

China Internet Cafe Holdings Group, Inc.  
Form 10-Q  
May 15, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2015

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: **333-199619**

**CHINA INTERNET CAFÉ HOLDINGS GROUP, INC.**

(Exact name of Company as specified in its charter)

**Nevada**

(State or other jurisdiction of incorporation or organization)

**98-0500738**

(I.R.S. Employer Identification No.)

**#1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City**

**Longgang District, Shenzhen**

**518172**

**Guangdong Province, People's Republic of China**

(Address of principal executive offices)

(Zip Code)

**+86-755-8989-6008**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 Web site, 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY**

**PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes " No "

**APPLICABLE ONLY TO CORPORATE ISSUERS**

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

As of May 14, 2015, there were 5,538,002 shares of \$0.00001 par value common stock issued and outstanding.

**CHINA INTERNET CAFÉ HOLDINGS GROUP, INC.**

FORM 10-Q

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**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015**

**(UNAUDITED)**

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**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements****CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2015</b>	<b>December 31, 2014</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$23,399,015	\$ 23,789,211
Rental deposit	88,368	62,222
Equipment deposit	3,241	3,226
Total current assets	23,490,624	23,854,659
Property, plant and equipment, net	1,559,365	1,882,823
Rental deposit-long-term portion	6,548	32,255
Total assets	\$25,056,537	\$ 25,769,737
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$28,203	\$ 45,283
Registration penalties payable	641,200	641,200
Deferred revenue	170,927	131,013
Payroll and payroll related liabilities	88,210	349,866
Income and other taxes payable	26,391	134,773
Accrued expenses	253,697	287,666
Amount due to a shareholder	1,811,154	1,711,061
Dividend payable on preferred stock	186,565	186,565
Total current liabilities	3,206,347	3,487,427
Stockholders' Equity:		
Common stock (\$0.00001 par value, 20,000,000 shares authorized, 5,538,002 shares issued and outstanding as of March 31, 2015 and December 31, 2014, respectively)	55	55
Additional paid-in capital	6,232,961	6,232,961
Statutory surplus reserves	718,744	718,744
Retained earnings	12,209,964	12,760,296
Accumulated other comprehensive income	2,688,466	2,570,254

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Total stockholders' equity	21,850,190	22,282,310
Total liabilities and stockholders' equity	\$25,056,537	\$ 25,769,737

The accompanying notes are an integral part of the condensed consolidated financial statements



**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED****STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)**

	<b>For The Three Months Ended March 31,</b>		
	<b>2015</b>	<b>2014</b>	
Revenue	\$ 376,864	\$ 7,659,342	
Cost of revenue	804,711	4,087,552	
Gross profit (loss)	(427,847	) 3,571,790	
Operating Expenses			
General and administrative expenses	142,398	110,529	
Total operating expenses	142,398	110,529	
Income (loss) from operations	(570,245	) 3,461,261	
Non-operating income			
Interest income	19,938	35,366	
Interest expense	-	(3,679	)
Other expenses	(25	) (317	)
Total non-operating income	19,913	31,370	
Income (Loss) before income taxes	(550,332	) 3,492,631	
Income taxes	-	882,865	
Net income/(loss)	(550,332	) 2,609,766	
Net income (loss) attributable to China Internet Cafe Holdings Group, Inc. common stockholders	\$ (550,332	) \$ 2,609,766	
Other comprehensive income (loss)			
Net income (loss)	\$ (550,332	) \$ 2,609,766	
Foreign currency translation	118,212	(390,114	)
Total comprehensive income (loss)	\$ (432,120	) \$ 2,219,652	
Earnings (loss) per share			
- Basic	\$ (0.10	) \$ 0.10	#
- Diluted	\$ (0.10	) \$ 0.10	#
Weighted average common stock outstanding			
- Basic	5,538,002	5,137,905	
- Diluted	5,538,002	5,137,905	

# The earnings per share and weighted average number of common shares for March 31, 2014 were retroactively restated to reflect the one-for-five reverse stock split effective on June 16, 2014.

The accompanying notes are an integral part of the condensed consolidated financial statements

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****FOR THE THREE MONTHS ENDED MARCH 31, 2015**

	Common Stock		Additional		Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Number of Shares	Amount	Paid-in Capital	Statutory Reserves			
<b>Balance at January 1, 2015</b>	5,538,002	\$ 55	\$6,232,961	\$718,744	\$12,760,296	\$2,570,254	\$22,282,310
Net loss for the period	-	-	-	-	(550,332 )	-	(550,332 )
Foreign currency translation difference	-	-	-	-	-	118,212	118,212
<b>Balance at March 31, 2015</b>	5,538,002	\$ 55	\$6,232,961	\$718,744	\$12,209,964	\$2,688,466	\$21,850,190

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

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For The Three Months Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
Cash flows from operating activities		
Net income (loss)	\$ (550,332	) \$ 2,609,766
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	331,071	935,176
Amortization	-	11,634
Deferred tax assets	-	(8,622 )
Changes in operating assets and liabilities:		
Inventory	-	16,906
Accounts payable	(17,222	) (15,635 )
Deferred revenue	39,113	153,881
Payroll and payroll related liabilities	(262,194	) 22
Income and other taxes payable	(108,557	) 349,572
Accrued expenses	(34,219	) 898
Amount due to a shareholder	99,975	49,011
Net cash provided (used) by operating activities	(502,365	) 4,102,609
Effect of foreign currency translation on cash	112,169	(367,059 )
Net increase (decrease) in cash and cash equivalents	(390,196	) 3,735,550
Cash and cash equivalents - beginning of period	23,789,211	40,241,459
Cash and cash equivalents - end of period	\$ 23,399,015	\$ 43,977,009
Cash paid during the period for:		
Interest paid	\$ -	\$ 3,679
Income taxes paid	\$ -	\$ 566,936

