the various channels described below and will target large consumer bases through partnerships. During 2014, FAB will pursue agreements with various channels for user paid subscriptions of the purchased content. We will acquire content for which we have the exclusive rights as well as sub-licensing rights for distribution. FAB will also acquire content for which we will have non-exclusive rights for distribution. Some of the agreements for non-exclusive content allow FAB to sub-license the content and others will not.

#### **Digital and Internet TV**

##### **One-time view TV Services:**

Fees will be generated through paid one-time access to individual content through Pay Per view (PPV) where a viewer must access the programming at a specific broadcast time and True Video on Demand (TVOD) where the programming is available any time. PPV and TVOD fees range from RMB 3 to 9 and FAB would receive a 50% split.

##### **Subscription TV Services**



Content is also offered on a monthly subscription basis for both Paid Channels of content (PTV) and Subscription Video on Demand (SVOD). Fees for these subscriptions range from RMB 10 to 25 and FAB would receive a 50 % split.

While these fees are not significant per charge, there is a very large consumer base in China, and we will target channel providers with a large number of consumers, such as Tongzhou Electronics TV Terminals and as we have with Future TV.

In September 2013, FAB entered into an agreement with Future TV Co. Ltd. to distribute its copyright-protected media content through pay TV terminals used in the home by Future TV's subscribers, and the trial operation kicked off in November 2013. The agreement with Future TV is a significant milestone for FAB, marking the launch of our subscription TV business and further extending our multi-channel distribution plans. Our goal is to have our Subscription TV network reach the majority of the households in China in five to ten years. This can be accomplished with our technical and management team, through the integration of digital TV (via cable network operators), IPTV and OTT (via telecom operators, and content aggregation licensing providers).

### Mobile Phones and Tablets

With the increasing trend towards mobile device use and growing consumer base, FAB will also partner with China's top mobile companies to distribute video. FAB copyright-protected content will be distributed to mobile users via mobile phones and tablets. This market segment is large and will continue to grow. For example, China Mobile Video Innovation base reaches an average of 130 million monthly users. Revenues from partnerships with mobile carriers will be based on revenue share for paid content and will be in the range of a 50/50 revenue share.

### Internet

Content will be offered for free via the Internet on destination web sites. The web sites are ad-supported through display advertisements on the site as well as advertising inserted within in the videos themselves. The Advertising revenue split is normally 50/50.

FAB will partner with Baidu a leading destination web site for video. Baidu is the largest Chinese search engine with their video web site having accounted for over 75% of the entire network traffic distribution in China. The APP activated users has accumulate to approximately 100 million, with 20 million daily active users. Baidu also offers paid content packaging through user subscriptions for premium packaged content where FAB content can be included for a revenue share.

### Libsyn

Libsyn is the subsidiary for our digital media and entertainment business. Libsyn is currently the industry's largest network of independent and professional digital media publishers utilizing RSS (podcasting) as a distribution method for episodic, audio and video shows. The Libsyn Network received over 1.6 billion download requests for shows in 2012 and 1.9 billion in 2013 to approximately 34 million monthly audience members in the fourth quarter of 2013. Libsyn's publishing platform hosted 16,241 shows in 2013. Management believes that Libsyn offers the best podcast publishing platform in the industry and is one of only a few podcast publishing platforms that are able to charge publishers for use of the service. The majority of podcast publishing platforms offer their service for free, in hopes of making money exclusively from advertising sales. Management believes that our ability to charge for the services we provide is a testament to the quality of service. The total number of episodes on the network totaled 1,688,057 in 2013, all of which are available for immediate distribution. With the continuing success of iPods, iPhones, iPads, Android's mobile phones, Blackberry's smartphones, we expect the number of content publishers using our service and the number of consumers watching the shows to continue to grow rapidly on an annual basis. LibsynPRO Enterprise service had 124 network publishers in 2013. As Libsyn derives a portion of its revenues through data transfer from PRO customers, our feature rich version of the PRO publishing platform provides management with the tools to grow the number of PRO publishers and thereby revenues associated with our data transfer business. For 2013, revenue from data transfer totaled \$480,723.

### LIBSYN – PUBLISHING SERVICES

Hosting, Distribution Network, Content, Platform Development

In 2013 the Libsyn Network received approximately 1.9 billion download requests for podcast episodes vs. 1.6 billion download requests in 2012, from a wide variety of distribution outlets to which Libsyn syndicates content. The Libsyn network received over 5.3 million requests for shows per day throughout 2013. Our network reaches over 34 million people around the world, creating what management believes is a strong media asset and a very compelling platform for advertisers as well as smartphone App sales. Download requests are calculated by counting the number of shows requested for download by audience members. Libsyn works to generate profits by inserting advertisements in the shows in partnership with the show's publishers, charging for the use of our publishing platform and through the sale of Apps. As the online digital media industry is in the emerging stages, the majority of these shows are distributed without advertising and the total download requests listed above are provided to give an understanding of the potential size of advertising inventory available for Libsyn's third party advertising partners and its in-house advertising sales team to fill.

Currently, Libsyn distributes digital shows for our producers to a variety of web portals and content aggregators, for both download and streaming. Approximately 70% of the shows Libsyn distribute reach audiences using Apple's iTunes platform which includes iTunes on the computer, iPods, iPads, iPhones and Apple TV. It is management's opinion that the Libsyn Network's substantial presence in the iTunes Podcast Store is one of the Company's valuable assets as consumers using iTunes are early adopters and spend money regularly on digital media. We believe this provides FAB with a unique offering for advertisers seeking that type of consumer and provides FAB with monetization opportunities for its podcast publishers through the sale of individual and network wide Apps.

Early in 2013, we debuted the next-generation Libsyn platform (Libsyn 4). In the fourth quarter of 2013, the most significant aspects of the system were developed for Libsyn 4, including content management, publishing, and statistics.

Previously existing content management components were redesigned to improve usability on tablets, and a file manager was introduced to allow producers to view all files associated with their shows in a single location.

The publishing workflow was streamlined and redesigned for an improved overall user experience. The previous publishing system was divided into two modes: basic and advanced. With Libsyn 4, the publishing workflow provides a single interface that collapses advanced features that producers may expand if needed. This design choice should decrease user confusion and thus the need for technical support.

New advanced statistics for Libsyn 4 were introduced in the fourth quarter of 2013, allowing producers to observe trends in geographic regions. This geographic trend analysis is particularly useful to producers who schedule events (e.g. comedians), and these trends may prove useful in the future for localized advertising.

The Libsyn platform allows producers to automatically publish to many social media platforms (referred to as "OnPublish") including Facebook and Twitter. With the Libsyn 4 release, the usefulness of OnPublish was improved.

First, social media services issue temporary authorizations for Libsyn producers to send them content. These authorizations must be renewed by the user from time to time. A dashboard widget was added to Libsyn 4 to show the status of these authorizations so they can be quickly renewed. Additionally, the functionality of the Libsyn 4's technology stats now shows the numbers of Facebook likes and Twitter re-tweets that come as a result of content released through OnPublish.

In the fourth quarter of 2013, Libsyn also introduced a new app to both the Windows Store and Windows Phone Store markets called "The Podcast Source." This app serves as a place for people to subscribe to and consume podcasts. The Podcast Source enables audiences to enjoy podcasts from not only Libsyn, but from any podcast that has an RSS feed. The app also supports MyLibsyn premium content, thus making the premium offering more visible to all subscribers of premium shows.

### LIBSYN - APPS

Apps are small software applications that users can purchase and download to their mobile devices with relative ease. App categories include video games, sports, productivity, entertainment, education and health & fitness. Some of these Apps are free, while others have to be purchased. These Apps range in price from \$.99 to \$100.00, with the average price under \$4.99.

### Sale of Podcast Apps

Libsyn created Apps that work on the iPhone and Android platforms and are currently for sale in the iTunes App Store, Verizon Store, Windows Store and the Amazon App Store. Libsyn currently has approximately 4,400 Apps for sale. Podcasters then market their very own App to their show's audience, many of whom use iPhones, iPods and Android phones.

Libsyn also offers Apps as a free monetizational tool to podcasters on the Libsyn Network as long as they have a qualifying monthly account. Currently, there are approximately 16,241 shows on the Libsyn Network and approximately 34 million audience members who consume podcasts. Libsyn submits each App for approval, which is not guaranteed and is based on the respective terms of service and approval process of the App Store, and manages the collecting of the revenue and distribution of the podcaster's share of the revenues. Libsyn expects to retain approximately 35% of the sale price that ranges from \$.99 to \$4.99 in most cases. These Apps are currently being sold around the world via Apple's App Store, the Verizon Store, Windows Store and the Amazon App Store. Throughout 2013, revenue from App and subscription sales totaled \$587,329.

Libsyn developed a "Network App" which allows for hundreds of podcast Apps inside one fully functional App. This is very similar to Amazon's Kindle App that includes tens of thousands of books inside one App. This Network App allows us to: 1) continue our business plan to offer App monetization tools to all producers in a streamlined, efficient process; 2) comply with the continually evolving and sometimes inconsistent App approval standards and their desire not to have 'cookie-cutter' Apps for all podcasts in iTunes in the App Store causing approval delays and rejections; 3) have more control over the actual marketing of the podcast Apps through expanded distribution of the Network App and cross promotional opportunities; 4) focus more time and attention on podcast shows with larger audiences that sell more apps than the smaller podcast shows.

#### Sale of Podcast Subscriptions and Episodes Via Custom Podcast Apps

Once a podcaster has successfully marketed an App to its audience and has created a significant install base, the podcaster offers new content on a subscription basis or release a special episode, in addition to its normal podcast episodes, and charge a nominal fee (\$1 - \$3) for that episode or episodes to its audience. By having a successful, extremely easy to use micropayment platform in iTunes/iPhone/iPod Touch, Android and Amazon, the podcast audiences are willing to pay a nominal fee (\$1.99), from time to time, for special episodes of their favorite podcast and even sign up for inexpensive subscriptions (\$.99 a month; \$8.99 for 12 months) for new content. Libsyn earns a portion of the subscription and episode revenue for administering the App account and delivering the content to the consumer.

#### LIBSYN - ADVERTISING

In 2013, Libsyn executed multiple national brand advertising campaigns for companies including Audible, Hover and Ting. These campaigns run across multiple shows, with different advertisers, resulting in \$948,631 in 2013 advertising revenue.

In order to increase the percentage of filled advertising inventory we must continue to execute on our advertising sales strategy, integrate third party ad networks and portals and create relationships with more advertising agencies and their clients. Management believes that most advertisers prefer to deal with a few companies with large reach rather than many companies with smaller reach as it makes their advertising 'buys' and tracking easier to monitor.

#### **Critical Accounting Policies and Estimates**

**Revenue Recognition** - Revenue is recognized when earned. The Company's revenue recognition policies are in compliance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605, 985 Software — Revenue Recognition and the Securities and Exchange Commission Staff Accounting Bulletin No. 101 and 104.

Product revenue is recognized when title to the product has transferred to customers in accordance with the terms of the sale; the sales price to the customer is fixed or determinable, and collectability is reasonably assured. Revenues are recorded net of applicable sales taxes.

The Company derives revenue from retail sales, sales to retailers, and Digital sales. Revenue from Digital sales includes advertisement revenue, membership card revenue, download revenue and licensing revenue.

Revenue from retail sales is recognized at the point-of-sale. Revenue from sales to retailers is recognized at the point of delivery of the product. Download service revenue is recognized when substantially all material services or conditions relating the sales have been performed or satisfied, and the Company has no obligation to refund any payment (cash or otherwise) received. Revenue generated from Membership sales is non-refundable. Membership card revenue is amortized over the life of the membership period, membership cards with par value of RMB 100 have an expiration period of three months, and par value of RMB 200, 300, 400 and 500 have an expiration period of twelve months. Advertisement revenue is recognized over the contract period. Licensing revenue is amortized ratably over the term of the agreement which is generally five years. Deferred revenue represents unearned revenues related primarily to sales of licenses and FAB Membership cards.

The Company recognizes revenue from providing podcast hosting services when the services are provided and the sale of apps when collection is received. The Company sells packaged and custom software products and related speech recognition product development consulting. Software product revenues are recognized upon shipment of the software product only if no significant Company obligations remain, the fee is fixed or determinable, and collection is received or the resulting receivable is deemed probable. Revenue from package software products is recorded when the payment has been received and the software has been shipped. Revenue is recognized, net of discount and allowances, at the time of product shipment. Revenue from non-recurring programming, engineering fees, consulting service, support arrangements and training programs is recognized when the services are provided.

**Accounts Receivable** – We evaluate the creditworthiness of our customers based on their financial information, if available, as well as information obtained from suppliers and past experiences with customers. Accounts receivable consist of trade receivables arising in the normal course of business. Any allowance established is subject to judgment and estimates made by management. The Company determines the allowance based on known troubled accounts, historical experience, and other currently available evidence. We established an allowance for doubtful accounts of \$14,000 at December 31, 2013 and 2012.

**Goodwill and Other Intangible Assets** - The Company accounts for Goodwill and finite-life intangible assets in accordance with provisions of FASB -ASC Topic 350, Intangibles--Goodwill and Other. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment at least annually in accordance with the provisions of Topic 350. Impairment losses arising from this impairment test, if any, are included in operating expenses in the period of impairment. Topic 350 requires that intangible assets with finite lives be amortized over their respective estimated useful lives, and reviewed for impairment in accordance with Topic 360, criteria for recognition of an impairment of Long-Lived Assets.

**Fair Value of Financial Instruments** - The Company accounts for fair value measurements for financial assets and financial liabilities in accordance with FASB ASC Topic 820. The authoritative guidance, which, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. Fair value is defined as the exit price, representing the amount that would either be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1. Observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Unless otherwise disclosed, the fair value of the Company's financial instruments including cash, accounts receivable, prepaid expenses, accounts payable, accrued expenses, current deferred revenue and notes payable approximates their recorded values due to their short-term maturities. Long-term deposits represent cash and therefore, their carrying value represents fair value. The fair value of the Company's long-term deposits, non-current deferred revenue, long-term bond payable and other liabilities has no material difference with the book values based on the calculated results.

**Stock-based Compensation** - The Company accounts for options in accordance with the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) ASC Topic 718, *Compensation – Stock Compensation*. For the years ended December 31, 2013 and 2012, the Company recorded stock-based employee compensation expense of \$423,796 and \$5,086 for vesting of stock options, respectively, and stock-based compensation expense to employees and consultants of \$329,600 and \$4,159,800, respectively, for options that were issued and immediately exercised. The plans are more fully described in Note 13 of our consolidated financial statements.

Estimating the fair value of options granted requires us to utilize valuation models and to establish several underlying assumptions. The fair value of option grants was estimated using the Black-Scholes option valuation model based on the following weighted average assumptions:

	<u>2013</u>	<u>2012</u>
Dividend yield	0%	0 %
Expected life	11 yrs	0 yrs
Expected volatility	82.76%	0%
Risk-free interest rate	2.17%	0.00%

The risk-free interest rate is the implied yield available for zero-coupon U.S. government issues with a remaining term equal to the expected life of the options.

The expected lives of the options are determined based on the Company’s expectations of individual option holders anticipated behavior and the term of the option.

Volatility is based upon price performance of the Company over an equivalent term of the issued options to determine potential volatility of the issued options.

**Income Taxes** - The Company is subject to the Income Tax Laws of U.S. and the PRC. The Company accounts for income taxes in accordance with ASC 740, “Income Taxes”. ASC 740 requires an asset and liability approach for financial accounting and reporting for income taxes and allows recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain. The components of deferred tax assets are individually classified as current and non-current based on their characteristics.

ASC 740-10-25 prescribes a more-likely-than-not threshold for consolidated financial statement recognition and measurement of a tax position taken (or expected to be taken) in a tax return. It also provides guidance on the recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, years open for tax examination, accounting for income taxes in interim periods and income tax disclosures. (See note 13 – Capital Stock and note 16- Contingencies).

**Recent Accounting Pronouncements** - The Company has adopted all recently issued accounting pronouncements that management believes to be applicable to the Company. The adoption of these accounting pronouncements, including those not yet effective, is not anticipated to have a material effect on the Company’s financial position or results of operations.

#### **Variable Interest Entity (“VIE”)**

FAB, through its wholly owned subsidiary and its VIE, is engaged in marketing and distributing various officially licensed digital entertainment products under the “FAB” brand throughout the PRC, including but not limited to audiovisual products such as Compact Discs, Video Compact Discs and Digital Video Disks as well as books, magazines, mobile phone accessories and cameras. The Company’s products and services are primarily distributed through its flagship stores, licenses, proprietary “FAB” kiosks and online virtual stores. FAB kiosks, located in high-traffic areas of office buildings, shopping malls, retail stores and airports, are self-service terminals that provide a range of entertainment and business applications.

FAB's organizational structure consists of Digital Entertainment International Limited ("DEI"), which is FAB's wholly-owned subsidiary; DEI's wholly owned subsidiary, Beijing Dingtai Guanqun Culture Co., Ltd. ("DGC"), and Beijing FAB Culture Media Co., Ltd. ("FAB Media") which is a variable interest entity ("VIE") of DGC and its wholly owned subsidiary, Beijing FAB Digital Entertainment Products Co., Ltd. ("FAB Digital").

In March 2012, a series of contractual arrangements were entered into between DGC, FAB Media and the individual shareholders of FAB Media. Such arrangements include an Exclusive Service Agreement; an Equity Pledge Agreement; a Call Option Agreement; and a Shareholders' Voting Right Proxy Agreement.

Pursuant to these agreements, DGC has the exclusive right to provide to FAB Media consulting services related to its business operation and management. The terms of these agreements are summarized below:

#### ***Exclusive Service Agreement***

Under the exclusive service agreements among DGC, a Wholly Foreign-Owned Enterprise ("WFOE"), FAB Media, as well as the respective registered shareholders of FAB Media, the registered shareholders of FAB Media have agreed:

- to irrevocably entrust the right of management and operation of FAB Media and the responsibilities and authorities of their shareholders and board of directors to the WFOE in accordance with the terms and conditions of the Exclusive Service Agreement.
- the WFOE, as the entrusted manager, shall provide full management to FAB Media's operations.
- the WFOE possesses its exclusive rights in nominate and approve the directors, chairman, general managers, financial controllers or other senior managers of FAB Media.
- the WFOE, for its provision of services, shall be paid a service fee by FAB Media, which equals 100% of the residual return of FAB Media, and which can be waived by the WFOE from time to time in its sole discretion.