The accompanying notes are an integral part of the condensed consolidated financial statements

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**1. Organization, Recapitalization and Nature of Business**

**China Internet Cafe Holdings Group, Inc. (“China Internet Cafe”)**

China Internet Cafe Holdings Group, Inc. (formerly known as China Unitech Group, Inc.) (“China Internet Café”, “the Company”, “we”, “us”, “our”) was incorporated in the State of Nevada on March 14, 2006. The Company was a development company from incorporation until the quarter ended June 30, 2010. On July 2, 2010, the Company successfully closed a share exchange transaction with the shareholders of Classic Bond Development Limited, a British Virgin Islands corporation (“Classic Bond”). The Company will operate through its variable interest entities in China to execute the current business plan of those affiliates which involves the operation of a chain of China-based internet cafes, the “Business.” On February 1, 2011, the Company changed its name from China Unitech Group, Inc. to China Internet Cafe Holdings Group, Inc.

**Recapitalization of Classic Bond Development Limited**

On July 2, 2010, the Company entered into a share exchange transaction with Classic Bond Development Limited, a British Virgin Islands corporation (“Classic Bond”), and the shareholders of Classic Bond. Pursuant to the Share Exchange Agreement, China Internet Cafe acquired 100% of the issued and outstanding capital stock of Classic Bond in exchange for 3,800,000 newly issued shares of the Company’s common stock, which represented approximately 94% of the 4,040,000 issued and outstanding shares of common stock after the transaction and after the coincident cancellation of 994,720 shares of common stock held by the Company’s former majority stockholder. The business, assets and liabilities did not change as a result of the reverse acquisition.

This share exchange transaction resulted in the shareholders of Classic Bond obtaining a majority voting interest in the Company. Generally accepted accounting principles require that the Company whose shareholders retain the majority interest in a combined business be treated as the acquirer for accounting purposes, resulting in a reverse acquisition with Classic Bond as the accounting acquirer and China Internet Cafe as the acquired party. Accordingly, the share exchange transaction has been accounted for as a recapitalization of Classic Bond whereby Classic Bond is deemed to be the continuing, surviving entity for accounting purposes, but through reorganization, has deemed to have adopted the capital structure of China Internet Cafe. The equity section of the accompanying financial statements has been restated to reflect the recapitalization of the Company due to the reverse acquisition as of the first day of the first period presented.

Accordingly, all references to common shares of Classic Bond's common stock have been restated to reflect the equivalent number of China Internet Cafe's common shares. In other words, the 2,000,000 Classic Bond shares outstanding are restated as 4,040,000 common shares, as of July 2, 2010. Each share of Classic Bond is restated to 2.2 shares of China Internet Cafe.

The book value of the net assets that for accounting purposes, were deemed to have been acquired by Classic Bond from China Internet Cafe, as of the date of acquisition (July 2, 2010) were \$3,333.

During the recapitalization, the Company incurred restructuring expenses of \$300,000, related legal and professional fee of \$129,033 and the interest expenses of \$6,053 related to the short term loan for paying restructuring expenses. All of these expenses amounting to \$435,086 in total were recorded as reorganizational expenses in statement of income.

#### **Classic Bond Development Limited (“Classic Bond”)**

Classic Bond Development Limited was incorporated on November 2, 2009 in the British Virgins Islands (“BVI”) with 50,000 authorized common shares with no par value. On November 2, 2009, 50,000 common shares at \$0.129 (HK\$1) each were issued for \$6,452 (HK\$50,000) cash to several shareholders including Mr. Guo Dishan who is the 65% equity interest shareholder and the sole director of the Company.

On June 23, 2010, the Company issued 1,950,000 shares of common stock of Classic Bond to 42 individuals for an aggregate of \$84,093 (HK\$651,721) for 641,046 shares and 1,308,954 shares associated with the reorganization of the Company at a value of \$167,519 (HK\$1,308,954) which is reflected as contributed capital by existing shareholders of Junlong and the total amount was \$251,612. As of June 30, 2010, 2,000,000 shares of Common Stock were issued and outstanding.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**1. Organization, Recapitalization and Nature of Business (continued)**

Classic Bond is in the business of operating internet cafés, throughout the Longang District of Shenzhen in Province of Guangdong of People's Republic of China ("PRC"). The Company conducts its operations through the following subsidiaries: (a) a wholly-owned subsidiary of the Company located in the PRC: Shenzhen Zhonghefangda Network Technology Co., Ltd. ("Zhonghefangda") and (b) an entity located in the PRC: Shenzhen Junlong Culture Communication Co., Ltd. ("Junlong"), which is controlled by the Company through contractual arrangements between Zhonghefangda and Junlong, as if Junlong were a wholly-owned subsidiary of Classic Bond.

**Shenzhen Zhonghefangda Network Technology Co., Ltd. ("Zhonghefangda")**

Zhonghefangda, Classic Bond's wholly-owned subsidiary, was incorporated in People's Republic of China ("PRC") on June 10, 2010 with registered capital of \$129,032 (HK\$1 million). Zhonghefangda is engaged in provision of management and consulting services and Mr. Guo Dishan is the legal representative of Zhonghefangda.

On June 11, 2010, to protect the Company's shareholders from possible future foreign ownership restrictions, Zhonghefangda and Junlong entered into a series of agreements. Under these agreements Zhonghefangda obtained the ability to direct the operations of Junlong and to receive a majority of the residual returns. Therefore, management determined that Junlong became a variable interest entity ("VIE") under the provisions of Financial Accounting Standards Board ("FASB") ASC 810-10 and Zhonghefangda was determined to be the primary beneficiary of Junlong. Accordingly, beginning June 11, 2010, Zhonghefangda is able to consolidate the assets, liabilities, results of operations and cash flows of Junlong in its financial statements. Because the legal representatives and ultimate major stockholder of Zhonghefangda and Junlong is the same person, Mr. Guo Dishan, Zhonghefangda and Junlong were deemed, until June 11, 2010, to be under common control.

**Exclusive Management and Consulting Agreement**

On June 11, 2010, Zhonghefangda signed an exclusive management and consulting services agreement with Junlong. Pursuant to the agreement, Zhonghefangda agreed to provide management and consulting services to Junlong, upon request, in connection with the operation of the Business. The agreement provides that Junlong will compensate Zhonghefangda by paying an amount equal to the aggregate net profit of Junlong for a period of twenty (20) years and

for succeeding periods of the same duration until the agreement is terminated by both parties under agreed conditions. Zhonghefangda will reimburse Junlong the full amount of any net losses incurred by Junlong during the term of this agreement. As a result of entering into the exclusive management and consulting agreement, Zhonghefangda should be deemed to control Junlong as a Variable Interest Entity and Junlong is consolidated in the accompanying financial statements.

**Shenzhen Jun Long Culture Communication Co., Ltd. (“Junlong”)**

Junlong is a Chinese enterprise organized in the People’s Republic of China (“PRC”) on December 26, 2003 in accordance with the Laws of the People’s Republic of China with the registered capital of \$0.136 million (equivalent to RMB 1 million). In 2001, the Chinese government imposed higher capital (RMB10 million for regional internet café chain and RMB50 million for national internet café chain) and facility requirements for the establishment of internet cafes. On August 19, 2004, Junlong was granted approval from Shenzhen Municipal People’s Government to increase its registered capital by \$1,230,500 from \$136,722 to \$1,367,222 million (increased by RMB 9 million, from RMB 1 million to RMB 10 million) The capital verification process has been completed. In April and July of 2010, Junlong acquired three internet cafes in Shenzhen.

In 2005, Junlong obtained internet cafe licenses to operate an internet café chain from the Ministry of Culture, and opened its first internet cafe in April, 2006 and our members can access the internet at our venues. We opened 7 internet cafes in 2006, 5 internet cafes opened in 2007, 11 internet cafes opened in 2008, 5 internet cafes opened in 2009, 16 internet cafes opened in 2010, 15 internet cafes opened in 2011, and 3 internet cafes opened in 2012. The Company closed 51 internet cafes during the year of 2014. In total, as of March 31, 2015, the Company owned 11 internet cafes within Shenzhen, Guangdong.



**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**2. Summary of Significant Accounting Policies**

*(a) Basis of presentation*

The Company's accounting policies used in the preparation of the accompanying financial statements conform to accounting principles generally accepted in the United States of America ("US GAAP") and have been consistently applied.

*(b) Principle of consolidation*

The consolidated financial statements include the accounts of China Internet Cafe Holdings Group, Inc., Classic Bond Development Limited, Zhonghefangda and the VIE-Junlong. All significant intercompany balances and transactions have been eliminated in the consolidation. The consolidated financial statements included herein, presented in accordance with United States generally accepted accounting principles and stated in US dollars, have been prepared by the Company, pursuant to the rules and regulations of the Securities and Exchange Commission.

*(c) Use of estimates*

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. These accounts and estimates include, but are not limited to, the valuation of receivables due from related parties, inventories and the estimation of useful lives of plant and machinery and intangibles assets. Actual results could differ from those estimates.

Warrants that could require cash settlement or have anti-dilution price protection provisions are recorded as liabilities at their estimated fair value at the date of issuance, with subsequent changes in estimated fair value recorded in other income (expense) in our statement of loss and comprehensive loss in each subsequent period. In general, warrants with anti-dilution provisions are measured using the binomial valuation model. The methodology based, in part, upon inputs for which there is little or no observable market data requires the Group to develop its own assumptions. The assumptions used in calculating the estimated fair value of the warrants represent our best estimates, however these estimates involve inherent uncertainties and the application of judgment. As a result, if factors change and different assumptions are used, the warrant liability and the change in estimated fair value could be materially different. Also see Note 10.

*(d) Revenue recognition*

Internet café members purchase prepaid IC cards which include stored value or deposit money into member's accounts associated with their ID cards directly that will be deducted based on time usage of computers at the internet cafe. Revenues derived from the prepaid IC cards and ID card's accounts at the internet café are recognized when services are provided. This is based upon the usage of computer time at the internet cafe. Outstanding customer balances in the IC cards and ID card's accounts are included in deferred revenue on the balance sheets. The Company does not charge any service fees that cause a decrease to customer balances. There is no expiration date for IC cards and ID card's accounts. During 2014, the company began to use members' ID card's accounts instead of prepaid IC cards.

In 2005, Junlong obtained internet cafe licenses to operate an internet café chain from the Ministry of Culture, and opened its first internet cafe in April, 2006 and our members can access the internet at our venues. We opened 7 internet cafes in 2006, 5 internet cafes opened in 2007, 11 internet cafes opened in 2008, 5 internet cafes opened in 2009, 16 internet cafes opened in 2010, 15 internet cafes opened in 2011, and 3 internet cafes opened in 2012. The Company closed 51 internet cafes during the year of 2014. In total, as of March 31, 2015, the Company owned 11 internet cafes within Shenzhen, Guangdong.

The Company also records revenue from commissions received from the sale of third parties on-line gaming cards, snacks and drinks. Commission revenue amounting to 20% of the value of the on-line gaming cards, snacks and drinks is recognized at the time the gaming cards, etc. are sold to customers. During the three months ended March 31, 2015 and 2014, the commission income was \$13,132 and \$118,445, respectively, less than 4% and 1% of total revenue.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**2. Summary of Significant Accounting Policies (continued)**

*(e) Cost of revenue*

Cost of revenue consists primarily of depreciation of each internet café's computer equipment and hardware and overhead associated with the internet cafes including rental payments, utilities, value added taxes, and surcharges. Our value added taxes is 3% on gross revenue generated from selling time of internet surfing in our internet cafes. Our other surcharges are an education surcharge of 3% of value added tax amount, city development surcharge of 7% of value added tax amount, a culture development surcharge of 3% of gross revenue, and a snacks and drinks business tax of 5% of gross revenue.