#### ***Call Option Agreement***

DGC entered into call option agreement with FAB Media and its respective registered shareholders, who irrevocably granted to DGC or its designated person exclusive options to purchase, when and to the extent permitted under PRC law, all of the equity interests in FAB Media. The exercise price for the options to purchase all of the equity interests in FAB Media is the minimum amount of consideration permissible under the applicable PRC law. The agreements have an initial term of ten years and are renewable at DGC's sole discretion. These call option agreements provide, among other things, that without DGC's prior written consent:

- the registered shareholders of each VIE may not transfer, encumber, grant a security interest in, or otherwise dispose of in any way any equity interests in their VIE;
- FAB Media may not sell, transfer, mortgage or otherwise dispose of in any way its assets, business or income, nor may it create any security interest therein (other than created in the ordinary course of its business);
- no shareholders resolution should be passed to increase or reduce the registered capital of each VIE or otherwise alter the capital structure of such VIE;
- FAB Media may not declare or pay any dividends to its registered shareholders;
- FAB Media may not merge with any third parties, or purchase or transfer any assets or businesses from or to any third parties;
- FAB Media may not engage in any transactions that may cause substantially adverse effects on its assets, obligations, operations, share capital and other rights;
- FAB Media may not incur any indebtedness, except where transactions were entered into in the ordinary course of business;

#### ***Equity Pledge Agreement***

Under DGC's Equity Pledge Agreement with FAB Media and its respective registered shareholders, the registered shareholders of FAB Media pledged all of their respective equity interests in FAB Media to DGC to secure the performance of

the registered shareholders', FAB Media's obligations under the various VIE agreements, including the Exclusive Service Agreement and other agreements described above.

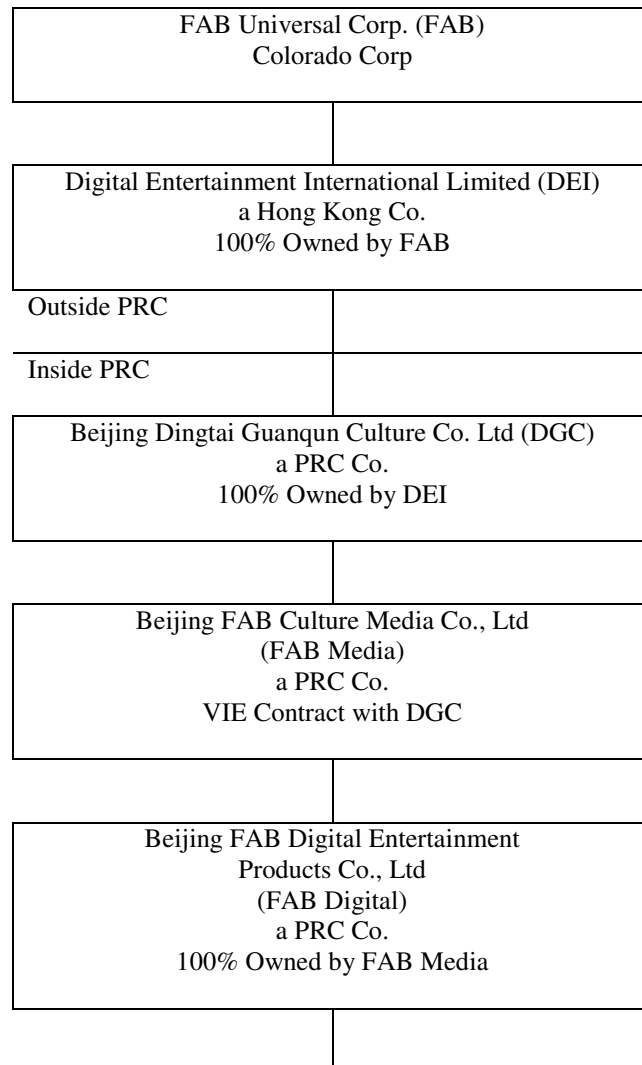
If FAB Media or any of its respective registered shareholders breaches any of their respective contractual obligations under these agreements, DGC, as pledgee, will be entitled to certain rights, including the right to sell the pledged equity interests.

The registered shareholders of FAB Media agreed not to transfer, sell, pledge, dispose of or otherwise create any new encumbrance on their respective equity interests in FAB Media, as the case may be, without DGC's prior written consent. Unless terminated at DGC's sole discretion, each Equity Pledge Agreement has a term of ten years and will be automatically renewed upon the expiration of the term.

***Shareholder's Voting Right Proxy Agreement***

Each registered shareholder of FAB Media has executed a power of attorney to appoint DGC to be his or her attorneys, and irrevocably authorize DGC to vote on his or her behalf on all of the matters concerning FAB Media, as the case may be, that may require shareholders' approval.

The following schematic diagram illustrates the relationships between the various FAB entities:



Beijing FAB Interactive Culture Media Co. Ltd.  
(BFICM)  
a PRC Co.  
100% owned by FAB Digital

FAB Media conducts businesses relating to value-added telecommunications services and distribution of audio-visual products. The Catalog for the Guidance of Foreign Investment Industries (the “Catalog”) as promulgated and amended from time to time by the Ministry of Commerce and the National Development and Reform Commission, is the principal guide to foreign investors’ investment activities in the PRC. The most updated version of the Catalog became effective in January 2012; both businesses relating to value-added telecommunications services and businesses relating to distribution of audio-visual products fall within the scope of foreign investment restricted industries. Furthermore, in accordance with the Provisions on Administration of Foreign Invested Telecommunications Enterprises promulgated by the State Council, the foreign equity ownership in a value-added telecommunications services provider must not exceed 50%. In accordance with the Measures on Administration of Sino-foreign Audio-visual Product Distribution Enterprises, the percentage of foreign equity ownership in such enterprises distributing audio-visual products cannot be higher than 49%. Due to such regulatory restrictions, the FAB parties have to operate their businesses in a VIE structure.



We have obtained an opinion of counsel regarding the enforceability of the VIE Agreements. The form of the legal opinion from FAB counsel includes the following opinions, among others: (i) each of the VIE Agreements has been duly executed and is legally binding on each of the parties thereto under PRC Laws; (ii) each of the parties to the VIE Agreements has full power, authority and legal capacity to enter into, execute and perform its obligations thereunder; (iii) the execution and delivery by each party of the VIE Agreements does not, and the performance by each party of its obligations thereunder will not, violate or breach any governmental authorization or any PRC Laws or the organizational documents or any other agreement or obligation of such party; and (iv) to the knowledge of opining counsel, there is no issue, fact or circumstance that would lead it to believe that any government agency would revoke the VIE Agreements or any transaction thereunder.

FAB Universal Corp. is the parent company and conducts its business through its wholly owned subsidiary, Beijing Dingtai Guanqun Culture Co., Ltd. (“DGC”), which is a wholly foreign-owned enterprise (“WFOE”) with limited liability incorporated in the PRC in March 2011. DGC has entered into a series of contractual agreements with the owners of FAB Media.

In March 2012, a series of contractual arrangements were entered into among DGC, FAB Media and its individual shareholders. Such arrangements include the above-referenced Exclusive Service Agreement, Share Pledge Agreement, Option Agreement and Voting Right Proxy Agreement.

Pursuant to these agreements, DGC has the exclusive right to provide to FAB Media consulting services related to business operation and management. The key terms of these agreements include:

- DGC has the sole discretion to make all operating and business decisions for FAB Media on behalf of the equity owners, including business operations, policies and management, approving all matters requiring shareholder approval;
- FAB Media has agreed to pay all of the operating costs incurred by DGC, and intends to transfer 100% of the income earned to DGC; DGC also has the right to determine the amount of the fees it will receive;
- During the term of these agreements, DGC will retain the rights to the intellectual properties if they are created by DGC;
- FAB Media may not enter into any other agreements with any third party to receive consulting service without the prior consent of DGC;
- The equity owners pledge their respective equity interests in the FAB Media as a guarantee for the payment of technical and consulting services fees under the Exclusive Service Agreement;
- The shareholders of FAB Media have irrecoverably and unconditionally granted to DGC or its designee an exclusive option to purchase, to the extent permitted by PRC laws, all or any portion of equity interest of the FAB Media.

All these contractual agreements obligate DGC to absorb a majority of the risk of loss from FAB Media’s activities and entitle DGC to receive a majority of its residual returns. In essence, DGC has gained effective control over FAB Media. Based on these contractual arrangements, the Company believes that FAB Media should be considered as variable interest entity (“VIE”) under the FASB Accounting Standards Codification (“ASC”) 810, “Consolidation.” Accordingly, management believes that the accounts of these two entities should be consolidated with those of DGC, the primary beneficiary. Each of the VIE agreements is discussed in more detail above.

DEI is effectively controlled by the majority shareholders of FAB Media. DEI has 100% equity interest in DGC. Accordingly, DGC and FAB Media are effectively controlled by the same majority shareholders. Therefore, DGC and FAB Media are considered to be under common control. The consolidation of DGC and FAB Media has been accounted for at historical cost and prepared on the basis as if the aforementioned exclusive contractual agreements between DGC and FAB Media had become effective as of the beginning of the first period presented in the accompanying consolidated financial statements.

There are risks involved with the operation of our business in reliance on the VIE agreements, including the risk that the VIE agreements may be determined by PRC regulators or courts to be unenforceable. DEI believes the VIE agreements are binding and enforceable under applicable law. However, if the VIE agreements were for any reason determined to be in breach of any existing or future PRC laws or regulations, the relevant regulatory authorities would have broad discretion in dealing with such breach, including:

- imposing economic penalties;
- discontinuing or restricting the operations of the DGC, and/or FAB Media;

- imposing conditions or requirements in respect of the VIE agreements with which DGC may not be able to comply;
- requiring the various entities to restructure the relevant ownership structure or operations; and
- taking other regulatory or enforcement actions that could adversely affect the companies' businesses.

Moreover, FAB Media could violate the VIE agreements, go bankrupt, suffer from difficulties in its businesses or otherwise become unable to perform its obligations under the VIE agreements. Due to the above-referenced uncertainties surrounding the treatment of VIE arrangements under PRC law, we may have difficulty enforcing the VIE agreements and, as a result, our operations, reputation, business and stock price could be severely adversely affected.

**Reverse Split** - On February 22, 2012, the Company effected a 1-for-12 reverse stock split. All references to stock issuances and per share data have been reflected in the accompanying share data.

## **Results of Operations.**

### **Year Ended December 31, 2013 Compared to Year Ended December 31, 2012**

FAB Universal derives its revenue from the sale of copyright protected media, FAB Brand licenses, advertising sales and FAB Membership cards sold in mainland China as well as from our podcast hosting fees, podcast advertising sales, and subscription sales.

During 2013, FAB recorded revenues of \$110.9 million, an increase of \$83.4 million, from our revenues of \$27.5 million in 2012. This increase was driven by an increase in revenue from first full year of operation since the acquisition of DEI in September 2012. During the fourth quarter of 2012, DEI reported \$22.9 million of revenue. During 2013, revenue from the wholesale segment generated \$60.4 million in revenue with the retail segment providing \$9.0 million and Digital Media/licensing delivering \$41.5 million. Within the Digital segment, Advertising delivered \$17.3 million, FAB Memberships delivered \$11.3 million and FAB Brand Licensing delivered \$7.7 million, while content download revenue was minimal and the Libsyn business generated \$5.0 million. The Libsyn business saw significant increases in hosting fees, ad revenue and the addition of subscription revenue. The increase in hosting fees was due to the increase in the number of producers using our services.

During 2013, our cost of revenue was \$63.5 million, an increase of \$47.1 million over the 2012 figure of \$16.4 million. This increase was driven by the addition of the DEI business and cost of revenue for the sale of copyright protected media. During the 2013, cost of revenue from the wholesale segment was \$48.5 million with the retail segment incurring \$6.5 million and Digital Media/licensing totaling \$8.4 million. FAB generated a gross profit of \$47.4 million in 2013, versus a gross profit of \$11.0 million in 2012.

In 2013, FAB had operating expenses of \$17.5 million, as compared to \$13.8 million in 2012. Our operating expenses consisted of:

Selling expenses increased to \$4.7 million in 2013, from \$2.2 million in the prior year. The increase was due to the addition of DEI, adding \$2.5 million of incremental selling expense.

General and administrative expenses increased to \$11.0 million in 2013, from \$8.5 million in the prior year. The increase was driven due to the reporting of three additional quarters for DEI in 2013. For 2012, the expense was driven due to the issuance of stock to employees, officers and directors for the work associated with the acquisition of DEI. Also, consulting fees were \$1.6 million in 2013 compared to \$2.8 million in 2012.

Research and development costs for 2013 were \$302,361 versus \$269,562 for 2012. These are expenses associate with continued work for the podcast hosting business.

Other expense increased to \$2.7 million in 2013 from \$79,136 in 2012. This increase is due to recording \$1.2 million of interest expense on the long-term bond, \$1.2 million for the contingent loss for the settlement of the lawsuit regarding rent, and the amortization of the financing costs totaling \$111,387.

Net income available to common stockholders increased to \$20.7 million in 2013, as compared to a net loss available to common stockholders of \$4.0 million in 2012. This increase in net income available to common stockholders for 2013 is a result of adding the acquisition of DEI for a full year in 2013. Basic and diluted income per common share was \$0.99 in 2013, compared to a loss per share of \$0.34 in 2012.

## **Liquidity and Capital Resources.**

### **2013 compared to 2012**

Current assets at December 31, 2013 included \$108.8 million in cash and accounts receivable, an increase of \$82.2 million, from our cash and accounts receivable of \$26.6 million at December 31, 2012. The increase in cash was primarily contributed as a result of the operations from DEI.

During fiscal 2013, our operating activities provided cash of \$54.4 million, as compared to \$8.9 million in net cash provided by operating activities during 2012. This increase was driven from our net income, delivering 21.9 million as well as management of our inventory contributing \$4.6 million, and the sale of FAB Brand license fees providing \$ 29.5 million in cash.

In 2013, depreciation and amortization expense was \$6.9 million, which increased from \$2.0 million in 2012. This increase was attributed to the amortization of intangible assets during all of 2013 versus the fourth quarter of 2012.

Net cash provided by investing activities was \$3.6 million for 2013 versus cash used of \$8.2 million in 2012. The decrease was driven by the acquisition of DEI in 2012 providing \$13.4 million in cash with the acquisition off-set by payment of long-term deposits to customers in the fourth quarter of 2012 totaling \$4.9 million. During 2013, the Company experience a net return of long-term deposits totaling \$5.2 million off-set by the purchase of equipment and copyrights.

In 2013, net cash provided by financing activities was \$20.1 million, versus \$1.5 million in 2012. During 2013, the Company received proceeds of \$16.3 million for the issuance of bonds bearing interest at 11% annually, and borrowed net funds on traditional notes totaling \$ 5.2 million. In 2012, the warrant holders exercised 341,208 warrants at \$3.25 per share for 341,207 shares of the Company's common stock. The Company received proceeds of \$1,108,923.

At December 31, 2013, the Company had working capital of \$76.1 million, as compared to working capital of \$11.3 million at December 31, 2012. This increase in working capital is due to cash received with the addition of the DEI operations and the issuance of long-term debt instruments.

### **Contractual Obligations**

Not applicable to smaller reporting companies.

### **Off-Balance Sheet Arrangements**

We have operating leases for certain facilities, but otherwise do not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, results of operations, liquidity, or capital resources.

### **Item 7A. Quantitative and Qualitative Disclosure about Market Risk**

Not applicable to smaller reporting companies.

**Item 8. Financial Statements and Supplementary Data.**

FAB UNIVERSAL CORP AND SUBSIDIARIES  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
Reports of Independent Registered Public Accounting Firms	45
Consolidated Balance Sheets as of December 31, 2013 and 2012	47
Consolidated Statements of Operations and Comprehensive Income and Loss for the years ended December 31, 2013 and 2012	48
Statement of Stockholders' Equity for the years ended December 31, 2013 and 2012	49
Consolidated Statements of Cash Flows for the years ended December 31, 2013 and 2012	50
Notes to Consolidated Financial Statements	51

## REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRMS

To the Board of Directors and Stockholders of:  
FAB Universal Corp and Subsidiaries

We have audited the accompanying consolidated balance sheet of FAB Universal Corp and Subsidiaries (the “Company”) as of December 31, 2013, and the related consolidated statements of operations and comprehensive income and loss, stockholders’ equity, and cash flows for the year then ended. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of FAB Universal Corp and Subsidiaries as of December 31, 2013, and the consolidated results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ KCCW Accountancy Corp.

Diamond Bar, California  
June 25, 2014

Friedman LLP [Letterhead]  
REPORT OF INDEPENDENT  
REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors  
FAB UNIVERSAL CORP AND SUBSIDIARIES  
Pittsburgh, Pennsylvania 15213

We have audited the accompanying consolidated balance sheets of FAB Universal Corp and subsidiaries as of December 31, 2012, and the related consolidated statements of operations and comprehensive income and loss, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The consolidated financial statements referred to above present fairly, in all material respects, the financial position of FAB Universal Corp and subsidiaries as of December 31, 2012 and the results of their operations and their cash flows for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

/s/ Friedman LLP

March 15, 2013  
New York, New York

FAB UNIVERSAL CORP AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

	December 31, 2013	December 31, 2012
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 99,546,530	\$ 19,671,937
Restricted Cash	1,651,800	-
Accounts receivable, net	7,554,919 [1]	6,927,045 [1]
Advances to suppliers, net	81,500	154,770
Inventory	686,067	5,207,008
Deferred tax assets, current	2,830,200	1,771,799
Other current assets	591,194	979,021
Total current assets	112,942,210	34,711,580
Property, and equipment, net	16,574,131	16,720,637
Goodwill	62,092,932	60,652,957
Intangible assets, net	23,903,476	27,875,748
Deferred tax assets, non-current	5,227,865	3,346,166
Long-term deposits	20,092,845	24,488,131
Total assets	\$ 240,833,459	\$ 167,795,219
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Short-term bank loans	\$ 6,276,842	\$ 2,072,619
Accounts payable	3,309,610	6,471,270
Accrued expenses	4,209,753	3,077,785
Deferred revenue	15,457,102	8,250,402
Taxes payable	2,608,821	1,603,821
Notes Payable	1,651,801	-
Contingent liability	1,238,850	-
Due to related parties	122,596	41,341
Other payable	1,976,119	1,910,378
Total current liabilities	36,851,494	23,427,616
Long-term deposits from customers	2,244,797	2,474,604
Deferred revenue	25,432,654	7,923,450
Long-term bond payable	16,518,005	-
Long-term payables	-	39,204
Total liabilities	81,046,950	33,864,874
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred Stock	-	-
Common stock	20,806 [3]	20,469 [4]
Additional paid-in capital	207,903,478	206,786,139
Accumulated other comprehensive income	5,469,380	1,384,365
Accumulated deficit	(53,607,155)	(74,260,628)
Total stockholders' equity	159,786,509	133,930,345
Total liabilities and stockholders' equity	\$ 240,833,459	\$ 167,795,219

[1] net of \$14,000 allowance

[2] \$.001 par value, 10,000,000 shares authorized, 290 shares issued and outstanding

[3] \$.001 par value, 200,000,000 shares authorized, 20,805,860 shares issued and outstanding

[4] \$.001 par value, 200,000,000 shares authorized, 20,468,860 shares issued and outstanding

The accompanying notes are an integral part to the consolidated financial statements.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE INCOME (LOSS)

	For the Years Ended	
	December 31, 2013	December 31, 2012
Revenue	\$ 110,873,419	\$ 27,458,730
Cost of Revenue	63,459,542	16,439,641
Gross Profit	47,413,877	11,019,089
 <b>OPERATING EXPENSES</b>		
Selling expenses	4,712,444	2,217,635
General and administrative	10,963,845	8,472,478
Consulting fees	1,555,990	2,812,075
Research and development	302,361	269,562
Total Expenses	17,534,640	13,771,750
Income (loss) from continuing operations	29,879,237	(2,752,661)
 <b>OTHER INCOME (EXPENSE):</b>		
Loss on disposal of assets	-	(32,502)
Interest income	168,221	284
Interest expense	(1,423,545)	(23,304)
Other income (expense)	(1,430,047)	(23,614)
Total Other Income (Expense)	(2,685,371)	(79,136)
Income (loss) from continuing operations before income taxes	27,193,866	(2,831,797)
 Income tax expense	6,540,393	1,350,704
Net income (loss) from continuing operations	20,653,473	(4,182,501)
Net income (loss) from discontinued operations, net of tax	-	178,276
Net Income (Loss)	20,653,473	(4,004,225)
 Other comprehensive income		
Foreign Currency translation gain	4,085,015	1,384,365
 <b>COMPREHENSIVE INCOME (LOSS)</b>	 \$ 24,738,488	 \$ (2,619,860)
 <b>BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE FROM CONTINUING OPERATIONS</b>		
	\$ 0.99	\$ (0.36)
<b>BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE FROM DISCONTINUED OPERATIONS</b>		
	-	0.02
<b>BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE</b>		
	\$ 0.99	\$ (0.34)
<b>BASIC AND DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>		
	20,757,353	11,779,195

The accompanying notes are an integral part to the consolidated financial statements.