*(f) Credit risk*

The Company may be exposed to credit risk from its cash at banks. An allowance has been considered for estimated irrecoverable amounts determined by reference to past default experience and the current economic environment. No allowance is considered necessary for the period.

*(g) Cash and cash equivalents*

Cash and cash equivalents include cash on hand, cash accounts, interest bearing savings accounts and time certificates of deposit with a maturity of three months or less when purchased.

*(h) Inventory*

Inventory represents the IC cards we purchased from IC card manufacturers. Inventories are stated at the lower of cost or market value. Cost is determined using the first-in, first-out (FIFO) method. In 2014, the Company changed its booking system from IC cards to ID cards and disposed all unused IC cards.

*(i) Fair Value of Financial Instruments*

The Company applies the provisions of accounting guidance, FASB Topic ASC 820 that requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value, and defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties.

The Company adopted the provisions of Accounting Standards Codification (“ASC”) 820, Fair Value Measurements and Disclosures. ASC 820 clarifies the definition of fair value, prescribes methods for measuring fair value, and establishes a fair value hierarchy to classify the inputs used in measuring fair value as follows:

*Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities available at the measurement date.

*Level 2* – Inputs are unadjusted quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs derived from or corroborated by observable market data.

*Level 3* – Inputs are unobservable inputs which reflect the reporting entity’s own assumptions on what assumptions the market participants would use in pricing the asset or liability based on the best available information.

The availability of inputs observable in the market varies from instrument to instrument and depends on a variety of factors including the type of instrument, whether the instrument is actively traded, and other characteristics particular to the transaction. For many financial instruments, pricing inputs are readily observable in the market, the valuation methodology used is widely accepted by market participants, and the valuation does not require significant management discretion. For other financial instruments, pricing inputs are less observable in the market and may require management judgment.

*(j) Stock-Based Compensation*

Our advisor assists the Company for ongoing corporate compliance and development are accounted for under ASC 505-50. ASC 505-50-30-11 (previously EITF 96-18) further provides that an issuer measure the fair value of the equity instruments in these transactions using the stock price and other measurement assumptions as of the earlier of the following dates, referred to as the measurement date:

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**2. Summary of Significant Accounting Policies (continued)**

- i. The date at which a commitment for performance by the counterparty to earn the equity instruments is reached (a performance commitment); and
- ii. The date at which the counterparty's performance is complete.

*(k) Equipment deposits*

The Company prepaid equipment deposits amount of \$3,241 to purchase fire protection systems for its new headquarters in Shenzhen in 2012 and the provider did not obtain the inspection of the fire protection system as of March 31, 2015.

*(l) Property, plant and equipment*

Property, plant and equipment, comprising computer equipment and hardware, leasehold improvements, office furniture and vehicles are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives listed below.

	Estimated Useful Lives
Leasehold improvements	5 years
Cafe computer equipment and hardware	2-5 years
Cafe furniture and fixtures	5 years
Office furniture, fixtures and equipment	5 years
Motor vehicles	5 years

Leasehold improvements mainly result from decoration expense. All of the Company's leases have terms of 5 years and leasehold improvements are amortized over 5 years, which represents the shorter of useful life and lease term.

*(m) Intangible Assets*

Our intangible assets consist of definite-lived assets subject to amortization such as Business License and Customer Lists. The useful lives of the Business License are 9 to 15 years and we amortize the customer lists over 5 years. We calculate amortization of definite-lived intangible assets on a straight-line basis over the useful lives of the intangible assets. Development cost of internal-use software is insignificant and is recorded as expense in the period such cost occurs.

*(n)Deferred Revenue*

Deferred revenue represents unused balances of the prepaid amounts received for IC/ID cards. The Outstanding customer balances are \$170,927 and \$131,013 as of March 31, 2015 and December 31, 2014, respectively, and are included in deferred revenue on the balance sheets. Management has evaluated the deferred revenue balance and has determined any potential revenue from the unused balance to be immaterial at the quarter ended March 31, 2015.

*(o)Comprehensive income (loss)*

The Company follows the FASB's accounting standard. Comprehensive income (loss) is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investments from owners and distributions to owners. For the Company, comprehensive income (loss) for the periods presented includes net income (loss) and foreign currency translation adjustments.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**2. Summary of Significant Accounting Policies (continued)**

*(p) Income taxes*

Income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Current tax is based on the profit or loss from ordinary activities adjusted for items that are non-assessable or disallowable for income tax purpose and is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date. Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 740-10-50-2 requires that deferred tax assets and liabilities be recognized for future tax consequence attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of income in the period that includes the enactment date. 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. Losses incurred by the Company in prior years provide for a net operating loss carry-forward. However, all net operating losses are from the U.S. shell company and we currently anticipate insufficient income to utilize these losses in the future, so the asset balance has been fully reserved for.

*(q) Consolidation of Variable Interest Entities*

According to the requirements of Statement of Financial Accounting Standards No. 810-10, "Variable interest Entities", the Company has evaluated the economic relationships of its wholly owned subsidiary, Shenzhen Zhonghefangda Network Technology Co., Ltd. ("Zhonghefangda") with Junlong and has determined that it is required to consolidate Zhonghefangda and Junlong pursuant to the rules of FASB ASC Topic 810-10. Therefore Junlong is considered to be a VIE, as defined by FASB ASC Topic 810-10 of which Classic Bond is the primary beneficiary as a result of its wholly owned subsidiary Zhonghefangda. Classic Bond, as mentioned above, will absorb a majority of the economic risks and rewards of the VIE that are being consolidated in the accompanying financial statements.

The carrying amount of the VIE's' assets and liabilities are as follows:

March 31,	December 31,
2015	2014

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Current assets and Long term rental deposit	\$23,475,636	\$ 23,871,651
Property, plant and equipment	1,559,366	1,882,823
Total assets	25,035,002	25,754,474
Total liabilities	(6,132,923 )	(6,453,674 )
Net assets	\$ 18,902,079	\$ 19,300,800

*(r) Foreign currency translation*

Assets and liabilities of the Company with a functional currency other than US\$ are translated into US\$ using period end exchange rates. Income and expense items are translated at the average exchange rates in effect during the period. Foreign currency translation differences are included as a component of Accumulated Other Comprehensive Income in Stockholders' Equity.

The exchange rates used to translate amounts in RMB into USD for the purposes of preparing the financial statements were as follows:

	March 31, 2015	March 31, 2014	December 31, 2014
Period-end RMB : USD exchange rate	6.1091	-	6.1385
Three months average RMB : USD exchange rate	6.1358	6.1156	-

The RMB is not freely convertible into foreign currency and all foreign exchange transactions must take place through authorized institutions. No representation is made that the RMB amounts could have been, or could be, converted into USD at the rates used in translation.



**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**(UNAUDITED)**

**2. Summary of Significant Accounting Policies (continued)**

*(s) Post-retirement and post-employment benefits*

The Company contributes to a state pension plan in respect of its PRC employees. Other than the above, neither the Company nor its subsidiary or the consolidated VIE's provides any other post-retirement or post-employment benefits.

*(t) Earnings (loss) per share (EPS)*

Earnings(loss) per share is calculated in accordance with ASC 260-10 which requires the Company to calculate net income(loss) per share based on basic and diluted net income(loss) per share, as defined. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted EPS is similar to basic EPS but presents the dilutive effect on a per share basis of potential common shares (e.g., convertible securities, preferred stock and warrants) as if they had been converted at the beginning of the periods presented, or issuance date, if later. Potential common shares that have an anti-dilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted EPS. See Note 14 for details.

*(u) Retained earnings-appropriated*

In accordance with the relevant PRC regulations and Zhonghefangda and Junlong's articles of association, Zhonghefangda and Junlong are required to allocate their respective net income to statutory surplus reserve.

*(v) Statutory surplus reserves*

In accordance with the relevant laws and regulations of the PRC and the articles of associations of Zhonghefangda and Junlong, each is required to allocate 10% of its net income reported in the PRC statutory accounts, after offsetting any prior years' losses, to the statutory surplus reserve, on an annual basis. When the balance of such reserve reaches 50% of the respective registered capital of the company, no further allocation is optional.

As of March 31, 2015 and December 31, 2014, the statutory surplus reserves of Zhonghefangda and Junlong reached 50% of the registered capital of the subsidiary and the Company was not required to allocate any further amount to it.

The statutory surplus reserves can be used to offset prior years' losses, if any, and may be converted into registered capital, provided that the remaining balances of the reserve after such conversion is not less than 25% of registered capital. The statutory surplus reserve is non-distributable.

*(w)Recent Accounting Pronouncements*

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which are intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. It lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This amendment provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes.

The amendment is effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. Currently, the Company is evaluating the impact of the pending adoption of ASU 2014-14 on the disclosure of the consolidated financial statements.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2015 AND DECEMBER 31, 2014****(UNAUDITED)****2. Summary of Significant Accounting Policies (continued)**

In January 2015, the FASB issued ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. It eliminates from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item.

The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The adoption of ASU 2015-01 is not expected to have any material impact on the Company's consolidated financial statements.

**3. Cash and cash equivalents**

Cash and cash equivalents are summarized as follows:

	March 31, 2015	December 31, 2014
Cash and cash equivalents at bank	\$23,383,227	\$23,770,744
Cash on hand	15,788	18,467
	\$23,399,015	\$23,789,211

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents. As of March 31, 2015 and December 31, 2014, \$23,365,024 and \$23,758,813 of the Company's cash and cash equivalents were held by major banks located in the PRC, which management believes are of high credit quality, and \$6,818 and \$528 of the Company's cash and cash equivalents were held by Chase Bank, respectively.

#### 4. Property, Plant and Equipment, net

Property, plant and equipment, net, consist of the following:

	March 31, 2015	December 31, 2014
Leasehold improvements	\$778,636	\$ 774,906
Cafe computers equipment and hardware	2,234,927	2,224,223
Cafe furniture and fixtures	186,117	185,225
Office furniture, fixtures and equipment	140,213	139,541
Motor vehicles	486,806	484,475
	\$3,826,699	\$ 3,808,370
Less: Accumulated depreciation	(2,267,334)	(1,925,547 )
Property, plant and equipment, net	\$1,559,365	\$ 1,882,823

For the three months ended March 31, 2015, depreciation expense amounted to \$331,071, of which \$305,963 and \$25,108 were recorded as cost of sales and general and administrative expense, respectively.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**(UNAUDITED)**

**5.Short Term Loan**

On June 13, 2013, the Company entered into a loan agreement with China Construction Bank for \$162,288 (RMB 1,000,000), which was secured by a director's guarantee. The annual interest rate is approximately 9%. The loan was paid in full on June 12, 2014.

For the three months ended March 31, 2015 and 2014, the interest expense on this loan was \$-0- and \$3,679, respectively.

**6.Income and Other Taxes Payable**

Income and other tax payables consist of the following:

	March 31, 2015	December 31, 2014
Value added taxes	\$ 11,355	\$ 60,917
Income tax	-	-
Withholding individual income tax payable	2,317	5,629
Other tax payable	12,719	68,227
Total	\$ 26,391	\$ 134,773

**7.Due To Related Party**

	March 31, 2015	December 31, 2014
Mr. Dishan Guo	\$1,811,154	\$ 1,711,061

The amount due to Mr. Dishan Guo is unsecured with no stated interest and is payable on demand. The amount due as of September 30, 2014, represents amounts accumulated since 2007 used to pay daily operating expenses and professional fees. In May of 2014, \$1,507,429 was paid to Mr. Dishan Guo per his demand.