FAB UNIVERSAL CORP AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit
	Shares	Amount	Shares	Amount			
Balance at December 31, 2011	-	\$ -	8,125,530	\$ 8,126	\$ 84,024,736	\$ -	\$ (70,256,403)
Stock issued for consulting services	-	-	479,169	479	953,025	-	-
Stock issued upon exercise of options for services	-	-	1,221,818	1,222	4,158,578	-	-
Stock Issued upon conversion of warrants	-	-	356,992	357	1,108,566	-	-
Acquisition of Digital Entertainment International	-	-	10,282,611	10,282	118,296,017	-	-
Fractional share adjustment with the 1 for 12 reverse stock split	-	-	2,740	3	(3)	-	-
Compensation for vested stock options	-	-	-	-	5,086	-	-
Spin-Off of Future Healthcare of America	-	-	-	-	(1,759,866)	-	-
Foreign currency translation gain	-	-	-	-	-	1,384,365	-
Net Loss for the year ended December 31, 2012	-	-	-	-	-	-	(4,004,225)
Balance at December 31, 2012	<u>-</u>	<u>\$ -</u>	<u>20,468,860</u>	<u>\$ 20,469</u>	<u>\$ 206,786,139</u>	<u>\$ 1,384,365</u>	<u>\$ (74,260,628)</u>
Stock issued for consulting services	-	-	337,000	337	693,543	-	-
Compensation for vested stock options	-	-	-	-	423,796	-	-
Foreign currency translation gain	-	-	-	-	-	4,085,015	-
Net Income for the year ended December 31, 2013	-	-	-	-	-	-	20,653,473
Balance at December 31, 2013	<u>-</u>	<u>\$ -</u>	<u>20,805,860</u>	<u>\$ 20,806</u>	<u>\$ 207,903,478</u>	<u>\$ 5,469,380</u>	<u>\$ (53,607,155)</u>

The accompanying notes are an integral part to the consolidated financial statements.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	For The Years Ended December 31	
	2013	2012
Cash Flows from Operating Activities		
Net income (loss) from continuing operations	\$ 20,653,473	\$ (4,182,501)
Net income from discontinued operations	-	178,276
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Loss on disposal of PPE and leasehold improvements	-	435,183
Gain on sale of equipment	-	(6,000)
Stock issued to employees and consultants	329,600	5,113,304
Non-cash compensation - options vested	423,796	5,086
Recovery of doubtful accounts	-	(1,612)
Deferred tax benefit	(2,747,056)	(609,986)
Contingent loss	1,219,691	-
Depreciation and amortization expense	6,887,986	1,972,047
Change in assets and liabilities:		
Accounts receivable	(426,976)	(64,441)
Prepaid expenses	362,362	117,453
Inventory	4,601,158	(1,305,928)
Accounts payable	(3,285,173)	661,935
Accrued expense	1,408,638	528,309
Taxes payable	943,213	(916,504)
Deferred revenue	24,032,521	6,839,129
Net Cash Provided by continuing operations	54,403,233	8,763,750
Net Cash Provided by discontinued operations	-	100,071
Net Cash Provided by Operating Activities	54,403,233	8,863,821
Cash Flows from Investing Activities:		
Purchase of property and equipment	(658,374)	(420,881)
Cash of discontinued operations	-	129,445
Cash acquired from Acquisition of DEI (FAB)	-	13,413,658
Proceeds from sale of property and equipment	-	6,000
Return (payment) of long-term deposits	5,190,125	(4,880,390)
Purchase of copyrights	(895,001)	-
Net Cash Provided by Investing Activities	3,636,750	8,247,832
Cash Flows from Financing Activities:		
Issuance of common stock	-	1,108,923
Increase in restricted cash	(1,626,254)	-
Proceeds from long-term bond offering	16,262,542	-
Proceeds from related party	80,121	-
Proceeds from short term loan	6,179,766	-
Proceeds from notes payable	1,626,254	593,881
Payments of short-term loans	(2,430,988)	(218,766)
Net Cash Provided by Financing Activities	20,091,441	1,484,038
Effect of Exchange Rate Change on Cash	1,743,169	168,926
Net Increase in Cash	79,874,593	18,764,617
Cash at Beginning of Year	19,671,937	907,320
Cash at the end of Year	\$ 99,546,530	\$ 19,671,937
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest expense	\$ 195,411	\$ 38,582
Cash paid for income taxes	\$ 9,240,810	\$ 1,732,050

The accompanying notes are an integral part to the consolidated financial statements.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

FAB Universal Corp. (“Parent”, “Company”), a Colorado corporation was organized on July 1, 1998. The Company operates in three segments, Wholesale, Retail and Digital Media Services. The Wholesale segment engages primarily in the sale of audio-visual products as well as books and magazines to retail businesses. The Retail segment conducts its business through our retail stores, selling copyright protected audio and video products, including CDs, VCDs, DVDs, books, magazines and portable electronic devices. The Digital Media Services segment licenses its multi-year programs for our FAB brand. It also includes the revenue share for advertising, and includes the services provided by our podcast hosting, content management tools and advertising services. (See Note 2) On February 27, 2007, the Company organized Wizzard Acquisition Corp., a Pennsylvania corporation, to acquire and dissolve into the operations of Webmayhem, Inc. (“Libsyn”, “Libsyn Media”), a Pennsylvania corporation, in a transaction accounted for as a purchase. Libsyn is a wholly owned subsidiary of the Company.

On September 26, 2012, (the “Closing”) Parent purchased all of the issued and outstanding shares of Digital Entertainment International Ltd. (“DEI”), a company incorporated under the law of the Hong Kong Special Administrative Region, in a transaction accounted for as a purchase. The accompanying consolidated financial statements include the financial statements of DEI; its wholly owned subsidiary, Beijing Dingtai Guanqun Culture Co., Ltd. (“DGC”); Beijing FAB Culture Media Co., Ltd. (“FAB Media”), which is a variable interest entity (“VIE”), and Beijing FAB Digital Entertainment Products Co., Ltd. (“FAB Digital”), a wholly owned subsidiary of FAB Media.

DEI is a holding company and conducts its business through its wholly owned subsidiary, DGC, which is a wholly foreign-owned enterprise (“WFOE”) with limited liability incorporated in the PRC in March 2011. DGC has entered into a series of contractual agreements with the owners of FAB Media. . On March 10, 2014, the owners of FAB Media injected additional \$653,200 (RMB 4 million) into FAB Media, which will be accounted for as additional paid-in capital in consolidation.

DEI, through its wholly owned subsidiary and its VIE, is engaged in marketing and distributing various officially licensed digital entertainment products under the “FAB” brand throughout the PRC, including but not limited to audiovisual products such as digital music files, Compact Discs, Video Compact Discs and Digital Video Disks as well as books, magazines, mobile phone accessories and cameras. DEI’s products and services are primarily distributed through its flagship stores, wholesale services, proprietary “FAB” kiosks, and online virtual stores.

FAB Digital is a wholly owned subsidiary of FAB Media and specializes in the distribution of entertainment and audio visual products through its two flagship stores in Beijing as well as its online stores. Beijing Jinglv Tong Travel and Science Technology Co., Ltd., which is fully owned by FAB Digital, changed to Beijing FAB Huzhong Times Technology Co., Ltd. in May 2013, and the name was changed again to Beijing FAB Interactive Culture Media Co., Ltd. (“BFICM”) in December 2013.

In November 2013, three subsidiaries of DGC were incorporated in PRC with a registered capital of RMB 1 million each. These three organizations are each 100% owned by DGC and they are: Beijing FAB Vast Cosmos Technology Co. Ltd. (“BFVCT”), Beijing FAB Wide Spread Culture Development Co., Ltd. (“BFCD”) and Beijing FAB Prosperous Trading Co., Ltd. (“BFPT”). In December 2013, FAB Entertainment Corp., a California Corporation, which is also fully owned by DGC, was formed. These four companies had no operations in 2013 and were formed for the purpose of developing international business.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION--(Continued)

In June 2012, a series of contractual arrangements were entered into between DGC, FAB Media and the individual shareholders of FAB Media. Such arrangements include an Exclusive Service Agreement; an Equity Pledge Agreement; a Call Option Agreement; and a Shareholders' Voting Right Proxy Agreement.

Pursuant to these agreements, DGC has the exclusive right to provide to FAB Media consulting services related to business operation and management. The key terms of these agreements include:

- 1) DGC has the sole discretion to make all operating and business decisions for FAB Media on behalf of the equity owners, including business operations, policies and management, approving all matters requiring shareholder approval;
- 2) FAB Media has agreed to pay all of the operating costs incurred by DGC, and transfers 100% of the income earned to DGC; DGC also has the right to determine the amount of the fees it will receive;
- 3) During the term of these agreements, DGC will retain the rights to the intellectual properties if they are created by DGC;
- 4) FAB Media may not enter into any other agreements with any third party to receive consulting service without the prior consent of DGC;
- 5) The equity owners pledge their respective equity interests in the FAB Media as a guarantee for the payment of technical and consulting services fees under the Exclusive Service Agreement;
- 6) The shareholders of FAB Media have irrecoverably and unconditionally granted DGC or its designee an exclusive option to purchase, to the extent permitted by PRC laws, all or any portion of equity interest of the FAB Media.

All these contractual agreements obligate DGC to absorb a majority of the risk of loss from FAB Media's activities and entitle DGC to receive a majority of its residual returns. In essence, DGC has gained effective control over FAB Media. Based on these contractual arrangements, the Company believes that FAB Media should be considered a variable interest entity under the Statement of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, "Consolidation". Accordingly, the accounts of this entity are consolidated with those of DGC, the primary beneficiary.

DEI is effectively controlled by the majority shareholders of FAB Media. DEI has 100% equity interest in DGC. Accordingly, DGC, and FAB Media are effectively controlled by the same majority shareholders.

Therefore, DGC and FAB Media are considered under common control. The consolidation of DGC and FAB Media into DEI has been accounted for at historical cost and prepared on the basis as if the aforementioned exclusive contractual agreements between DGC and FAB Media had become effective as of the beginning of the first period presented in the accompanying consolidated financial statements.

Selected information of the consolidated balance sheet of FAB Media and its wholly-owned subsidiaries as of December 31, 2013 and 2012, and the consolidated results of operations for the year ended are summaries as follows:

	December 31, 2013	December 31, 2012
Cash and Restricted cash	\$ 99,077,811	\$ 19,291,600
Accounts receivable, net	7,227,270	6,666,985
Deferred tax assets, current	2,830,200	1,771,799
Other current assets	4,820,393	5,779,940
<b>Total current assets</b>	<b>113,955,674</b>	<b>33,510,324</b>
Property, plant and equipment, net	14,989,176	15,182,291
Intangible assets, net	434,304	-
Deferred tax assets, non-current	5,227,865	3,346,166
Long-term deposits	20,089,263	24,484,549
<b>Total assets(1)</b>	<b>154,696,282</b>	<b>76,523,330</b>

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION--(Continued)

	December 31, 2013	December 31, 2012
Short-term bank loans	\$ 6,276,842	\$ 1,612,826
Accounts payable	2,924,374	5,856,233
Accrued expenses	4,008,363	2,637,676
Deferred revenue, current	15,294,998	8,178,970
Other current liability	7,491,885	3,534,867
<b>Total current liabilities</b>	<b>35,996,462</b>	<b>21,820,572</b>
Long-term deposits from customers	2,244,797	2,474,604
Deferred revenue, non-current	25,432,654	7,923,450
Long-term bonds payable	16,518,005	-
<b>Total liabilities(1)</b>	<b>80,191,918</b>	<b>32,218,626</b>
	For the year ended December 31, 2013	Period from September 27, 2012 to December 31, 2012
Revenue	\$ 105,932,361	\$ 23,708,308
Net income	20,820,847	3,136,626

(1) Total assets and liabilities of the VIE are reported net of intercompany balances that have been eliminated with the VIE consolidation

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements presented reflect the accounts of Parent, Libsyn, and DEI. All significant inter-company transactions have been eliminated in consolidation. The operations of FHA, which includes the Interim subsidiary, was spun-off into its own company effective October 1, 2012. The record date for the spin-off of our Home Healthcare subsidiary into a separate entity was September 5, 2012, and the stock began trading on the OTC BB effective October 1, 2012. The transaction was treated as a special dividend for the shareholders of record as of September 5, 2012.

**Accounting Estimates** - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management made assumptions and estimates for determining reserve for accounts receivable, obsolete inventory, the realization of deferred tax assets and in determining the impairment of finite life intangible assets and goodwill and accruals for income tax uncertainties and other contingencies when applicable. Actual results could differ from those estimated by management.

**Reclassification** - The financial statements for the period ended December 31, 2012 have been reclassified to conform to the headings and classifications used in the December 31, 2013 financial statements.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

**Restricted cash**-Restricted cash represents deposits not readily available to the Company because they are required to be pledged to secure note payable outstanding as of December 31, 2013 (note 8).

**Inventory** - Inventory includes books and video products and is recorded at the lower of cost or market, using the first-in, first-out (“FIFO”) method. The Company estimates net realizable value based on current market value and inventory aging analyses. As of December 31, 2013 no reserve for slow-moving or obsolete inventory is considered necessary.

**Revenue Recognition** - Revenue is recognized when earned. The Company's revenue recognition policies are in compliance with FASB ASC Topic 985-605, Software — Revenue Recognition. The Company's revenue recognition policies are also in compliance with the Securities and Exchange Commission Staff Accounting Bulletin No. 101 and 104.

Digital media publishing services are billed on a month to month basis. The Company recognizes revenue from providing digital media publishing services when the services are provided and when collection is probable. The Company recognizes revenue from the insertion of advertisements in digital media, as the digital media with the advertisement is downloaded and collection is probable. The Company recognizes revenue from the sale of apps and premium subscriptions when sold and collection is probable.

The Company sells packaged and custom software products and related voice recognition product development consulting. Software product revenues are recognized upon shipment of the software product only if no significant Company obligations remain, the fee is fixed or determinable, and collection is received or the resulting receivable is deemed probable.

In the PRC, Value Added Tax (“VAT”) of 17% of the invoice amount is collected in respect of the sales of goods on behalf of tax authorities. The VAT collected is not revenue of the Company; instead, the amount is recorded as a liability on the balance sheet until such VAT is paid to the authorities.

Product revenue is recognized when title to the product has transferred to customers in accordance with the terms of the sale; the sales price to the customer is fixed or determinable, and collectability is reasonably assured. Revenues are recorded net of applicable sales taxes.

The Company derives revenue from retail sales, sales to retailers, and Digital sales. Revenue from Digital sales includes advertisement revenue, membership card revenue, download revenue and licensing revenue.

Revenue from retail sales is recognized at the point-of-sale. Revenue from sales to retailers is recognized at the point of delivery of the product. Download service revenue is recognized when substantially all material services or conditions relating the sales have been performed or satisfied, and the Company has no obligation to refund any payment (cash or otherwise) received. Revenue generated from Membership sales is non-refundable. Membership card revenue is amortized over the life of the membership period, membership cards with par value of RMB 100 have an expiration period of three months, and par value of RMB 200, 300, 400 and 500 have an expiration period of twelve months. Advertisement revenue is recognized over the contract period. Licensing revenue is amortized ratably over the term of the agreement which is generally five years. Deferred revenue represents unearned revenues related primarily to sales of licenses and FAB Membership cards.

Revenue from package software products is recorded when the payment has been received and the software has been shipped. Revenue is recognized, net of discount and allowances, at the time of product shipment. Revenue from non-recurring programming, engineering fees, consulting service, support arrangements and training programs is recognized when the services are provided.

**Accounts Receivable** – We evaluate the creditworthiness of our customers based on their financial information, if available, as well as information obtained from suppliers and past experiences with customers. Accounts receivable consist of trade receivables arising in the normal course of business. Any allowance established is subject to judgment and estimates made by management. The Company determines the allowance based on known troubled accounts, historical experience, and other currently available evidence. We established an allowance for doubtful accounts of \$14,000 at December 31, 2013 and 2012.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

**Stock-based Compensation** - The Company accounts for options in accordance with the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) ASC Topic 718, *Compensation – Stock Compensation*. For the years ended December 31, 2013 and 2012, the Company recorded stock-based employee compensation expense of \$423,796 and \$5,086 for vesting of stock options, respectively, and stock-based compensation expense to employees and consultants of \$329,600 and \$4,159,800, respectively, for options that were issued and immediately exercised.

**Functional Currency / Foreign Currency Translation** – The functional currency of FAB Universal Corp is the United States Dollar (USD). The functional currency of DEI is the Renminbi (“RMB”) and its reporting currency is U.S. dollars for the purpose of these financial statements. The Company’s consolidated balance sheet accounts are translated into U.S. dollars at the period-end exchange rates (6.054 RMB to \$1 at December 31, 2013) and all revenue and expenses are translated into U.S. dollars at the average exchange rates prevailing during 2013 (6.1492 RMB to \$1) in which these items arise. Translation gains and losses are deferred and accumulated as a component of other comprehensive income in stockholders’ equity. Transaction gains and losses that arise from exchange rate fluctuations from transactions denominated in a currency other than the functional currency are included in the statement of operations as incurred.

**Fair Value of Financial Instruments** - The Company accounts for fair value measurements for financial assets and financial liabilities in accordance with FASB ASC Topic 820. The authoritative guidance, which, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. Fair value is defined as the exit price, representing the amount that would either be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1. Observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Unless otherwise disclosed, the fair value of the Company’s financial instruments including cash, accounts receivable, prepaid expenses, accounts payable, accrued expenses, current deferred revenue and notes payable approximates their recorded values due to their short-term maturities. Long-term deposits represent cash and therefore, their carrying value represents fair value. The fair value of the Company’s long-term deposits, non-current deferred revenue, long-term bond payable and other liabilities has no material difference with the book values based on the calculated results.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

**Property and Equipment** - Property and equipment are stated at cost less accumulated depreciation. Depreciation and amortization is calculated on the straight-line method over the estimated useful lives of the assets as set out below:

	<u>Estimated Useful Life</u>
Electronic equipment	2-5 years
Office furniture and equipment	2-10 years
Vehicles	5 years
Building	48.5 years
Leasehold improvements	Shorter of lease terms or estimated useful life

**Goodwill and other Intangible Assets** - The Company accounts for Goodwill and other intangible assets in accordance with provisions of FASB -ASC Topic 350, Intangibles--Goodwill and Other. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment at least annually in accordance with the provisions of Topic 350. Impairment losses arising from this impairment test, if any, are included in operating expenses in the period of impairment. Topic 350 requires that intangible assets with finite lives be amortized over their respective estimated useful lives, and reviewed for impairment in accordance with Topic 360, criteria for recognition of an impairment of Long-Lived Assets.

**Income Taxes** - The Company is subject to the Income Tax Laws of U.S. and the PRC. The Company accounts for income taxes in accordance with ASC 740, "Income Taxes". ASC 740 requires an asset and liability approach for financial accounting and reporting for income taxes and allows recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain. The components of deferred tax assets are individually classified as current and non-current based on their characteristics.

ASC 740-10-25 prescribes a more-likely-than-not threshold for consolidated financial statement recognition and measurement of a tax position taken (or expected to be taken) in a tax return. It also provides guidance on the recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, years open for tax examination, accounting for income taxes in interim periods and income tax disclosures. There is no material uncertain tax positions as of December 31, 2013 and 2012, respectively (See note 13 – Capital Stock and note 16- Contingencies).

**Recent Accounting Pronouncements** - The Company has adopted all recently issued accounting pronouncements that management believes to be applicable to the Company. The adoption of these accounting pronouncements, including those not yet effective, is not anticipated to have a material effect on the Company's financial position or results of operations.

NOTE 3 – GOODWILL AND OTHER INTANGIBLE ASSETS

The Company completed an analysis of the fair value of the business as it relates to the goodwill associated with Libsyn. The analysis of the business enterprises' fair value was performed as of December 31, 2013. Based on the results of the application of the Fair Value, no impairment of goodwill was recorded in connection with Libsyn. When making these estimates, we were required to make estimates of future operating trends and judgments on discount rates and other variables. Actual future results and other assumed variables could differ from those estimated.

Goodwill consists of:

	December 31, 2013	December 31, 2012
Digital Entertainment International - DEI	\$ 50,608,681	\$ 49,168,706
Webmayhem Inc.(Libsyn)	11,484,251	11,484,251
Total Goodwill	<u>\$ 62,092,932</u>	<u>\$ 60,652,957</u>



FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – GOODWILL AND OTHER INTANGIBLE ASSETS - Continued

The following is a summary of goodwill:

	For the Year Ended December 31, 2013	For the Year Ended December 31, 2012
Goodwill at beginning of period	\$ 60,652,957	\$ 12,673,912
Foreign currency translation gain	1,439,975	-
Acquisition of DEI	-	49,168,706
Goodwill discontinued operations	-	(1,189,661)
Goodwill at end of period	<u>\$ 62,092,932</u>	<u>\$ 60,652,957</u>

**Other intangible assets** - Other intangible assets consist of customer relationships, intellectual property, trade name and non-compete, which were generated through the acquisition of DEI. Management considers these intangible assets to have finite-lives except trade name. These assets are being amortized on a straight-line basis over their estimated useful lives.

As of December 31, 2013, identifiable intangible assets consist of following:

	Preliminary Fair Value	Weighted Average Useful Life (in Years)	Accumulated Amortization	Currency Translation Adjustment	Net Carrying Amount
Customer Relationships	\$ 8,900,000	3	\$ 3,828,235	\$ 293,749	\$ 5,365,514
Intellectual Property	4,300,000	3	1,849,597	141,923	2,592,326
Trade name	13,876,000	(a)	(a)	572,093	14,448,093
Copyrights	902,653	(b)	128,436	0	774,217
Non-compete	1,885,200	2	1,216,345	54,471	723,326
Total	<u>\$ 29,863,853</u>		<u>\$ 7,022,613</u>	<u>\$ 1,062,236</u>	<u>\$ 23,903,476</u>

- (a) The FAB trade name has been determined to have an indefinite life.  
(b) The copyrights useful lives are from 1 year to 10 years.

The estimated future amortization expenses related to other intangible assets as of December 31, 2013 are as follows:

For twelve months ending December 31,	
2014	\$ 5,491,673
2015	3,830,173
2016	87,014
Thereafter	46,523
Total	<u>\$ 9,455,383</u>

NOTE 4 – ACCOUNTS RECEIVABLE

Accounts receivable as of December 31, 2013 and 2012 consist of the following:

	December 31,	
	2013	2012
Accounts receivable	\$ 7,568,919	\$ 6,941,045
Allowance for doubtful accounts	(14,000)	(14,000)
Accounts receivable, net	<u>\$ 7,554,919</u>	<u>\$ 6,927,045</u>

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – ACCOUNTS RECEIVABLE – Continued

Currently, the Company grants credit to customers with well-established credit history with terms from net 30 days to twelve months while the Company generally requests other customers to pay either in advance or upon delivery. The Company determines the allowance based on known troubled accounts, historical experience, and other currently available evidence.

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment and related accumulated depreciation are as follows:

	December 31 2013	December 31 2012
Electronic equipment	\$ 1,726,239	\$ 1,436,466
Office furniture and equipment	62,248	54,077
Vehicles	372,996	57,471
Building	14,072,796	14,366,218
Leasehold improvements	3,804,395	3,607,563
	<u>20,038,674</u>	<u>19,521,795</u>
Less: Accumulated depreciation	(3,464,543)	(2,801,158)
Total property and equipment, net	<u>\$ 16,574,131</u>	<u>\$ 16,720,637</u>

Depreciation expense for the years ended December 31, 2013 and 2012 was \$1,283,946 and \$554,707, respectively.

NOTE 6 – LONG-TERM DEPOSITS

Long term deposits consist of following:

	December 31, 2013	December 31, 2012
Prepayments for setting up flagship stores	\$ 3,303,601	\$ 20,862,420
Anti-piracy sales guarantee deposits	3,303,601	3,370,083
Building Deposit	13,214,404	-
Rent deposits	271,239	255,628
Total Long-Term Deposits	<u>\$ 20,092,845</u>	<u>\$ 24,488,131</u>

Long term deposits include anti-piracy sales guarantee deposits made to product licensors by FAB Media, rent deposits made to landlords, prepayment for real estate purchase and prepaid payment which made to commission agents. The deposits for no-piracy sales guaranties are fully refundable when FAB Media decides to terminate the license agreements with the licensors to sell their products. The rent deposits are also fully refundable at the end of the lease term. The prepaid payments are used for new FAB flagship stores opening in other locations and real estate purchasing. The decrease in prepayments for setting up flagship stores is due to the refund from eleven third-parties in the amount of RMB 110 million (approximately \$17.8 million) in 2013.

NOTE 7 – SHORT-TERM LOANS

Short-term bank loans consist as of December 31, 2013 and 2012:

	December 31, 2013	December 31, 2012
Prime Rate Financial	\$ -	\$ 459,793
Bank of Communication	1,651,800	8,024
China Merchants Bank	-	1,604,802
Minsheng Bank	1,321,440	-
Nanjing Bank	1,651,801	-
China Dalian Bank	1,651,801	-
Total Short-Term Loans	<u>\$ 6,276,842</u>	<u>\$ 2,072,619</u>

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 – SHORT-TERM LOANS – Continued

Short-term bank loans are primarily used for working capital needs. On April 25, 2012, FAB Digital entered into a loan agreement with China Merchants Bank (“CMB”) for a short term loan due April 25, 2013 in the amount of RMB 10,000,000 (Approximately \$1.5 million). The interest rate of the loan is around 8.52%, which is a variable interest rate based on the one year benchmark rates of similar loans published by the People’s Bank of China plus 35 basis points, adjustable on a monthly basis. In connection with the loan agreement, the Company’s Chairman, and major shareholder, entered into a pledge agreement with Beijing Lianhekaiyuan Investment and Guarantee Co. LTD (“LIGC”), the loan was guaranteed and collateralized by the software copyrights owned by the chairman and major shareholder. The loan was fully repaid on May 31, 2013, and was not renewed after Dec 31, 2013.

On September 23, 2012, FAB Digital entered into a new loan agreement with Bank of Communications (“BCM”) for a one-year term loan due October 10, 2013 in the amount of RMB 50,000 (approximately \$0.008 million). The interest rate of the loan is around 6.00%, which is a variable interest rate based on the one year benchmark rates of similar loans published by the People’s Bank of China. The loan was fully repaid on October 31, 2013, and was not renewed after Dec 31, 2013.

On March 25, 2013, FAB Digital entered into a new loan agreement with Bank of Communications (“BCM”) for a one-year term loan due March 28, 2014 in amount of RMB 10,000,000 (approximately \$1.6 million). The interest of the loan is 7.8%, which is a variable interest rate based on the one year benchmark rate of the actual loan payment day plus 30 basis points. In connection with the loan agreement, FAB Digital entered into a cooperation agreement with Beijing Caizhirongda Investment Management Co. LTD (“BCIM”), the loan was guaranteed by BCIM. The loan was fully repaid on April 2, 2014.

On December 12, 2013, FAB Digital entered into a new loan agreement with China Nanjing Bank for a one-year term loan due December 12, 2014 in amount of RMB 10,000,000 (approximately \$1.6 million). The loan has a fixed interest rate of 7.80%. Based on the relevant guarantee agreement, the loan was guaranteed and collateralized by the property owned by Company’s major shareholder.

On December 12, 2013, FAB Digital entered into a new loan agreement with China Dalian Bank for a one-year term loan due December 12, 2014 in amount of RMB 10,000,000 (approximately \$1.6 million). The loan has a fixed interest rate of 7.80%. Based on the relevant guarantee agreement, the loan was guaranteed by Company’s major shareholder.

On December 26, 2013, FAB Digital entered into a new loan agreement with China Minsheng Bank for a one-year term loan due December 26, 2014 in amount of RMB 8,000,000 (approximately \$1.3 million). The loan has a fixed interest rate of 7.80%. Based on the relevant guarantee agreement, the loan was guaranteed by Company’s major shareholder.

On October 1, 2012, FAB Universal entered into a financing agreement with Prime Rate Premium Finance Corp for an 18 month loan due January 1, 2014 in the amount of \$573,750. The loan had a 4.25% interest rate and the loan was repaid over 15 equal installments of \$39,343. The final payment was made prior to the due date of January 1, 2014.

NOTE 8 – NOTES PAYABLE

As of December 31, 2013 and December 31, 2012, the Company had notes payables of approximately \$ 1,651,800 and \$0, respectively, represents the outstanding and used notes are guaranteed to be paid by bank and mature within a short-term period of three months after balance sheet dates, the company is required to maintain cash deposits at 100% of the total balance of note payables in bank account, note payable will be paid in full at maturity.

NOTE 9 – LONG TERM BOND PAYABLE

On April 25, 2013, FAB Digital received the proceeds from a bond offering in the amount of RMB 97,000,000 (Approximately \$15.8 million), net of the underwriter’s fee of RMB 3,000,000. The bond matures in three years and bears simple interest at the rate of 11% per annum with an option to adjust the interest rate at the end of the second year. The bonds are puttable by the holders at the end of the second year. The bonds are secured by a pledge of shares in a company that does business with the Company, a certain real estate asset owned by a third party and are guaranteed by the Company’s Chairman. Interest is paid annually on the anniversary of the bond. The bond is due in full upon maturity on April 25, 2016.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 – STATUTORY RESERVE

The Company is required to make appropriations to reserve funds, comprising the statutory surplus reserve and discretionary surplus reserve, based on after-tax net income determined in accordance with generally accepted accounting principles of the PRC (the “PRC GAAP”). Appropriation to the statutory surplus reserve should be at least 10% of the after-tax net income. Such appropriation may cease if the balance of the fund is equal to 50% of the entities’ registered capital or shareholders’ equity. The Company has reserved \$131,825 at both December 31, 2013 and 2012 since the amount has reached the statutory limit of 50% of the registered capital.

NOTE 11 – RELATED PARTIES

The table below sets forth the related parties and their affiliation with the Company:

<u>Related Parties</u>	<u>Affiliation with the Company</u>
Guangdong Endless Culture Co., Ltd.(GEC)	Affiliated Company controlled by the chairman and major shareholder
Zhang Hongcheng	Chairman and major stockholder

Amounts due to related parties are as follows:

	December 31 <u>2013</u>	December 31 <u>2012</u>
Guangdong Endless Culture co., Ltd	\$ -	\$ 4,814
Zhang Hongcheng	122,596	36,527
Total due to related parties	<u>\$ 122,596</u>	<u>\$ 41,341</u>

Mr. Zhang Hongcheng paid certain professional fees on behalf of FAB Media for the quarter ended September 30, 2012. Mr. Zhang Hongcheng also loaned \$85,000 to DEI for investment purposes on March 1, 2013.

FAB Media has five business locations, one of which is subleased from GEC. In addition, GEC entered into a lease agreement with Xidan Joy City on behalf of FAB Media for a term of eight-years from April 2008 to March 2016.

Subsequently, FAB Media entered into a sublease agreement with GEC. The average monthly rent expense is \$50,414. FAB Media paid the rental and promotion expense to Xidan Joy City directly.

Future minimum annual rental payments due are as follows:

<u>Twelve months ending December 31,</u>	<u>Rental Commitments</u>
2014	\$ 1,238,325
2015	1,214,969
2016	754,117
2017	250,208
2018	-
Thereafter	-
Total	<u>\$ 3,457,619</u>

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – INCOME TAXES

The Company is subject to income taxes on an entity basis on income arising in or derived from U.S. as well as the People's Republic of China ("PRC") in which each entity is domiciled.

DEI was incorporated in Hong Kong in November 2010, and has not earned any income that was derived in Hong Kong since inception and therefore was not subject to Hong Kong income tax.

Certain subsidiaries of the Company were organized under the laws of the PRC which are subject to Enterprise Income Tax ("EIT") on the taxable income as reported in their respective statutory financial statements adjusted in accordance with the Enterprise Income Tax Law. Pursuant to the PRC Income Tax Laws, DGC, FAB Digital, BFICM, BFWSCD, BFPT and BFVCT are subject to EIT at a statutory rate of 25%.

FAB Media was qualified as a High and New Technology Enterprise in Beijing High-Tech Zone in December 24, 2010, and is entitled to a preferential tax rate of 15% through December 2015.

DEI files income tax returns with both the National Tax Bureau and the Local Tax Bureaus in the PRC. All tax returns of DEI since inception are subject to tax examination by tax authorities.

DEI recognized deferred tax assets in the amount of \$8,058,065 and \$5,117,965 as of December 31, 2013 and 2012, respectively. Deferred tax assets represent temporary differences arising primarily from deferred revenue and the allowance for doubtful accounts. The components of deferred tax assets are as follows:

	December 31, 2013	December 31, 2012
Current deferred tax assets		
Deferred revenue	\$ 2,830,200	\$ 1,771,799
Valuation allowance	-	-
Net current deferred tax assets	<u>\$ 2,830,200</u>	<u>\$ 1,771,799</u>
Non-current deferred assets		
Deferred revenue	\$ 5,227,865	\$ 3,346,166
Valuation allowance	-	-
Net non-current deferred tax assets	<u>\$ 5,227,865</u>	<u>\$ 3,346,166</u>
	<u>\$ 8,058,065</u>	<u>\$ 5,117,965</u>

Income tax expense (benefit) consists of:

	December 31 2013	December 31 2012
Current income tax expense	\$ 9,287,453	\$ 1,908,689
Deferred income tax benefit	(2,747,060)	(609,985)
Total net taxes expense	<u>\$ 6,540,393</u>	<u>\$ 1,350,704</u>

Taxes payable consist of the following:

	December 31 2013	December 31 2012
Value added tax payable	\$ 365,558	\$ (411,352)
Income tax payable	1,988,083	1,885,489
Business tax payable	(6,592)	(6,404)
Other	261,772	136,088
Total taxes payable	<u>\$ 2,608,821</u>	<u>\$ 1,603,821</u>

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – INCOME TAXES (Continued)

The Company accounts for U.S. income taxes in accordance with FASB ASC Topic 740, Accounting for Income Taxes which requires the Company to provide a net deferred tax asset or liability equal to the expected future tax benefit or expense of temporary reporting differences between book and tax accounting and any available operating loss or tax credit carryforwards. At December 31, 2013 and 2012, the total of all deferred tax assets was \$21,016,096 and \$21,381,056, respectively, and the total of the deferred tax assets related to good will was \$(279,788) and \$275,687, respectively. The amount of and ultimate realization of the benefits from the deferred tax assets for income tax purposes is dependent, in part, upon the tax laws in effect, the Company's future earnings, and other future events, the effects of which cannot be determined. Because of the uncertainty surrounding the realization of the deferred tax assets the Company has established a valuation allowance of \$21,021,779 and \$21,386,739 for the years ended December 31, 2013 and 2012. The change in the valuation allowance for the years ended December 31, 2013 and 2012 was \$(364,960) and \$3,022,397, respectively.

The components of U.S. income tax expense (benefit) from continuing operations for the years ended December 31, 2013 and 2012 consist of the following:

	For the years ended December 31	
	2013	2012
Current tax expense:		
Federal	\$ -	-
State	-	-
Current tax expense	<u>-</u>	<u>-</u>
Deferred tax expense (benefit):		
Allowance for doubtful accounts	-	414
Bonus accrual	-	12,874
Vacation accrual	-	340
Non-cash compensation – Options	(172,033)	-
Goodwill – tax amortization	555,476	555,476
Net operating loss carryforward	(18,483)	(3,519,099)
Change in effective rate	-	(72,401)
Valuation allowance	<u>(364,960)</u>	<u>3,022,396</u>
Deferred Tax Expense	<u>-</u>	<u>-</u>
Income tax expense	<u>\$ -</u>	<u>\$ -</u>

Deferred income tax expense/(benefit) results primarily from the reversal of temporary timing differences between tax and financial statement income.

A reconciliation of income tax expense at the U.S. federal statutory rate to income tax expense at the company's effective rate is as follows:

	December 31,	
	2013	2012
Current deferred tax assets:		
Computed tax at the expected statutory rate	\$ (110,943)	\$ (2,475,330)
State and local income taxes, net of federal	(20,893)	(479,154)
Return to accrual adjustment	493,593	-
Other non-deductible expenses	3,203	2,760
Non-cash compensation – options	-	1,729
Change in valuation allowance	(364,960)	3,022,396
Change in effective rate	-	(72,401)
Income tax expense	<u>\$ -</u>	<u>\$ -</u>

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – INCOME TAXES (Continued)

The temporary differences, tax credits and carryforwards gave rise to the following deferred tax asset at December 31, 2013 and 2012:

	December 31,	
	2013	2012
Current deferred tax assets (liabilities):		
Allowance for doubtful accounts	\$ 5,683	\$ 5,683
Bonus accrual	-	-
Vacation accrual	-	-
Valuation allowance	(5,683)	(5,683)
Total current deferred tax assets (liabilities)	-	-
Long-term deferred tax assets (liabilities):		
Excess of goodwill/intangible assets		
amortization for tax over book	(279,788)	275,687
Non-cash compensation – Options	172,033	-
Net operating loss carryforward	21,123,851	21,105,369
Valuation allowance	(21,016,096)	(21,381,056)
Total long-term deferred tax assets (liabilities)	-	-
	\$ -	\$ -

The Company has available at December 31, 2013 operating loss carryforwards of approximately \$52,000,000 in the U.S. which may be applied against future taxable income and which expires in various years through 2032. Various provisions of the Internal Revenue Code limit the amount of net operating loss or other tax attributes that can be used prospectively following a business combination or merger. The Company has determined that it is not subject to these limitations for the 2013 tax year. The Company will evaluate the applicability of the tax attribute-limiting provisions prospectively.