## **8. Income Tax**

The Company is subject to U.S. federal income tax, and the Company's subsidiary and affiliated entity incorporated in the PRC are subject to enterprise income taxes in the PRC. The Company's applicable enterprise income tax rate in PRC is 25% of its net income.

For the three months ended March 31, 2015 and 2014, the Company did not record any uncertain tax benefits.

Aggregate undistributed earnings of approximately \$15.1 million as of March 31, 2015 of the Company's affiliated entity that are available for distribution to the Company are considered to be indefinitely reinvested, and, accordingly, no provision has been made for the Chinese dividend withholding taxes that would be payable upon distribution to the Company. Additionally, the Chinese tax authorities have clarified that distributions made out of pre-January 1, 2009 retained earnings would not be subject to the withholding tax.

The tax authorities may examine the tax returns of the Company three years after its fiscal year ended.

## **9. Employee Benefits**

The Company contributes to a state pension scheme organized by municipal and provincial governments in respect of its employees in PRC. The pension expense related to this plan is calculated at a range of 8% of the average monthly salary. The pension expense was \$4,410 and \$3,209 for the three months ended March 31, 2015 and 2014, respectively.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**(UNAUDITED)**

**10. Stockholders' Equity**

**Common Stock**

On July 2, 2010, China Internet Cafe entered into a share exchange transaction with Classic Bond and the shareholders of Classic Bond. Pursuant to the Share Exchange Agreement, China Internet Cafe acquired 100% of the issued and outstanding capital stock of Classic Bond in exchange for 3,800,000 newly issued shares of the Company's common stock, which represented approximately 94% of the 4,040,000 issued and outstanding shares of common stock after the transaction and after the coincident cancellation of 994,720 shares of common stock held by the Company's former majority stockholder. The business, assets and liabilities did not change as a result of the reverse acquisition.

On June 16, 2014 the Company effected a one (1)-for-five (5) reverse stock split of the Company's issued and outstanding shares of common stock, decreasing the number of outstanding shares from 25,689,524 to 5,138,002. These statements have been adjusted to reflect this reverse split on a historical pro-forma basis.

As of March 31, 2015 and December 31, 2014, there were 5,538,002 shares of Common Stock issued and outstanding, respectively.

**Series A Preferred Stock**

On February 16, 2011, the Company filed with the Secretary of State of Nevada, as an amendment to its Articles of Incorporation, a Certificate of Designation, Preferences and Rights for the 5% Series A Convertible Preferred Stock, par value \$0.00001 per share (the "Series A Preferred Stock"). On February 22, 2011, the Company issued 854,941 shares of its Series A Preferred Stock.

For each outstanding share of Series A Preferred Stock, dividends are payable quarterly, at the rate of 5% per annum (\$0.675 per share), on or before each date that is thirty days following the last day of March, June, September, and December of each year, commencing September 30, 2011. Dividends on the Series A Preferred Stock accrue and are

cumulative from and after the date of initial issuance. For the quarter ended September 30 and December 31 of 2012 and from January 1, 2013 to February 22, 2012, dividends have been accrued as dividends payable and are not paid as of June 30, 2014.

The Series A Preferred Stock was not subject to mandatory redemption (except on liquidation) but was redeemable in certain circumstances. Because of the possible redemption conditions, the Series A Preferred Stock was classified as mezzanine equity.

Each share of Series A Preferred Stock may be converted at any time, at the option of the holder, into a number of fully paid and non-assessable shares of Common Stock equal to the quotient of (i) the Series A Liquidation Preference of \$1.35 per share divided by (ii) the conversion price in effect as of the date of the Conversion Notice. The initial conversion price of the Series A Preferred Stock was \$1.35 per share.

In addition to the holder's right to convert the Series A Preferred Stock at any time, provided that the Common Stock underlying the Series A Preferred Stock is registered under an effective registration statement or is available for resale under Rule 144, without limitation, all outstanding shares of the Series A Preferred Stock automatically convert into shares of Common Stock at the earlier to occur of (i) February 22, 2013, the 24 month anniversary of the Closing Date of the issuance of the Series A Preferred Stock, or (ii) at such time that the volume-weighted average price of the Company's Common Stock is equal to or greater than \$3.00 (as may be adjusted for any stock splits or combinations of the Common Stock) for a period of ten consecutive trading days and such Common Stock has an average daily trading volume, for ten consecutive trading days, equal to or greater than 50,000 shares.

On February 22, 2013, in accordance with its terms, all 854,941 shares of Series A Preferred Stock outstanding automatically converted into 854,941 shares of common stock.



**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**10. Stockholders' Equity (continued)**

Securities Purchase Agreement

On February 22, 2011 (the "Closing Date"), the Company completed a private placement (the "Offering") of 474,967 units at a purchase price of \$13.50 per unit, each unit consisting of: (i) nine shares of the Company's Series A Preferred Stock, convertible on a one to one basis into nine shares of the Company's common stock; (ii) one share of Common Stock; (iii) two three-year Series A Warrants (the "Series A Warrants"), each exercisable for the purchase of one share of Common Stock, at an exercise price of \$2.00 per share; and (iv) two three-year Series B Warrants (the "Series B Warrants"), each exercisable for the purchase of one share of Common Stock, at an exercise price of \$3.00 per share. The Company received aggregate gross proceeds of \$6,412,055. The Offering was conducted pursuant to a Securities Purchase Agreement (the "Agreement") between the Company and various accredited investors (the "Investors").

Because certain of the instruments issued in the Offering are derivative instruments which will be initially and continuously carried at fair value, we believe the aggregate proceeds received should be allocated following the principles implicit in the guidance at ASC 815-15-30-2. The proceeds are first allocated to those derivative instruments that will initially and continuously be carried at fair value. The remaining proceeds, if any, are then allocated between the non-derivative host contract and other non-derivative instruments on a relative fair value basis.

The Company reviewed the features of the Series A Preferred Stock, other than the conversion feature, and concluded that, on balance, the terms and features of the host contract should be considered to be more akin to a debt instrument. Accordingly, the embedded conversion option may be required to be bifurcated and accounted for as a derivative instrument unless it meets the exemption provided by ASC 815-10-15-74a.

The conversion price of the Series A Preferred Stock is subject to adjustment if the Company subsequently sells Common Stock at a lower price. Also, as described below for the Warrants, the conversion option is denominated in U.S. dollars, a currency other than the Company's functional currency. Accordingly, the embedded conversion option is not considered to be indexed only to the Company's common stock. In addition, the Company may be required to redeem the Series A Preferred Stock for cash if, on receipt of a conversion request, it is unable to issue shares registered for resale for any reason. In addition, the conversion price of the Series A Preferred Stock is subject to

adjustment if the Company subsequently sells Common Stock at a lower price but there is no explicit limit on the number of shares that the Company may be required to issue. As a result of the foregoing, the exemption provided by ASC 815-10-15-74a is not available and the embedded conversion option has been bifurcated and accounted for as a derivative liability. Because the embedded conversion option has been bifurcated and accounted for as a derivative liability, no beneficial conversion option was required to be recognized.

### Warrants

The Series A and Series B Warrants are exercisable at any time and from time to time at an exercise price of \$2.00 and \$3.00 per share, respectively, and expired on February 22, 2014. The holder may elect a cashless exercise of the Warrants beginning 12 months after the issuance date but only if the shares underlying the Warrants are not registered for sale.

The Warrants contain standard anti-dilution adjustments for stock splits and similar events but the exercise price is not otherwise subject to adjustment.

The Company may call the Series A and Series B Warrants for redemption at a redemption price of \$0.01 per Warrant share if the shares underlying the Warrants are registered for sale and the volume-weighted average price of the Company's Common Stock is equal to or greater than \$6.00 per share or \$9.00 per share, respectively, for a period of ten consecutive trading days and such Common Stock has an average daily trading volume, for ten consecutive trading days, equal to or greater than 15,000 shares per day.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

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**10. Stockholders' Equity (continued)**

The Warrants are free-standing derivative instruments. Although the Company is a U.S. entity, the Company has no U.S. operations and all of its operations are conducted, through its subsidiaries, in the People's Republic of China. Accordingly, because the Company is fully invested in China and those operations in China represent the Company's only source of future revenues or income, the Company concluded that its functional currency should be considered to be the RMB. As a result, because the Warrants are denominated in U.S. dollars, they are denominated in a currency different from the Company's functional currency and therefore, in accordance with the guidance at ASC 815-40-15-7I, the Warrants are not considered to be indexed only to the Company's common stock. As a result, the exemption provided by ASC 815-10-15-74a is not available and the Warrants are recorded as a derivative liability.

Registration Rights Agreement

In connection with the Offering, the Company entered into a Registration Rights Agreement with the Investors, in which the Company agreed to file a registration statement to register for resale the Common Stock and the Common Stock issuable upon conversion of the Series A Preferred Stock and exercise of the Series A and Series B Warrants, within 45 calendar days of the Closing Date, and to have the registration statement declared effective within 150 calendar days of the Closing Date or within 180 calendar days of the Closing Date in the event of a full review of the registration statement by the Securities and Exchange Commission. If the Company does not comply with the foregoing obligations under the Registration Rights Agreement, the Company will be required to pay cash liquidated damages to each Investor, at the rate of 1% of the applicable subscription amount for each 30 day period or part thereof in which we are not in compliance; provided, that such liquidated damages will be capped at 10% of the subscription amount of each Investor and will not apply to any securities that may be sold pursuant to Rule 144 under the Securities Act, or which are subject to an SEC restriction with respect to Rule 415 under the Securities Act.

The required registration statement was filed by the required due date. However, the Company did not meet the deadline to render its S-1 registration statement effective. At September 30, 2014, the Company has accrued \$641,200 for the estimated liquidated damages it expects to pay.

Placement Agent Fees

In connection with the Offering, the Company paid its placement agents (i) a cash fee of 7% of the gross proceeds from sale of the Units, (ii) a cash management fee of 1% and (iii) a 0.5% non-accountable expense allowance. In addition to these placement agent cash fees aggregating \$545,025, the Company paid \$181,415 in legal fees and other expenses related to the Offering. After payment of the placement agent cash fees and legal and other expenses, the Company received net proceeds of \$5,675,614.

In addition, the placement agents received warrants to purchase such number of securities as is equal to 9% of the aggregate number of shares of common stock issuable in connection with the Units (the "Placement Agent Warrants"). The Placement Agent Warrants expire after three years and are exercisable at the following prices: (i) 85,548 Warrants - \$1.35 per share (ii) 17,099 Series A Warrants - \$2.00 per share and (iii) 85,494 Series B Warrants - \$3.00 per share. The terms of the Warrants, including anti-dilution protection for stock splits and similar events, are similar to the Warrants issued to the Investors, except that the 85,548 Warrants do not permit the Company to call the Warrants.