We file U.S. federal, and multiple U.S. state returns, and we are generally no longer subject to tax examinations for years prior to 2009 for U.S. federal and U.S. states tax returns.

NOTE 13 - CAPITAL STOCK

**Preferred Stock** - The Company has authorized 10,000,000 shares of preferred stock, \$.001 par value. As of December 31, 2012, the Company had 290 Series B Preferred shares issued and outstanding.

On September 26, 2012, at the Closing of the DEI acquisition, the Company issued, as additional consideration 290 “unregistered” and “restricted” shares of its Series B Convertible Preferred Stock.

The Preferred Stock has no dividend rights or voting rights or the right to receive any assets of the Company upon liquidation, dissolution or winding up. The Preferred Stock will be convertible into shares of the Company’s common stock in three tranches upon the occurrence of certain conversion events (see note 16 – Contingencies).

Upon the occurrence of each conversion event, the three tranches of Preferred Stock will be convertible into a number of shares of common stock that will bring the overall equity position in the Company of the holders of the Initial Company Shares, the Preferred Stock and the common stock issuable upon conversion of the Preferred Stock, on a fully diluted basis as of the date of Closing, to 70%, 74% and 78%, respectively. Based on a total of 10,702,309 fully-diluted outstanding common shares as of the Closing date, 14,689,444 common shares will be issuable upon conversion of the first tranche of Preferred Stock; 5,488,364 common shares upon conversion of the second tranche; and 7,484,132 common shares upon conversion of the third tranche.

**1 for 12 Reverse Stock Split** – On February 8, 2012, the Company shareholders approved a 1 for 12 reverse stock-split for shareholders of record on February 23, 2012. The company issued 2,739 common shares for the fractional shares resulting from the split.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - CAPITAL STOCK (Continued)

**Common Stock** - The Company has authorized 200,000,000 shares of common stock, \$.001 par value. As of December 31, 2013, the Company had 20,805,860 common shares issued and outstanding.

On January 25, 2013, the Company issued 257,000 common shares valued at \$529,080 to consultants for services rendered.

On May 21, 2013, the Company issued 80,000 common shares valued at \$164,800 to consultants for services rendered.

During the 2013, the company recorded \$423,796 of non-cash compensation expense related to the vesting of certain stock options issued.

On February 24, 2012, the Company issued 37,500 common shares upon the exercise of options valued at \$63,000 to consultants and employees for services rendered.

On March 21, 2012, the Company issued 28,334 common shares upon the exercise of options valued at \$47,601 to consultants and employees for services rendered.

On March 21, 2012, the Company issued 429,169 common shares valued at \$721,004 to consultants and employees for services rendered.

On May 29, 2012, the Company issued 70,553 common shares upon the exercise of options valued at \$118,529 to management for services rendered.

On June 4, 2012, the Company issued 37,254 common shares upon the exercise of options valued at \$76,371 to management for services rendered.

On August 2, 2012, the Company issued 15,784 common shares upon the cashless exercise of warrants valued at \$67,086.

On August 14, 2012, the Company entered into a Warrant Amendment Agreement with holders of its Common Stock Purchase Warrants. Under the terms of the Agreement, the parties agreed to reduce the exercise price of the Warrants from \$5.16 per share to \$3.25. The Warrant Holders exercised 341,208 warrants for 341,207 shares of the Company's Common Stock. The Company received proceeds of \$1,108,923.

On August 27, 2012, the Company issued 925,177 common shares upon the exercise of options valued at \$3,222,079 to consultants, employees, management and board members.

On August 29, 2012, the Company issued 50,000 common shares valued at \$232,500 to consultant for services rendered.

On September 26, 2012, the Company completed the acquisition of all of the issued and outstanding shares of capital stock of DEI, a company incorporated under the law of the Hong Kong Special Administrative Region in exchange for the issuance of a total of 10,282,611 "unregistered" and "restricted" shares of the Company's common stock, representing 49% of the Company's issued and outstanding common shares, on a fully-diluted basis, immediately after the closing. (See note 16 – Contingencies)

On September 28, 2012, the Company issued 123,000 common shares upon the exercise of options valued at \$632,220 to consultants for services.

During the 2012, the company recorded \$5,086 of non-cash compensation expense related to the vesting of certain stock options issued.

Effective October 1, 2012, FAB Universal Corp spun-off FHA, a wholly owned. Each shareholder of FAB Universal received one share of common stock of FHA for each share of FU held as of the record date of September 5, 2012. FHA is traded on the OTCBB under the ticker symbol "FUTU".



FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 – STOCK OPTIONS AND WARRANTS

At December 31, 2013, the Company had 99,060 warrants outstanding to purchase common stock of the Company at \$5.16 per share held by Iroquois Master Fund Ltd.

Under the terms of the warrant held by Iroquois Master Fund Ltd., if it is deemed that another person acquires more than 50% of the outstanding shares of Common Stock of the Company, a Fundamental Transaction, the holder of the warrant is entitled to receive the shares of stock originally represented by the warrant upon subsequent exercise of the warrant and any additional consideration, the “Alternate Consideration”.

Alternatively, at the Holder’s option, exercisable at any time concurrently with, or within 30 days after, the consummation of the Fundamental Transaction, the Company may purchase this Warrant from the Holder by paying to the Holder an amount of cash equal to the Black Scholes Value of the remaining unexercised portion of this Warrant on the date of the consummation of such Fundamental Transaction.

The Company has multiple Stock Options plans. Under the plans, the Board is empowered to grant stock options to employees and officers of the Company. The following table shows the total number of shares of common stock available under each plan, the number of options exercised during 2013 and the options that remain available under each plan.

<u>Plan Name</u>	<u>Total Available</u>	<u>Options Granted During 2013</u>	<u>Options Exercised During 2013</u>	<u>Remaining Available</u>
2013 Plan	3,000,000	-	-	3,000,000
2012 Plan	3,000,000	250,000	-	1,788,667
2010 Plan	166,667	-	-	0
2009 Plan	166,667	-	-	0
2008 Plan	16,667	-	-	28
2008 Key Employee Plan	33,334	-	-	260
2007 Plan	16,667	-	-	12
2007 Key Employee Plan	16,667	-	-	0
2006 Key Employee Plan	11,459	-	-	0
Total	<u>6,428,128</u>	<u>250,000</u>	<u>-</u>	<u>4,788,967</u>

The fair value of option grants during 2013 was determined using the Black-Scholes option valuation model. The significant weighted average assumptions relating to the valuation of the Company’s Stock Options for 2013 and 2012 were as follows:

	<u>2013</u>	<u>2012</u>
Dividend yield	0%	0%
Expected life	11 yrs	0 yrs
Expected volatility	82.76%	0.00%
Risk-free interest rate	2.17%	0.00%

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 – STOCK OPTIONS AND WARRANTS (Continued)

A summary of the status of options granted at December 31, 2013, and changes during the year then ended are as follows:

	For the Year Ended December 31, 2013			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	-	\$ 0.00	-	\$ -
Granted	250,000	3.52	10.5 years	-
Exercised	-	0.00	-	-
Forfeited	-	0.00	-	-
Expired	-	0.00	-	-
Outstanding at end of year	250,000	3.52	10.5 years	-
Vested and expected to vest in the future	-	0.00	0.0 years	-
Exercisable at end of year	-	0.00	0.0 years	-
Weighted average fair value of options granted	250,000	\$ 3.52	10.5 years	\$ -

The Company had zero non-vested options at the beginning of the year. At December 31, 2013 the Company had 250,000 options granted that remain unexercised.

During the years ended December 31, 2013 and 2012, the Company recorded \$423,796 and \$5,086 of non-cash compensation expense related to the vested stock options issued to employees.

For the years December 31, 2013 and 2012, the Company recorded non-cash compensation cost of \$329,600 and \$4,159,800 for vested and exercised options issued to management, board members, employees and consultants.

NOTE 15 – INCOME (LOSS) PER COMMON SHARE

The following data show the amounts used in computing income (loss) per share and the weighted average number of shares of common stock outstanding for the periods presented:

	2013	2012
Net income (loss) from continuing operations	\$ 20,653,473	\$ (4,182,501)
Net income from discontinued operations	-	178,276
Net income (loss) available to common shareholders (numerator)	\$ 20,653,473	\$ (4,004,225)
Weighted average number of common shares outstanding during the period used in basic and diluted income (loss) per share (denominator)	20,757,353	11,779,195

At December 31, 2013, the Company had 99,060 warrants outstanding to purchase common stock of the Company at \$5.16 per share, and the Company had 250,000 options outstanding to purchase common stock of the Company at \$3.52 per share.

At December 31, 2012, the Company had 99,060 warrants outstanding to purchase common stock of the Company at \$5.16 per share, which were not included in the loss per share computation because their effect would be anti-dilutive.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 - CONTINGENCIES

**Contingent Consideration for the Acquisition of DEI** As further discussed in Notes 1 and 12, the Initial Company Shares are subject to the terms of the Voting Agreement, which assigns to the Company's Board of Directors the right to vote all of the Initial Company Shares until the following milestones are achieved for a period of eight (8) consecutive and complete reporting quarters of the Company after the Closing:

(i) if DEI and the VIE Entity successfully complete all of the Corporate Governance Objectives for two (2) consecutive and complete reporting quarters after the Closing, the Company's Board of Directors will release the voting rights to 50% of the Initial Company Shares held by the designees at such time. (The voting rights were released on 50% of the Initial Company shares.)

(ii) upon successful completion of all of the Corporate Governance Objectives for six (6) consecutive and complete reporting quarters after the Closing, the Company's Board of Directors will release the voting rights to another 25% of the Initial Company Shares and; (The voting rights were not released on 25% of the Initial Company shares.)

(iii) upon the successful completion of all of the Corporate Governance Objectives for eight (8) consecutive and complete reporting quarters after the Closing, the Company's Board of Directors will release the voting rights to the remaining Initial Company Shares. (The voting rights were not released on the remaining Initial Company shares.)

Fifty percent of the Initial Company Shares (the "Lock-up Shares") are also subject to the terms of a Lock-up Agreement by which UEG's designees have agreed not to transfer, sell, hypothecate or gift such Lock-up Shares for a period of 12 months following the Closing date.

In addition, during the first 24 months after the Closing, DEI and each of its permitted transferees or designees will have piggyback registration rights with respect to all Initial Company Shares that are not then subject to the restrictions of the Lock-up Agreement or the Voting Agreement, and all Company shares that have been issued upon conversion of Preferred Stock to cause such shares to be included in (i) any registration statement that the Company files with the Securities and Exchange Commission to register under the Securities Act of 1933, as amended, common shares held by any person who was a stockholder of the Company at the time of Closing (or any transferee thereof); or (ii) any other registration statement filed by the Company so long as a majority of the Company's Board of Directors has made a good faith determination that such piggyback registration will not significantly prejudice the Company's ability to raise capital.

As additional consideration for the acquisition, the Company issued 290 share of Series B Convertible Preferred Stock. The Company further agreed to convert these shares of Preferred Stock into additional shares of common stock upon DEI achieving corporate government requirement and financial results.

The Preferred Stock will be convertible into shares of the Company's common stock in three (3) tranches upon the occurrence of the following conversion events:

(i) upon the successful completion of certain Corporate Governance Objectives for the four (4) consecutive and complete reporting quarters of the Company immediately following the Closing, the designees shall have the right to convert the first tranche of 210 shares of Preferred Stock into shares of the Company's common stock;

(ii) upon the successful completion of: (a) all of the Corporate Governance Objectives for the four (4) consecutive and complete reporting quarters of the Company immediately following the Closing; and (b) a Revenue Objective requiring DEI to attain sales revenues of at least US\$60,000,000 and net income of US\$12,000,000 for fiscal year 2011, UEG's designees shall have the right to convert the second tranche of 40 shares of Preferred Stock into shares of the Company's common stock. Only the revenue and net income objectives were met.

(iii) upon the successful completion of (a) all of the Corporate Governance Objectives for the six (6) consecutive and complete reporting quarters of the Company immediately following the Closing; and (b) a Revenue Objective requiring that DEI attain sales revenues of at least US\$70,000,000 and net income of US\$14,000,000 for fiscal year 2012, UEG's designees shall have the right to convert the third tranche of 40 shares of Preferred Stock into shares of the Company's common stock. Only the revenue and net income objectives were met.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 – CONTINGENCIES (Continued)

Pending lawsuit

In November and December 2013, three putative class action lawsuits were filed in the federal court for the Southern District of New York against FAB Universal Corp., its CEO and its CFO. The actions are: *Simmons v. Spencer et al.* (1:13-cv-08216-RWS, filed 11/18/13), *Stubblefield v. Fab Universal Corp. et al.* (1:13-cv-08499-RWS, filed 11/27/13), and *Cox v. Fab Universal Corp. et al.* (1:13-cv-08716-RWS, filed 12/09/13). According to the complaints, defendants made false and/or misleading statements and failed to disclose material adverse facts about FAB’s business, operations, prospects and performance. Plaintiffs allege that defendants overstated the number of kiosks that FAB had deployed. FAB’s kiosks are “inundated with pirated digital entertainment content,” and the company’s Chinese subsidiary issued RMB 100 million (\$16.4 million) worth of bonds to Chinese investors that are not reflected in the Company’s publicly disclosed financial statements. Based on the foregoing, plaintiffs assert causes of action for violation of Sections 10(b) and 20(a) of the securities Exchange Act of 1934. Plaintiffs seek unspecified compensatory damages, recessionary damages, fees and costs.

In February 2014, two derivative actions were filed in the federal court for the Southern District of New York against its CEO, CFO and board of directors. The suits are *Thorbjonsen v. Spencer et al.* (1:14-cv-00687-UA, filed 02/03/14) and *Rowekamp v. Spencer et al.* (1:14-cv-01114-RWS, filed 02/21/14). Plaintiffs in the derivative action claim, on behalf of FAB Universal that Defendants breached their fiduciary duties of loyalty, due care, good faith, independence, candor and full disclosure to shareholders; misappropriated material, non-public information of FAB Universal, and violated of Section 14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 promulgated there under.

In 2009, West Chang’an Avenue Development Co., Ltd (“landlord”) filed a lawsuit against FAB Media for unpaid rent and other payments due the landlord. The court ruled in favor of the plaintiff, and with this ruling the two parties reached a settlement, which included the implementation of the Lease Agreement commencing January 1, 2010. The ruling was that FAB pay rent in arrears, penalty and property fees totaling RMB 2 million (\$0.32million USD). The landlord then filed a claim against the Company for rent in arrears.

The Company appealed the decision, and the result was the court overturned the decision and remanded the case. However, after a retrial, the court ruled in favor of the plaintiff, and the company had to vacate the leased space, pay off the rent, property fees and penalty, totaling about RMB 5.9 million (\$0.95 million USD).

The case went through second trial, and the retrial procedure did not change the verdict. Payment plus interest on the debt of period, the amount payable rose to RMB 7 million (\$1.1 million USD). On May 23, 2014, the court ruled in favor of the plaintiff and the judgment for rent in arrears and penalty is RMB \$7.5 million (\$1.2 million USD). The judgment has been in force, and has entered into the implementation procedure. The Company has to fulfill the payment in an amount of approximately RMB \$7.5 million (\$1.2 million USD).

NOTE 17 – RESTATEMENT OF PREVIOUSLY ISSUED UNAUDITED QUARTERLY FINANCIAL INFORMATION

Subsequent to the issuance of our interim financial statements for the second and third quarter 2013, management became aware of several financial statement errors due to an unreported bond offering (see Note 8). The Company has restated certain line items in the unaudited consolidated financial statements. The restatement impact on the unaudited condensed consolidated statements consist of the following items:

Consolidated balance sheet

- reflect the net proceeds on the bond offering in cash totaling \$15.8 million;
- reflect the deferred financing costs as a prepaid expense of \$459,000 and \$419,000 as of June 30, 2013 and September 30, 2013, respectively. The amount represents the underwriter’s fee which is amortized on a straight-lined basis over the life of the bond (3 Years);
- reflect the accrual of interest expense \$324,000 and \$778,000 on the bond as accrued expense. The amounts represent interest due to the holders of the bond through June 30, 2013 and September 30, 2013, respectively. Interest on the bond is paid on an annual basis.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – RESTATEMENT OF PREVIOUSLY ISSUED UNAUDITED QUARTERLY FINANCIAL INFORMATION  
(Continued)

- reflect the long-term bond payable of \$16.3 million as of June 30, 2013 and September 30, 2013.

Consolidated statement of operations and comprehensive income (loss)

- The net impact of interest expense, deferred financing costs and interest income reflect a \$476,000 and \$820,000 decrease of net income for the three and nine month periods ended September 30, 2013, respectively.
- The net impact of interest expense, deferred financing costs and interest income reflect a \$344,000 decrease of net income for the three and six month periods ended June 30, 2013.

Consolidated statement of cash flows

- As a result of above and restatement, the corresponding line items on the consolidated statements of cash flows have been restated.

The effect of restatement and the impact on the quarterly unaudited condensed consolidated balance sheet as of June 30, 2013 and September 30, 2013, the unaudited consolidated statement of operation and comprehensive income (loss) for the three and six month periods ended June 30, 2013, and the three and nine month periods ended September 30, 2013, and the unaudited condensed consolidated statement of cash flows for the six months ended June 30, 2013 and nine months ended September 30, 2013, are presented below.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEET  
(includes only the restated accounts)

	As of June 30, 2013		
	As restated	As previously reported	Changes Inc(dec)
Cash	\$ 43,488,954	\$ 27,675,214	\$ 15,813,740
Other current assets	847,174	387,815	459,359
Total current assets	63,160,794	46,887,695	16,273,099
Total assets	210,889,142	194,616,043	16,273,099
Accrued expenses	3,069,905	2,745,809	324,096
Total current liabilities	28,073,327	27,749,231	324,096
Long-term bond payable	16,294,075	-	16,294,075
Total liabilities	65,792,912	49,174,741	16,618,171
Accumulated other comprehensive income	3,417,376	3,418,424	(1,048)
Accumulated deficit	(65,871,492)	(65,527,468)	(344,024)
Total stockholders' equity	145,096,230	145,441,302	(345,072)
Total liabilities and stockholders' equity	\$ 210,889,142	\$ 194,616,043	\$ 16,273,099

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – RESTATEMENT OF PREVIOUSLY ISSUED UNAUDITED QUARTERLY FINANCIAL INFORMATION  
(Continued)

FAB UNIVERSAL CORP AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF  
OPERATIONS AND COMPREHENSIVE INCOME (LOSS)  
(includes only the restated accounts)

	For the Three Months Ended June 30, 2013			For the Six Months Ended June 30, 2013		
	As restated	As previously reported	Change Inc(dec)	As restated	As previously reported	Change Inc(dec)
Interest income	\$ 8,461	\$ -	\$ 8,461	\$ 37,020	\$ 28,559	\$ 8,461
Interest (expense)	(327,115)	(4,004)	323,111	(366,265)	(43,154)	323,111
Other income (expense)	(85,147)	(55,773)	29,374	(84,344)	(54,970)	29,374
Total Other Income (Expense)	(403,801)	(59,777)	344,024	(413,589)	(69,565)	344,024
Income (loss) from continuing operations before income taxes	7,043,981	7,388,005	(344,024)	11,290,820	11,634,844	(344,024)
Net income (loss) from continuing operations	5,385,139	5,729,163	(344,024)	8,389,136	8,733,160	(344,024)
Net Income (loss)	5,385,139	5,729,163	(344,024)	8,389,136	8,733,160	(344,024)
Foreign currency translation gain	1,542,802	1,543,850	(1,048)	2,033,011	2,034,059	(1,048)
COMPREHENSIVE INCOME (LOSS)	\$ 6,927,941	\$ 7,273,013	\$ (345,072)	\$ 10,422,147	\$ 10,767,219	\$ (345,072)
BASIC AND DILUTED INCOME PER COMMON SHARE FROM CONTINUING OPERATIONS	\$ 0.26	\$ 0.28	\$ (0.02)	\$ 0.41	\$ 0.42	\$ (0.01)
BASIC AND DILUTED INCOME PER COMMON SHARE	\$ 0.26	\$ 0.28	\$ (0.02)	\$ 0.41	\$ 0.42	\$ (0.01)

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – RESTATEMENT OF PREVIOUSLY ISSUED UNAUDITED QUARTERLY FINANCIAL INFORMATION  
(Continued)

FAB UNIVERSAL CORP AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(includes only the restated accounts)

	For the Six Months Ended June 30, 2013		
	As restated	As previously reported	Change Inc/(dec)
<b>Cash Flows from Operating Activities</b>			
Net income (loss) from continuing operations	\$ 8,389,136	\$ 8,733,160	\$ (344,024)
Change in assets and liabilities:			
Prepaid expenses	144,161	603,520	(459,359)
Accrued expense	327,527	3,431	324,096
Net Cash Provided by (Used in) continuing operations	22,049,025	22,528,312	(479,287)
Net Cash Provided by (Used in) Operating Activities	22,049,025	22,528,312	(479,287)
<b>Cash Flows from Financing Activities:</b>			
Proceeds from long-term bond offering	16,294,075	-	16,294,075
Net Cash Used in Financing Activities	16,146,771	(147,304)	16,294,075
Effect of Exchange Rate Fluctuation on Cash	340,544	341,592	(1,048)
Net Increase (decrease) in Cash	23,817,017	8,003,277	15,813,740
Cash at Beginning of Period	19,671,937	19,671,937	-
Cash at the end of Period	\$ 43,488,954	\$ 27,675,214	\$ 15,813,740

FAB UNIVERSAL CORP AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEET  
(includes only restated accounts)

	As of September 30, 2013		
	As restated	As previously reported	Changes Inc/(dec)
Cash	\$ 59,444,652	\$ 43,575,330	\$ 15,869,322
Other current assets	713,113	293,724	419,389
Total current assets	79,593,866	63,305,155	16,288,711
Total assets	227,060,169	210,771,458	16,288,711
Accrued expenses	3,710,012	2,932,105	777,907
Total current liabilities	30,937,368	30,159,461	777,907
Long-term bond payable	16,336,933	-	16,336,933
Total liabilities	74,612,311	57,497,471	17,114,840
Accumulated other comprehensive income	3,766,299	3,772,701	(6,402)
Accumulated deficit	(59,055,756)	(58,236,029)	(819,727)
Total stockholders' equity	152,447,858	153,273,987	(826,129)
Total liabilities and stockholders' equity	\$ 227,060,169	\$ 210,771,458	\$ 16,288,711

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – RESTATEMENT OF PREVIOUSLY ISSUED UNAUDITED QUARTERLY FINANCIAL INFORMATION  
(Continued)

FAB UNIVERSAL CORP AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF  
OPERATIONS AND COMPREHENSIVE INCOME (LOSS)  
(Includes only restated accounts)

	For the Three Months Ended Sept. 30, 2013			For the Nine Months Ended Sept. 30, 2013		
	As restated	As previously reported	Change Inc(dec)	As restated	As previously reported	Change Inc(dec)
Interest income	\$ 40,941	\$ 27,079	\$ 13,862	\$ 77,961	\$ 55,638	\$ 22,323
Interest (expense)	(515,291)	(66,523)	448,768	(881,556)	(109,677)	771,879
Other income (expense)	(48,255)	(7,458)	40,797	(132,599)	(62,428)	70,171
Total Other Income (Expense)	(522,605)	(46,902)	475,703	(936,194)	(116,467)	819,727
Income (loss) from continuing operations before income taxes	8,680,283	9,155,986	(475,703)	19,971,103	20,790,830	(819,727)
Net income (loss) from continuing operations	6,815,736	7,291,439	(475,703)	15,204,872	16,024,599	(819,727)
Net Income (loss)	6,815,736	7,291,439	(475,703)	15,204,872	16,024,599	(819,727)
Foreign currency translation gain	348,923	354,277	(5,354)	2,381,934	2,388,336	(6,402)
COMPREHENSIVE INCOME (LOSS)	\$ 7,164,659	\$ 7,645,716	\$ (481,057)	\$ 17,586,806	\$ 18,412,935	\$ (826,129)
BASIC AND DILUTED INCOME PER COMMON SHARE FROM CONTINUING OPERATIONS	\$ 0.33	\$ 0.35	\$ (0.02)	\$ 0.73	\$ 0.77	\$ (0.04)
BASIC AND DILUTED INCOME PER COMMON SHARE	\$ 0.33	\$ 0.35	\$ (0.02)	\$ 0.73	\$ 0.77	\$ (0.04)



FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – RESTATEMENT OF PREVIOUSLY ISSUED UNAUDITED QUARTERLY FINANCIAL INFORMATION  
(Continued)

FAB UNIVERSAL CORP AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(includes only restated accounts)

	For the Nine Months Ended September 30, 2013		
	As restated	As previously reported	Change Inc/(dec)
<b>Cash Flows from Operating Activities</b>			
Net income (loss) from continuing operations	\$ 15,204,872	\$ 16,024,599	\$ (819,727)
Change in assets and liabilities:			
Prepaid expenses	285,139	704,528	(419,389)
Accrued expense	960,545	182,638	777,907
Net Cash Provided by continuing operations	38,576,554	39,037,763	(461,209)
Net Cash Provided by Operating Activities	38,576,554	39,037,763	(461,209)
<b>Cash Flows from Financing Activities:</b>			
Proceeds from long-term bond offering	16,336,933	-	16,336,933
Net Cash Provided by (Used in) Financing Activities	15,915,199	(421,734)	16,336,933
Effect of Exchange Rate Fluctuation on Cash	476,752	483,154	(6,402)
Net Increase (decrease) in Cash	39,772,715	23,903,393	15,869,322
Cash at Beginning of Period	19,671,937	19,671,937	-
Cash at the end of Period	\$ 59,444,652	\$ 43,575,330	\$ 15,869,322

NOTE 18 - CONCENTRATIONS

For the years ended December 31, 2013 and 2012, no individual customer accounted for more than 10% of the total revenues. As of December 31, 2013, three customers accounted for 16%, 11%, and 10% and as of December 31, 2012, no single customer accounted for more than 10% of total outstanding accounts receivable, respectively.

For the years ended December 31, 2013, no individual suppliers accounted for more than 10% of the Company's purchases, no single vendor accounted for more than 10% of total outstanding accounts payable. For the year ended December 31, 2012, four vendors provided 16%, 13%, 13% and 10% of the Company's purchases, respectively, one vendor accounted for 14% of the total outstanding accounts payable.

NOTE 19 - SEGMENT REPORTING

ASC 280, "Segment Reporting", establishes standards for reporting information about operating segments on a basis consistent with the Company's internal organizational structure as well as information about geographical areas, business segments and major customers in financial statements for details on the Company's business segments.

The Company is engaged in distribution of digital entertainment products and services. The Company's chief operating decision maker ("CODM") has been identified as the CEO who reviews the financial information of separate operating segments when making decisions about allocating resources and assessing performance of the group. Based on management's assessment, the Company has determined that it has three operating segments as of December 31, 2013 which are wholesale, retail and FAB brand licensing.

FAB UNIVERSAL CORP AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 - SEGMENT REPORTING (Continued)

The following table presents summary information by segment for the years ended December 31, 2013 and 2012, respectively:

	2013				2012			
	Wholesale	Retail	Digital	Total	Wholesale	Retail	Digital	Total
Revenue	\$ 60,404	\$ 9,010	\$ 41,459	\$ 110,873	\$ 16,409	\$ 2,000	\$ 9,050	\$ 27,459
Cost of revenue	\$ 48,537	\$ 6,543	\$ 8,379	\$ 63,459	\$ 12,902	\$ 1,449	\$ 2,089	\$ 16,440
Gross Profit	\$ 11,867	\$ 2,467	\$ 33,080	\$ 47,414	\$ 3,507	\$ 552	\$ 6,960	\$ 11,019
Total assets	\$ 74,705	\$ 49,741	\$ 116,387	\$ 240,833	\$ 37,061	\$ 24,719	\$ 106,015	\$ 167,795
Depreciation and amortization	\$ 252	\$ 888	\$ 5,748	\$ 6,888	\$ 156	\$ 305	\$ 1,511	\$ 1,972

NOTE 20 – QUARTERLY FINANCIAL INFORMATION (Unaudited)

The following table set forth unaudited financial information on a quarterly basis for each of the last two years:

(in thousands)	First	Second	Third	Fourth	Total
	Quarter	Quarter	Quarter	Quarter	
<b>2013</b>		restated	restated		
Revenues	\$ 22,636	\$ 25,857	\$ 29,751	\$ 32,629	\$ 110,873
Gross profit	8,375	11,495	14,090	13,454	47,414
Operating income (loss) – continuing operations	4,247	7,043	8,680	7,224	27,194
Net income (loss) – continuing operations	3,004	5,385	6,816	5,448	20,653
Net income (loss) available to common stockholders	3,004	5,385	6,816	5,448	20,653
Basic and diluted income (loss) per share – continuing operations	0.15	0.26	0.33	0.25	0.99
Basic and diluted income (loss) per share	0.15	0.26	0.33	0.25	0.99
<b>2012</b>					
Revenues	\$ 847	\$ 870	\$ 1,745	\$ 23,997	\$ 27,459
Gross profit	548	507	961	9,003	11,019
Operating loss – continuing operations	(1,103)	(517)	(4,784)	3,572	(2,832)
Net loss – continuing operations	(1,103)	(517)	(4,836)	2,274	(4,182)
Net loss	(997)	(330)	(4,950)	2,273	(4,004)
Basic and diluted loss per share – continuing operations	(0.13)	(0.06)	(0.50)	0.33	(0.36)
Basic and diluted loss per share	(0.12)	(0.04)	(0.51)	0.33	(0.34)

NOTE 21 - SUBSEQUENT EVENTS

On January 7, 2014, the Board of Directors decided not to purchase the Longyuan building, and the Company started the process for the return of the deposit. The deposit has not been returned and we are currently in negotiations with the owner of the building as to the amount of the compensation to be paid per the terms of the agreement of Intent for Property Transfer.

On January 23, 2014, FAB Entertainment Corporation, a subsidiary of DGC, entered into a 63 month agreement to lease office space located at 10100 Santa Monica Boulevard, Los Angeles, California. The company paid a security deposit of \$309,312, and the monthly rent will be \$25,776. The lease is guaranteed by FAB Universal Corp.

Management has evaluated subsequent events through June 25, 2014, the date which the consolidated financial statements were available to be issued. All subsequent events requiring recognition as of December 31, 2013 have been incorporated into these consolidated financial statements, and besides the disclosures herein, there are no additional subsequent events that require disclosure in accordance with FASB ASC Topic 855, “Subsequent Events”.

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

### **Item 9A. Controls and Procedures**

**Disclosure Controls and Procedures**—We maintain disclosure controls and procedures that are designed to ensure that information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934 (the “Exchange Act”), such as this Annual Report on Form 10-K, is recorded, processed, summarized and reported within the time periods specified by SEC rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”), to allow timely decisions regarding required disclosure.

Our management evaluated, with the participation of our CEO and CFO, the effectiveness of our disclosure controls and procedures as of December 31, 2013, pursuant to paragraph (b) of Rule 13a-15 under the Exchange Act. This evaluation included a review of the controls’ objectives and design, the operation of the controls, and the effect of the controls on the information presented in this Annual Report. Our management, including the CEO and CFO, do not expect that disclosure controls can or will prevent or detect all errors and all fraud, if any. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Our disclosure controls and procedures are designed to provide such reasonable assurance of achieving their objectives. Also, the projection of any evaluation of the disclosure controls and procedures to future periods is subject to the risk that the disclosure controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on their review and evaluation, and subject to the inherent limitations described above, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were not effective as of December 31, 2013 at the above-described reasonable assurance level.

This annual report does not include an attestation report of the company’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the company’s registered public accounting firm pursuant to rules of the Securities and Exchange Commission that exempts from this requirement issuers that are neither accelerated filers nor large accelerated filers.

There has been no change in our internal control over financial reporting during the quarter ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Board of Directors  
FAB UNIVERSAL CORP AND SUBSIDIARIES

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). Our internal control over financial reporting is designed to provide reasonable assurance to management and the Board of Directors regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework. Based on our assessment, management believes that we did not maintain effective internal control over financial reporting as of December 31, 2013.

Date: 6/27/14

By: /s/ Christopher J. Spencer  
Christopher J. Spencer  
Chief Executive Officer and President

Date: 6/27/14

By: /s/ John Busshaus  
John Busshaus  
Chief Financial Officer

Pittsburgh, Pennsylvania  
June 27, 2014

### Item 9B. Other Information

None; not applicable.

## PART III

### Item 10. Directors, Executive Officers, and Corporate Governance.

#### DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth:

- the names of our current directors and executive officers,
- their ages as of October 21, 2014, which is the anticipated record date for our 2014 annual meeting of stockholders; and
- the capacities in which they currently serve FAB:

Name	Age	Position(s)	Served in Position Since
Zhang Hongcheng	46	Chairman of the Board	2012
Christopher J. Spencer	45	Chief Executive Officer	2001
John Busshaus	51	Chief Financial Officer	2007
Denis Yevstifeyev	32	Director	2007
Douglas Polinsky	55	Director	2007

J. Gregory Smith	45	Director	2007
Gu Jianfen	79	Director	2012
James Rogers, Jr.	72	Director	2013

**Zhang Hongcheng** has served as Chairman of the Board since September 26, 2012. Mr. Zhang has 25 years' experience in digital entertainment product publishing and distribution industry in China. He is the Vice President of China Audio & Video Association, Member of Copyright Society of China, Chairman of National Anti-Piracy Alliance; Chairman of the China Digital Education Industry Alliance and Executive Chairman of International Digital Culture Industry Investment Forum. Mr. Zhang holds China -Europe International Business School EMBA degree.

**Christopher Spencer** has served as our Chief Executive Officer, President and as a director of FAB since February 7, 2001. Mr. Spencer has been responsible for our overall direction since our inception and has been instrumental in leading us to our current position in the podcasting industry. Mr. Spencer has service as Chief Executive Officer, President and a director of Future Healthcare of America since its inception on June 22, 2012. Mr. Spencer also serves as a member of the Board of Directors for T3 Motion Inc. and for Anpath Group Inc. From 1994 until 1996, Mr. Spencer founded and worked for ChinaWire, Inc., a high-technology company engaged in financial remittance between international locations and China. Mr. Spencer worked for Lotto USA, Inc. from 1992-1994, where he was founder and Chief Executive Officer for the Pennsylvania computer networking company. From 1990 until 1992, Mr. Spencer worked for John Valiant, Inc., and was responsible for business concept development and obtaining financing.

**John Busshaus** served as our Controller from April 2006, until his election as our Chief Financial Officer on January 29, 2007. Mr. Busshaus has been responsible for our overall accounting and financial reporting functions since joining the Company in April 2006. Mr. Busshaus has serviced as the Chief Financial Officer of Future Healthcare of America since its inception on June 22, 2012. From 2004 to 2006, Mr. Busshaus was an independent business consultant. Mr. Busshaus' efforts were assisting organizations with the implementation of Sarbanes Oxley, filing of SEC reports, and taking a company through an IPO. Mr. Busshaus worked for Talanga International from 2001 to 2004, where he was the Chief Financial Officer for the company. From 1999 to 2000, Mr. Busshaus worked for Mellon Bank as Controller and Vice President, and was responsible for strategic planning and managing the annual and monthly budgeting within Global Security Services. From 1994 to 1998, Mr. Busshaus worked for PepsiCo as Senior Business Planner, and was responsible for annual and quarterly budgets planning, as well as weekly, monthly and quarterly reporting of results. As a member of management, Mr. Busshaus' efforts contributed to the revenue growth and market share increases in a market that was categorized as saturated.

**Douglas Polinsky** has served as a Director of FAB since October 2007. Mr. Polinsky has service a s a Director of Future Healthcare of America since its inception on June 22, 2012. Mr. Polinsky serves as the President of Great North Capital Corp., a Minnesota-based financial services company he founded in 1995. Great North advises corporate clients on capital formation and other transaction-related financial matters. Mr. Polinsky earned a Bachelor of Science degree in Hotel Administration at the University of Nevada at Las Vegas.

**Greg Smith** has served as a Director of FAB since October 2007. Mr. Smith has service a s a Director of Future Healthcare of America since its inception on June 22, 2012. Mr. Smith is an award-winning producer and entrepreneur with over 10 years of experience in Non-Fiction Television. In 2000, Mr. Smith established The Solution Film Group, LLC and acts as the Company's President. Mr. Smith provides professional production and editorial support for various forms of non-fiction television entertainment, including the direction of media projects from development through production and post-production. His clients include Discovery Channel, Science Channel, Discovery HD Theater, Animal Planet, The Military Channel, PBS, and Discovery Networks International. Mr. Smith most recently won an Emmy in 2006 for the Discovery Channel's animated special Before the Dinosaurs. His other awards for excellence in production and editing include Emmys for the Discovery Channel's Walking with Prehistoric Beasts and Allosaurus: A Walking with Dinosaurs Special. From 1997 to 2000, Mr. Smith worked for Discovery Communications, Inc. in the capacity of Supervising Producer from January 1998 to November 2000, and Producer/Editor from October 1997 to January 1998. From 1995 to 1996, Mr. Smith worked for Discovery Channel Pictures serving as Assistant Editor from March 1996 to October 1997, and Production Assistant from September 1995 to March 1996. From 1994 to 1995, Mr. Smith worked for Crawford Communications in Atlanta, Georgia as a Manager of Satellite Services for The Learning Channel.

**Denis Yevstifeyev** has served as a Director of FAB since October 2007. Mr. Yevstifeyev has service a s a Director of Future Healthcare of America since its inception on June 22, 2012. Mr. Yevstifeyev currently runs a commercial printing company. From 2009 to 2012, Mr. Yevstifeyev served as the Director of Financial Planning & Analysis for Education Management Corporation – Online Higher Education. From 2007 to 2008, Mr. Yevstifeyev served as Sr. Financial

Reporting Analyst for American Eagle Outfitters, Inc, in Pittsburgh. His duties included: preparing and analyzing various internal and external financial reports; researching new accounting pronouncements and evaluating any impact on the financial statements. He also reviewed accounting workpapers and prepared the company's SEC filings for forms 8-K, 10-Q and 10-K. From 2005 to 2007, Mr. Yevstifeyev worked for Schneider Downs, Inc., where he worked on Sarbanes-Oxley compliance engagements. In 2005, Mr. Yevstifeyev graduated with a Bachelor of Science degree in Business from Washington and Jefferson College. He also graduated with honors from the Moscow Bank College of the Central Bank of Russia in Moscow with a degree in Finance in 2000. From 2002 to 2003, Mr. Yevstifeyev served as the Settlement Department Manager for SDM BANK in Moscow, where he dealt with domestic and international corresponding banks, among other responsibilities.

**Gu Jianfen** has served as a Director of FAB since September 2012. Ms. Gu is a musician who has served as a composer at Central Song and Dance Ensemble. She has been a council member for several international organizations, including the China International Cultural Exchange Center, Association for Promoting Peaceful Reunification of China, and Beijing Municipal Association for Friendship with Foreign Countries. Ms. Gu has been recognized by several organizations for her compositions. She won an Excellent Work Award of Asian & Pacific Region, sponsored by UNESCO. She was elected vice-president of the Chinese Musicians Association in 1999. Ms. Gu graduated from the Composition Department of Northeast Music School.

**James Rogers, Jr.** has served as a Director of FAB since June 2013. Mr. Rogers is the co-founder of the Quantum Fund and creator of the Rogers International Commodities Index (the "RICI"), and is presently the Chairman of Beeland Interests, Inc. Mr. Rogers graduated with a bachelor's degree in History from Yale University in 1964. He then acquired a second BA degree in Philosophy, Politics and Economics from Balliol College, Oxford University in 1966. The Quantum Fund was one of the first truly international funds. From 1970 to 1980, performance of Quantum Fund gained 4200% while the S&P advanced about 47%. In 1980, Mr. Rogers decided to "retire", and spent some of his time traveling on a motorcycle around the world. Since then, he has been a guest professor of finance at the Columbia Business School. In 1998, Mr. Rogers founded the Rogers International Commodity Index. In February, 2011, he announced that he has started a new index fund that focuses on "the top companies in agriculture, mining, metals and energy sectors as well as those in the alternative energy space including solar, wind and hydro." The index is called The Rogers Global Resources Equity Index.

There are no non-officer employees who are expected to make a significant contribution to the business.

#### Family Relationships.

There are no family relationships between any of our directors or executive officers.

#### Involvement in Certain Legal Proceedings.

During the past ten years, none of our present or former directors, executive officers or persons nominated to become directors or executive officers:

(1) A petition under the Federal bankruptcy laws or any state insolvency law was filed by or against, or a receiver, fiscal agent or similar officer was appointed by a court for the business or property of such person, or any partnership in which he was a general partner at or within two years before the time of such filing, or any corporation or business association of which he was an executive officer at or within two years before the time of such filing;

(2) Such person was convicted in a criminal proceeding or is a named subject of a pending criminal proceeding (excluding traffic violations and other minor offenses);

(3) Such person was the subject of any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining him from, or otherwise limiting, the following activities:

(i) Acting as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator, floor broker, leverage transaction merchant, any other person regulated by the Commodity Futures Trading Commission, or an associated person of any of the foregoing, or as an investment adviser, underwriter, broker or dealer

in securities, or as an affiliated person, director or employee of any investment company, bank, savings and loan association or insurance company, or engaging in or continuing any conduct or practice in connection with such activity;

(ii) Engaging in any type of business practice; or

(iii) Engaging in any activity in connection with the purchase or sale of any security or commodity or in connection with any violation of Federal or State securities laws or Federal commodities laws;

(4) Such person was the subject of any order, judgment or decree, not subsequently reversed, suspended or vacated, of any Federal or State authority barring, suspending or otherwise limiting for more than 60 days the right of such person to engage in any activity described in paragraph (f)(3)(i) of this section, or to be associated with persons engaged in any such activity;

(5) Such person was found by a court of competent jurisdiction in a civil action or by the Commission to have violated any Federal or State securities law, and the judgment in such civil action or finding by the Commission has not been subsequently reversed, suspended, or vacated;

(6) Such person was found by a court of competent jurisdiction in a civil action or by the Commodity Futures Trading Commission to have violated any Federal commodities law, and the judgment in such civil action or finding by the Commodity Futures Trading Commission has not been subsequently reversed, suspended or vacated;

(7) Such person was the subject of, or a party to, any Federal or State judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated, relating to an alleged violation of:

(i) Any Federal or State securities or commodities law or regulation; or

(ii) Any law or regulation respecting financial institutions or insurance companies including, but not limited to, a temporary or permanent injunction, order of disgorgement or restitution, civil money penalty or temporary or permanent cease-and-desist order, or removal or prohibition order; or

(iii) Any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or

(8) Such person was the subject of, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26))), any registered entity (as defined in Section 1(a)(29) of the Commodity Exchange Act (7 U.S.C. 1(a)(29))), or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

## SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires our officers and directors, and persons who own more than 10% of a registered class of our equity securities, to file reports of ownership and changes in ownership with the SEC. Officers, directors, and greater than 10% stockholders are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. Based solely on a review of the copies of such forms furnished to us with respect to fiscal 2013 and on representations that no other reports were required, we believe that during the 2013 fiscal year all applicable Section 16(a) filing requirements were met.

## CORPORATE GOVERNANCE

### Code of Ethics

We uphold a set of basic values to guide our actions and are committed to maintaining the highest standards of business conduct and corporate governance. We have adopted a Code of Business Conduct and Ethics for directors, officers (including our principal executive officer and principal financial officer) and employees, which, in conjunction with our Certificate of Incorporation, Bylaws and Board of Directors committee charters, form the framework for governance of FAB Universal.

The Code of Ethics and Business Conduct, Board of Directors committee charters, Bylaws and Certificate of Incorporation are available at our corporate offices. Stockholders may request free printed copies of these documents from:

FAB Universal Corp.  
Attn: Chief Financial Officer  
5001 Baum Blvd., Suite 770  
Pittsburgh, PA 15213

### **Board of Directors Independence**

The Board of Directors has determined that each of J. Gregory Smith, Denis Yevstifeyev, Gu Jianfen and Douglas Polinsky has no material relationship with us (either directly or as a partner, stockholder or officer of an organization that has a relationship with us) and satisfies the independence requirements required by the NYSE MKT. The non-management independent directors meet in executive session, without management, at least annually. Mr. Polinsky, an independent non-management director, chairs all executive session meetings of directors.

#### Committees of the Board of Directors

The Board of Directors has adopted written charters for two standing committees: the Nominating Committee and the Audit Committee. The Board has determined that all members of the Nominating and Audit Committees are independent and satisfy the relevant SEC or NYSE MKT independence requirements for members of such committees.

*Nominating Committee.* The Nominating Committee currently consists of Mr. Polinsky as chair, Mr. Yevstifeyev, and Mr. Smith. This committee provides assistance to the Board in identifying individuals qualified to become members of the Board of Directors consistent with Board criteria. The committee also oversees the evaluation of the Board of Directors and management. There have not been any material changes to the procedures by which stockholders recommend nominees to the Board of Directors.

*Audit Committee.* The Audit Committee currently consists of Mr. Polinsky as chair, Mr. Yevstifeyev, and Mr. Smith. Mr. Yevstifeyev, the Board of Directors has determined, is an “audit committee financial expert” as defined under SEC rules. This committee oversees the integrity of our financial statements, disclosure controls and procedures, the systems of internal accounting and financial controls, compliance with legal and regulatory requirements, the qualifications and independence of the independent auditors and the performance of our internal audit function and independent auditors, and the quarterly reviews and annual independent audit of our financial statements. Our independent auditors report directly to the Audit Committee.

We will provide a free printed copy of any of the charters of any Board committee to any stockholder on request.

*Compensation Committee.* The Compensation Committee currently consists of Mr. Rogers as chair, Mr. Polinsky, and Ms. Gu. This committee provides assistance to the Board of Directors in overseeing our compensation policies and practices. It reviews and approves the compensation levels and policies for the Board of Directors; reviews and approves corporate goals and objectives with respect to CEO compensation and, based upon these evaluations, determines and approves the CEO’s compensation; makes recommendations to the Board of Directors with respect to non-CEO executive officer compensation. The Compensation Committee also has the responsibility to provide the report to stockholders on executive officer compensation, which appears below.

### **Item 11. Executive Compensation.**

#### **COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

No member of the compensation committee (i) was an officer or employee of the Company or a subsidiary of the Company during 2013, (ii) was formerly an officer of the Company or a subsidiary of the Company, or (iii) had any relationship required to be disclosed pursuant to Item 404 of Regulation S-K.

During fiscal 2013, none of the Company’s executive officers served as (i) a member of a compensation committee of another company, one of whose executive officers served on the Company’s compensation committee; (ii) a director of



another company, one of whose executive officers served on the Company's compensation committee; or (iii) a member of a compensation committee of another company, one of whose executive officers served as one of the Company's directors.

## COMPENSATION DISCUSSION AND ANALYSIS

### Overview and General Philosophy

At FAB, our focus is to create value through advancement and growth of our media distribution business in China. We are also focused on growing our media business through hosting fees and monetization of unique users. Our executive compensation program supports this goal of value creation by:

- rewarding executives for obtaining performance milestones;
- aligning the interests of executives with the interests of stockholders; and
- attracting and retaining highly motivated and talented executives.

Our compensation elements simultaneously fulfill one or more of these three objectives. The elements include:

- base salary;
- discretionary bonuses (in the form of cash, restricted stock, and stock options);
- benefits programs.

The type and amount of compensation is determined considering current pay, competitive pay data from the external talent market and the opportunity for future pay. We combine compensation elements for each executive in a manner that will meet the performance, alignment and retention goals listed above as well as eliciting the best possible contribution from the executive.

### Compensation Objectives

Our executive compensation philosophy is built around two objectives: supporting stockholder value creation through, aligning the interests of executives with the interests of stockholders, and attracting and retaining highly motivated and talented executives.

Due to our diverse businesses, we have determined that no specific peer group is appropriate to use in defining market pay levels for our named executives. We therefore use general industry data of companies which are a similar size to us based on market capitalization to establish market pay levels.

### Obtained Performance Milestones:

- We construct our annual bonus opportunities to have appropriately aggressive targets that require significant achievement against performance milestones.

### Aligned Interests:

- Our base pay practices reduce fixed costs and emphasize performance-based incentive programs, which we believe are in the best interests of stockholders.
- We base our annual bonus opportunities on performance milestones and value to the stockholder that focus executives on performance results that are of common interest to stockholders.
- We award long-term equity incentive opportunities using stock options and restricted stock so that appreciating stock value is a significant factor in executive compensation.

### Executive Retention:

- We believe our use of lower base salary levels accompanied by an emphasis on incentive programs attracts executives that are appropriately aggressive, innovative, and willing to risk a larger share of their compensation on their own performance and the performance of the Company.
- Discretionary bonuses allow us to adjust to unique market conditions in a timely fashion in order to retain key executives.

#### Compensation Administration

*General Process.* Executive compensation decisions at FAB are the product of several factors, modified by judgment and discretion as necessary. The predominant factors include:

- key performance measurements such as revenue, monthly download of content, and key business developments;
- strategic initiatives such as acquisitions, and implementation of process improvements;
- achievement of specific operational goals relating to the sphere of influence led by the executive;
- compensation of other executives within the Company (to ensure internal equity); and

For the CEO, these factors are judged and compensation is recommended by the Compensation Committee of the Board of Directors and approved by the Board. For the other executive officers (including all of the named executives in the Summary Compensation Table), the factors are considered by the CEO, who recommends compensation levels. These judgments and recommendations are then reviewed and approved or revised by the Compensation Committee.

Generally, the Compensation Committee reviews and makes adjustments to base compensation once per year, effective at the beginning of each fiscal year (January 1). Annual incentives are typically paid within two months of the fiscal year end, usually in mid-February. Equity grants are typically awarded in the spring of each year, in March or early April.

*Role of Compensation Committee.* The Compensation Committee oversees the design, development and implementation of our compensation program. The Committee evaluates the performance of the CEO and determines CEO compensation consistent with the objectives of the compensation program. The Committee also approves all incentive compensation plans and approves or revises recommendations made by the CEO for compensation decisions affecting other executives. The Committee also approves all bonuses, awards and grants under all incentive plans.

*Role of CEO.* Our CEO is responsible for the implementation and administration of our compensation program throughout the organization. The CEO evaluates the performance of executives and, consistent with the objectives of the compensation program, meets with the Compensation Committee to consider and recommend compensation programs, set and evaluate performance milestone, and makes specific recommendations on the form and amount of compensation for named executives.

#### Compensation Components

*Short-Term Compensation.* Consistent with our stated compensation philosophy, our key metric for executive short-term compensation is annual total cash compensation. Discretionary bonuses provide significant upside potential which results in targeted annual total cash compensation.

Our performance for fiscal 2013 was on targeted levels. Company-wide, total revenue for the year was \$111.0 million, and cash on hand at year end was \$101.0 million, an increase of \$81.5 million.

*Base Salary.* We consider base salary a tool to provide executives with a reasonable base level of income relative to the scope of the positions they hold. Base salaries are established based on the level of responsibility for the position. With the exception of the CEO and named executives all base salaries are reviewed annually, and are adjusted from time to time to reflect changes in responsibility level.

In 2013 our named executives' salaries ranged from \$350,000 to \$400,000. In 2012, our named executives' salaries ranged from \$188,760 to \$400,000. Changes in senior executive base pay during fiscal year 2012 included an increase in Mr. Spencer's annual base pay on October 1, 2012 from \$188,760 to \$400,000; and an increase in Mr. Busshaus' annual base pay from \$166,375 to \$350,000 on October 1, 2012.

*Annual Bonus.* Currently, there is not an established annual incentive bonus plan.

*Discretionary Bonuses.* Because there is not an annual incentive plan, the Compensation Committee may determine a discretionary bonus is to be awarded to appropriately reward senior executives. In these cases, discretionary bonuses are used to assure that executives are appropriately rewarded. The Committee determines discretionary bonuses for the CEO. The CEO recommends discretionary bonuses for all other named executives, which are then approved or adjusted by the Committee.

In fiscal year 2013 discretionary bonuses were not awarded to the executive officers, and in 2012, discretionary bonuses were awarded to the executive officers.

Our Compensation Committee believes that we have executed on our compensation philosophy given the level of Company performance in fiscal 2013.

*Long-Term Incentive Compensation.* In 2013 and 2012, we offered a limited group of employees, including all named executives, stock options.

In fiscal 2013, we plan to execute a long-term incentive design that will utilize stock options. For senior management, including named executives, the primary emphasis will be on stock option awards. This results primarily in senior management focus on stock price performance, directly aligning the interests of executives with the interests of stockholders. It also puts a higher percentage of long-term compensation at risk as the design delivers less immediate value to executives.

All stock-options granted to the named executives by the Company must have prior Compensation Committee approval. The exercise price for all stock-based awards coincides with the date the Committee approves the award grant. It is against Company policy to back-date stock-based awards or to try to time stock-based awards for any reason and we have never engaged in these practices.

*Award Adjustment or Recovery.* We do not have a policy to recover or otherwise adjust payments made or awards earned as a result of changes in subsequent periods relating to performance measures upon which such payments or awards are based, sometimes referred to as a "clawback" policy. We have not required any named executive to return any award or repay any payment received in any fiscal year.

*Tax Deductibility of Compensation.* Section 162(m) of the Internal Revenue Code of 1986, as amended, imposes a \$1,000,000 limit on the amount that a public company may deduct for compensation paid to named executives unless compensation is based on an individual's meeting pre-established performance goals determined by a compensation committee and approved by stockholders.

#### Retirement and Other Benefits

Generally, we view retirement savings as a personal matter. We currently do not offer any pre-tax retirement savings through the use of a traditional 401(k) plan; a deferred compensation plan; or other retirement programs.

*Perquisites.* Eligible employees, including named executives, participate in various other employee benefit plans, including medical and dental care plans; flexible spending accounts for health care; life, accidental death and dismemberment and disability insurance; and vacation plans. The primary purpose of providing these plans and limited perquisites to senior executives is to attract and retain talented executives to manage the Company. With respect to non-insurance perquisites, we prefer to take a minimalist approach. For fiscal 2013, the Company did not have executive non-insurance perquisites.

#### Summary Compensation Table

The following sets forth the compensation of FAB's Chief Executive Officer during fiscal 2013, and the other persons who served as executive officers during fiscal 2013. Unless otherwise noted, the amounts shown represent what was earned in fiscal 2013.

SUMMARY COMPENSATION TABLE – FISCAL 2013

<u>Name and principal position</u>	<u>Year</u>	<u>Salary(4)</u> <u>(\$)</u>	<u>Bonus(1)</u> <u>(\$)</u>	<u>Stock(2)</u> <u>awards (\$)</u>	<u>Option(3)</u> <u>awards</u> <u>(\$)</u>	<u>Nonequity</u> <u>incentive plan</u> <u>compensation</u> <u>(\$)</u>	<u>Nonqualified</u> <u>deferred</u> <u>compensation</u> <u>earnings (\$)</u>	<u>All other</u> <u>compensation</u> <u>(\$)</u>	<u>Total (\$)</u>
Chris Spencer – CEO	2013	400,000	0	0	0	0	0	0	400,000
	2012	241,322	100,000	996,031	0	0	0	0	1,337,353
	2011	175,806	30,000	0	31,163	0	0	0	236,969
John Busshaus – CFO	2013	350,000	0	0	0	0	0	0	350,000
	2012	211,317	100,000	1,079,566	0	0	0	0	1,390,883
	2011	155,705	25,000	0	31,163	0	0	0	211,868
Steve Sun – COO	2013	0	0	0	0	0	0	0	0
	2012	0	0	0	0	0	0	0	0
	2011	0	0	0	0	0	0	0	0

- (1) The bonuses shown in this column represent discretionary awards during the respective year by the compensation committee and board.
- (2) The stock awards in 2012 represent the fair value of stock granted to the officers. The stock was issued as discretionary bonuses for the work done for the acquisition of DEL.
- (3) Stock-based compensation for 2011 represents the amounts recognized for financial reporting purposes for granting of stock options.
- (4) The salaries in 2013 for our executive officers were paid in accordance with the respective officers employment agreement

Restricted Stock Awards

There were no issuances of restricted stock award during fiscal 2013 to any named executive.

Outstanding Equity Awards at Fiscal Year End

The following table sets forth information concerning outstanding equity awards for the named executives as of December 31, 2013.

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2013

<u>Name</u>	<u>Option awards</u>				<u>Stock awards</u>				
	<u>Number of securities underlying unexercised options (#)</u> <u>exercisable</u>	<u>Number of securities underlying unexercised options (#)</u> <u>unexercisable</u>	<u>Equity incentive plan awards: number of securities underlying unexercised unearned options (#)</u>	<u>Option exercise price (\$)</u>	<u>Option expiration date</u>	<u>Number of shares or units of stock that have not vested (#)</u>	<u>Market value of shares or units of stock that have not vested (\$)</u>	<u>Equity incentive plan awards: number of unearned shares, units or other rights that have not vested (#)</u>	<u>Equity incentive plan awards: market or payout value of unearned shares, units or other rights that have not vested (\$)</u>
John L. Busshaus	0	0	0	0	0	0	0	0	0
Chris Spencer	0	0	0	0	0	0	0	0	0
Steve Sun	0	0	0	0	0	0	0	0	0

Grants of Plan-Based Awards for 2013

There were no plan-based equity awards made to our executive officers during fiscal 2013.

### Option Exercises and Stock Vested

The following table sets forth information concerning fiscal 2013 option exercises and restricted stock that vested during fiscal 2013 for the named executives.

#### OPTION EXERCISES AND STOCK VESTED DURING FISCAL 2013

Name	Option awards		Stock awards	
	Number of shares acquired on exercise (#)	Value realized on exercise (\$)	Number of shares acquired on vesting (#)	Value realized on vesting (\$)
Christopher Spencer	0	0	0	0
John L. Busshaus	0	0	0	0
Steve Sun	0	0	0	0

### Pension Benefits

The Company does not have any plans that provide for payments or other benefits at, following, or in connection with retirement.

### Nonqualified Deferred Compensation

The Company does not have a Deferred Compensation Plan for its executive officers.

### Other Potential Post-Employment Payments

As of December 31, 2013, there were no named executives with employment contracts that require or required severance or other post-employment payments.

### Summary Information about Equity Compensation Plans

As of December 31, 2013, we had five stock option plans approved by stockholders. The shares of common stock have been reserved for ultimate issuance under each plan. As of December 31, 2013, options for approximately 4,788,967 shares of common stock could be granted under the plans.

The Compensation Committee, or in its absence, the full Board, administers and interprets the plans. This Committee is authorized to grant options and other awards both under the plans and outside of any plan to eligible employees, officers, directors, and consultants. Terms of options and other awards granted under the plans, including vesting requirements, are determined by the Committee and historically have varied significantly. Options and other awards granted under the plans vest over periods ranging from zero to ten years, expire ten years from the date of grant and are not transferable other than by will or by the laws of descent and distribution. Incentive stock option grants are intended to meet the requirements of the Internal Revenue Code.

*2007 Stock Option Plan.* A total of 16,667 shares of common stock are reserved for issuance under the 2007 Stock Option Plan. The 2007 Plan has not expired and awards up to 12 can be granted under the 2007 Plan. The 2007 Plan provided for the granting of both incentive stock options (ISOs) and non-statutory stock options (NSOs).

*2008 Stock Option Plan.* A total of 16,667 shares of common stock are reserved for issuance under the 2008 Stock Option Plan. The 2008 Plan has not expired and awards up to 28 can be granted under the 2008 Plan. The 2008 Plan provides for the granting of both incentive stock options (ISOs) and non-statutory stock options (NSOs).

*2008 Key Employee Stock Option Plan.* A total of 33,334 shares of common stock are reserved for issuance under the 2008 Key Employee Stock Option Plan. The 2008 Key Employee Plan has not expired and awards up to 260 can be granted under the 2008 Key Employee Plan. The 2008 Key Employee Plan provides for the granting of both incentive stock options (ISOs) and non-statutory stock options (NSOs).

*2012 Stock Option Plan.* A total of 2,000,000 shares of common stock are reserved for issuance under the 2012 Stock Option Plan. The 2012 Plan has not expired and awards up to 1,788,667 can be granted under the 2012 Plan. The 2012 Plan provides for the granting of both incentive stock options (ISOs) and non-statutory stock options (NSOs).

*2013 Stock Option Plan.* A total of 3,000,000 shares of common stock are reserved for issuance under the 2013 Stock Option Plan. The 2013 Plan has not expired and awards up to 3,000,000 can be granted under the 2012 Plan. The 2013 Plan provides for the granting of both incentive stock options (ISOs) and non-statutory stock options (NSOs).

*No Loans for Option Exercises.* It is our policy to not make loans to employees or officers for the purpose of paying for the exercise of stock options.

*Stockholder Approval of Equity Compensation Plans.* The following table presents information as of December 31, 2013, about our common stock that may be issued upon the exercise of options granted to employees, consultants or members of the Board of Directors under all of our existing equity compensation plans and individual arrangements. As described above, we have seven stock option plans under which options have been granted.

<b>Plan Category</b>	<b>Maximum shares to be issued upon exercise of options</b>	<b>Weighted-average exercise price of outstanding options</b>	<b>Shares remaining available for future issuance under existing equity compensation plans (excluding shares reflected in first column)</b>
Plans approved by stockholders	0	\$ 0	4,788,967
Plans not approved by stockholders	0	0	0
<b>Total</b>	<b>0</b>	<b>\$ 0</b>	<b>4,788,967</b>

## DIRECTOR COMPENSATION

In 2013, we paid our non-employee directors a cash retainer. In 2014, the Board of Directors will consider stock options or other appropriate equity incentive grants to the outside directors. We reimburse directors for out-of-pocket expenses they incur when attending meetings of the Board. Salaried executives who serve as directors are not paid for their services as directors and accordingly, Christopher Spencer is not included in the director compensation table below.

The following table sets forth the compensation we paid our non-employee directors in 2013. Unless otherwise noted, the amounts shown represent what was earned in fiscal 2013.

### DIRECTOR COMPENSATION TABLE – FISCAL 2013

<b>Name</b>	<b>Fees earned or paid in cash (\$)</b>	<b>Stock awards (\$)</b>	<b>Option awards (\$)</b>	<b>Non-equity incentive plan compensation (\$)</b>	<b>Nonqualified deferred earnings (\$)</b>	<b>All other compensation (\$)</b>	<b>Total (\$)</b>
Doug Polinsky	32,000	0	0	0	0	0	32,000
J. Gregory Smith	32,000	0	0	0	0	0	32,000
Denis Yevstifeyev	32,000	0	0	0	0	0	32,000
James Rogers Jr.	14,000	0	747,875	0	0	0	761,875
Gu Jianfen	24,000	0	0	0	0	0	24,000
Zhang Hongcheng	58,518	0	0	0	0	0	58,518

All outside directors are entitled to base annual cash compensation of \$24,000, which we pay monthly. Currently, the outside directors also receive options for the purchase of common stock which normally vest at the rate of 24,000 shares each year, through December 31, 2013. Other compensation represents compensation earned as of December 31, 2013, but not paid.

## Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

### Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by stockholders	0	\$ 0	4,788,967
Equity compensation plans not approved by stockholders	0	0	0
Total	0	\$ 0	4,788,967

### Security Ownership of Certain Beneficial Owners

The following table sets forth certain information as of June 25, 2014 regarding the beneficial ownership of our common stock, for:

- each person (or group of affiliated persons) who, insofar as we have been able to ascertain, beneficially owned more than 5% of the outstanding shares of our common stock;
- each director;
- each named executive; and
- all directors and executive officers as a group.

We relied on information received from each stockholder as to beneficial ownership, including information contained on Schedules 13D and 13G and Forms 3, 4 and 5. As of June 25, 2014 there were 20,805,860 shares of common stock outstanding. As of that date, there were 250,000 options to purchase shares of common stock and warrants to purchase 99,060 shares of common stock.

Name and Address of Beneficial Owner <sup>(1)</sup>	Amount and Nature of Beneficial Ownership <sup>(2)</sup>	Percent of Class
<b>5% Stockholders:</b>		
None		
<b>Directors:</b>		
Douglas Polinsky	4,074	*
J. Gregory Smith	83,000	*
Zhang Hongcheng	2,332,200	11.2%
James Rogers Jr.	69,060 (3)	1.5%
<b>Executive Officers:</b>		
Christopher Spencer, Chief Executive Officer	229,642	1.1%
John L. Busshaus, Chief Financial Officer	57,524	*
All directors and executive officers as a group (5 persons)	2,775,500	13.3%

\* Less than 1%

(1) The address of each director and officer is c/o FAB Universal Corp, 5001 Baum Blvd. Suite 770, Pittsburgh, Pennsylvania 15213.

- (2) The persons named in this table have sole voting and investment power with respect to all shares of common stock reflected as beneficially owned by them. A person is deemed to be the beneficial owner of securities that can be acquired by such person within sixty (60) days from March 5, 2014, and the total outstanding shares used to calculate each beneficial owner's percentage includes such shares, although such shares are not taken into account in the calculations of the total number of shares or percentage of outstanding shares. Beneficial ownership as reported does not include shares subject to option or conversion that are not exercisable within 60 days of June 25, 2014.

## **Changes in Control**

As partial consideration for the acquisition of DEI, the Company issued 290 share of Series B Convertible Preferred Stock. The Company further agreed to convert these shares of Preferred Stock into additional shares of common stock upon DEI achieving corporate government requirement and financial results.

The Preferred Stock will be convertible into shares of the Company's common stock in three (3) tranches upon the occurrence of the following conversion events:

(i) upon the successful completion of certain Corporate Governance Objectives for the four (4) consecutive and complete reporting quarters of the Company immediately following the Closing, the designees shall have the right to convert the first tranche of 210 shares of Preferred Stock into shares of the Company's common stock;

(ii) upon the successful completion of: (a) all of the Corporate Governance Objectives for the four (4) consecutive and complete reporting quarters of the Company immediately following the Closing; and (b) a Revenue Objective requiring DEI to attain sales revenues of at least US\$60,000,000 and net income of US\$12,000,000 for fiscal year 2011, UEG's designees shall have the right to convert the second tranche of 40 shares of Preferred Stock into shares of the Company's common stock. The revenue and net income objectives were met.

(iii) upon the successful completion of (a) all of the Corporate Governance Objectives for the six (6) consecutive and complete reporting quarters of the Company immediately following the Closing; and (b) a Revenue Objective requiring that DEI attain sales revenues of at least US\$70,000,000 and net income of US\$14,000,000 for fiscal year 2012, UEG's designees shall have the right to convert the third tranche of 40 shares of Preferred Stock into shares of the Company's common stock. The revenue and net income objectives were met

Upon the occurrence of each conversion event, the three tranches of Preferred Stock will be convertible into a number of shares of common stock that will bring the overall equity position in the Company of the holders of the Initial Company Shares (as defined in the Share Exchange Agreement), the Preferred Stock and the common stock issuable upon conversion of the Preferred Stock, on a fully diluted basis as of the date of Closing, to 70%, 74% and 78%, respectively.

Other than the foregoing, there are no known arrangements known to the Company, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the Company.

## **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

### Transactions with Related Persons.

During the fiscal years ended December 31, 2013 and 2012, there were no transactions, and there are no currently proposed transactions, in which the Company was or is to be a participant and the amount involved exceeds the lesser of \$120,000 or one percent of the average of the Company's total assets at year end for the last two completed fiscal years, and in which any related person had or will have a direct or indirect material interest. Survival Spanish, an Education podcaster ran advertising campaigns on his shows and sold podcast Apps and Premium Apps during 2013. Survival Spanish is owned by David Spencer. David Spencer is a sibling of the CEO of the Company. During 2013, payments were made to Mr. Spencer totaling \$1,462.

### Parents of the Issuer.

The Company has no parents.

### Promoters and certain control persons.



None; not applicable.

Director independence.

The Board of Directors has determined that each of J. Gregory Smith, Denis Yevstifeyev, Gu Jianfen, James Rogers, Jr. and Douglas Polinsky has no material relationship with us (either directly or as a partner, stockholder or officer of an organization that has a relationship with us) and satisfies the independence requirements required by the NYSE MKT. The non-management independent directors meet in executive session, without management, at least annually. Mr. Polinsky, an independent non-management director, chairs all executive session meetings of directors.

**Item 14. Principal Accountant Fees and Services.**

The following is a summary of the fees billed to FAB by its principal auditors during the calendar years ended December 31, 2013 and 2012:

<u>Fee category</u>	<u>2013</u>	<u>2012</u>
Audit Fees <sup>(1)</sup>	\$ 469,500	\$ 317,500
Audit – related fees	0	0
Tax fees	0	0
All other fees	0	0
Total fees	\$ <u>469,500</u>	\$ <u>317,500</u>

- (1) Consists of fees for audit of the Company's annual financial statements, audit of the financial statements of acquired subsidiaries, the review of interim financial statements included in the Company's quarterly reports, and the review of other documents filed with the Securities and Exchange Commission.

Audit fees - Consists of fees for professional services rendered by our principal accountants for the audit of our annual financial statements and the review of financial statements included in our Forms 10-Q or services that are normally provided by our principal accountants in connection with statutory and regulatory filings or engagements.

Audit-related fees - Consists of fees for assurance and related services by our principal accountants that are reasonably related to the performance of the audit or review of FAB's financial statements and are not reported under "Audit fees."

Tax fees - Consists of fees for professional services rendered by our principal accountants for tax compliance, tax advice and tax planning.

All other fees - Consists of fees for products and services provided by our principal accountants, other than the services reported under "Audit fees," "Audit-related fees" and "Tax fees" above.

The Audit Committee is informed of and approves all services our auditors provide. The Audit Committee pre-approves the annual audit fee, tax services, and non-routine SEC filing reviews, as well as the fees for all large projects that are expected to cost more than \$50,000. In addition, it has pre-approved \$100,000 for items that relate to routine accounting services related to items such as new, routine SEC filings requiring consents, and routine tax consultations. Upon performance of such services, the Audit Committee is informed of and approves the matters to which such consultations relate. Upon approval by the Audit Committee, the amount is added back to the pre-approved \$100,000.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

(a) Financial Statements.

Consolidated Balance Sheets of FAB Universal Corp and subsidiaries as of December 31, 2013 and 2012

Consolidated Statements of Operations and Comprehensive Loss of FAB Universal Corp and subsidiaries for the years ended December 31, 2013 and 2012

Consolidated Statements of Stockholders' Equity of FAB Universal Corp and subsidiaries for the years ended December 31, 2013 and 2012

Consolidated Statements of Cash Flows of FAB Universal Corp and subsidiaries for the years ended December 31, 2013 and 2012

Notes to Consolidated Financial Statements

(b) Exhibits. (1)

<u>Exhibit Number</u>	<u>Description</u>
3.1	Articles of Incorporation(2)
3.2	Certificate of Amendment filed May 22, 2000 (2)
3.3	Articles of Amendment filed February 7, 2001 (2)
3.4	Articles of Amendment filed July 3, 2007 (2)
3.5	Articles of Amendment/Certificate of Designation regarding rights and preferences of Series A Preferred Stock (3)
3.6	Articles of Amendment filed June 15, 2011 (4)
3.7	Articles of Amendment filed February 8, 2012 (5)
3.8	Articles of Amendment filed September 19, 2012 (6)
3.9	Articles of Amendment filed September 27, 2012 (7)
3.10	Amended and Restated Bylaws(8)
10.1	Subscription Agreement (7)
10.2	Engagement Agreement, as amended (9)
10.2	Form of Securities Purchase Agreement (9)
10.3	Form of Warrant (10)
10.4	Waiver Agreement (10)
10.5	Lock-Up Agreement (10)
10.6	Form of Securities Purchase Agreement (11)
10.7	Form of Warrant (11)
10.8	Securities Purchase Agreement (12)
10.9	Form of Warrant (12)
10.10	Share Exchange Agreement (15)

- 10.11 Warrant Amendment Agreement (13)
- 10.12 Employment Agreement of Christopher J. Spencer (14)
- 10.13 Employment Agreement of John Busshaus (14)
- 10.14 Form of Voting Agreement (14)
- 10.15 Form of Lock-up Agreement (14)
- 31.1 302 Certification of Christopher J. Spencer
- 31.2 302 Certification of John Busshaus
- 32 906 Certification
  - (1) Summaries of all exhibits contained within this Report are modified in their entirety by reference to these Exhibits.
  - (2) Incorporated by reference from our Registration Statement on Form SB-2 filed with the Securities and Exchange Commission on July 26, 2007.
  - (3) Incorporated by reference from our Current Report on Form 8-K dated June 29, 2007, filed with the Securities and Exchange Commission on July 3, 2007.
  - (4) Incorporated by reference from our Current Report on Form 8-K dated June 15, 2011, filed with the Securities and Exchange Commission on June 17, 2011.
  - (5) Incorporated by reference from our Current Report on Form 8-K dated February 8, 2012, filed with the Securities and Exchange Commission on February 9, 2012.
  - (6) Incorporated by reference from our Current Report on Form 8-K dated September 19, 2012, filed with the Securities and Exchange Commission on September 19, 2012.
  - (7) Incorporated by reference from our Current Report on Form 8-K dated September 26, 2012, filed with the Securities and Exchange Commission on September 28, 2012.
  - (8) Incorporated by reference from our Current Report on Form 8-K dated September 5, 2007, filed with the Securities and Exchange Commission on September 10, 2007.
  - (9) Incorporated by reference from our Current Report on Form 8-K dated January 18, 2011, filed with the Securities and Exchange Commission on January 20, 2011.
  - (10) Incorporated by reference from our Current Report on Form 8-K dated January 20, 2011, filed with the Securities and Exchange Commission on January 25, 2011.
  - (11) Incorporated by reference from our Current Report on Form 8-K dated March 1, 2011, filed with the Securities and Exchange Commission on March 4, 2011.
  - (12) Incorporated by reference from our Current Report on Form 8-K dated August 2, 2011, filed with the Securities and Exchange Commission on August 8, 2011.
  - (13) Incorporated by reference from our Current Report on Form 8-K dated August 14, 2012, filed with the Securities and Exchange Commission on August 14, 2012.

- (14) Incorporated by reference from our Current Report on Form 8-K dated September 26, 2012, filed with the Securities and Exchange Commission on September 28, 2012.
- (15) Incorporated by reference from our Annual Report on Form 10-K dated December 31, 2012, filed with the Securities and Exchange Commission on March 15, 2013.

(c) Financial Statement Schedules.

The following documents are filed as part of this Report:

1. Financial Statements

See Index to Consolidated Financial Statements

2. Financial Statement Schedules:

All financial statement schedules have been omitted because they are not applicable or the required information is presented in the financial statements or the notes to the consolidated financial statements.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FAB UNIVERSAL CORP.

*Date:* 6/27/14

*By:* /s/ Christopher J. Spencer  
Christopher J. Spencer  
Chief Executive Officer and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

*Date:* 6/27/14

*By:* /s/ Christopher J. Spencer  
Christopher J. Spencer  
Chief Executive Officer and President

*Date:* 6/27/14

/s/ John Busshaus  
John Busshaus  
Chief Financial Officer