#### Securities Escrow Agreement

In connection with the Offering, we also entered into a Securities Escrow Agreement with the Investors and Mr. Dishan Guo (the "Stockholder"), the Company's chairman and principal stockholder, pursuant to which the Stockholder placed in escrow one share of our Common Stock for each \$10 of Units sold to the Investors, equal to 641,205 shares of Common Stock (the "Escrow Shares"). The escrow agreement establishes a performance threshold for the Company based on net income (as defined and subject to certain non-cash adjustments) for the year ending December 31, 2011 of \$10,000,000. If the Company achieves 95% or more of the performance threshold, the shares will be returned to the Stockholder. If the Company's net income is less than \$9,500,000, then the shares will be delivered to the Investors in the amount of 10% of the escrow shares for each full percentage point by which such performance threshold was not achieved, up to a maximum of the 641,205 shares placed in escrow.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**10. Stockholders' Equity (continued)**

The Stockholder's agreement to place the shares in escrow was undertaken in his capacity as a major stockholder of the Company. In accordance with the guidance at ASC 718-10-S99-2, the Company does not believe the potential return of the shares to the Stockholder is compensatory because such return is not contingent on his continued employment with the Company. The Investors who may receive shares under the escrow arrangement have no relationship with the Company other than in their capacity as shareholders.

The shares are outstanding and are included in the weighted average shares outstanding for purposes of computing basic earnings per share.

Lock-up Agreement

On the Closing Date, the Company entered into a lock-up agreement (the "Lock-Up Agreement") with the Stockholder whereby the Stockholder is prohibited from selling our securities that he directly or indirectly owns (the "Lock-Up Shares") until nine months after the Registration Statement is declared effective (the "Lock-Up Period"). In addition, the Stockholder further agreed that during the 12 months immediately following the Lock-Up Period, the Stockholder will not offer, sell, contract to sell, assign or transfer more than 0.833% of the Lock-Up Shares during each calendar month following the Lock-Up Period, other than engaging in a transfer in a private sale of the Lock-Up Shares if the transferee agrees in writing to be bound by and subject to the terms of the Lock-Up Agreement.

*Accounting for Derivative Instruments*

The Warrants and Placement Agent Warrants are derivative instruments as defined in ASC 815-10-15-83. ASC 815-10-15-74 provides that a contract that would otherwise meet the definition of a derivative instrument but that is both (a) indexed to a company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. FASB ASC 815-40-15 and 815-40-25 provide guidance for determining whether those two criteria are met. For purposes of this evaluation, the Company has concluded that the Company's functional currency is the Renminbi. Because the Warrants are denominated in U.S. Dollars, FASB ASC 815-40-15-7I provides that they are not considered to be indexed only to the Company's Common Stock. Accordingly, the exemption in FASB ASC 815-10-15-74 is not available and the Warrants are classified as a

derivative instrument liability.

The Series A Preferred Stock is a hybrid financial instrument that embodies the risks and rewards typically associated with both equity and debt instruments. Accordingly, we are required to evaluate the features of this contract to determine its nature as either an equity-type contract or a debt-type contract. We determined that the Series A Preferred Stock is generally more akin to a debt-type contract, principally due to its potential redemption requirements, its fixed rate quarterly dividend requirement and its lack of voting rights. This determination is subjective. However, in complying with the guidance provided in FASB ASC 815, we concluded, based upon the preponderance and weight of all terms, conditions and features of the host contract, that the Series A Preferred Stock was more akin to a debt instrument for purposes of considering the clear and close relationship of the embedded derivative features to the host contract. ASC 815 requires bifurcation when the embedded derivative features and the host contract have risks that are not clearly and closely related. Certain exemptions to this rule, such as that for conventional convertible instruments that are convertible into a fixed number of shares, were not available to us because the conversion price of the Series A Preferred Stock is not fixed and will be adjusted if the Company sells shares of Common Stock at a price lower than the conversion price. Also, because the conversion price of the Series A Preferred Stock is denominated in U.S. Dollars, as for the warrants discussed above, the embedded conversion option is not considered to be indexed only to the Company's Common Stock. In addition, the Company may be required to redeem the Series A Preferred Stock if it is unable to deliver registered shares on conversion. Accordingly, the exemption in FASB ASC 815-10-15-74 is not available and the embedded conversion option, along with certain other features of the Series A Preferred Stock that have risks of equity, required bifurcation and classification in liabilities as a compound embedded derivative financial instrument.

Derivative financial instruments are initially measured at their fair value and are then re-valued at each reporting date, with changes in the fair value reported as charges or credits to income.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

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**10. Stockholders' Equity (continued)**

*Valuation of Derivative Instruments*

The Warrants and the Placement Agent Warrants were initially valued, using a binomial model, at \$649,821 and \$262,966, respectively, based on the quoted market price of the Common Stock of \$1.00 per share, a term equal to the remaining life of the Warrants, an expected dividend yield of 0%, a risk-free interest rate of 1.32% based on constant maturity rates published by the U.S. Federal Reserve applicable to the remaining life of the Warrants and estimated volatility of 85%, based on a review of the historical volatility of publicly-traded companies considered by management to be comparable to the Company.

The compound embedded derivative financial instrument related to the Series A Preferred Stock, consisting primarily of the embedded conversion option, was initially valued, using a binomial model, at \$1,604,794, based on the quoted market price of the Common Stock of \$1.00, a term equal to the expected life of the conversion option, an expected dividend yield of 0%, a risk-free interest rate of 0.78% based on constant maturity rates published by the U.S. Federal Reserve applicable to the expected life and estimated volatility of 85%.

After allocating a portion of the proceeds received to the fair value of the Warrants and the embedded derivative instrument in the Series A Preferred Stock, the remaining proceeds were allocated to the Common Stock component of the Units and the carrying value of the Series A Preferred Stock host contract.

On February 22, 2013, all outstanding shares of the Series A Preferred Stock were converted to common stock. As of that date, the conversion feature of the Series A Preferred Stock was out-of-the-money and accordingly had no value. The aggregate change in the fair value of the embedded derivative instrument related to the Series A Preferred Stock between December 31, 2012 and February 22, 2013 of \$64,280 has been credited to income.

At December 31, 2013, the Warrants, the Placement Agent Warrants and the embedded derivative instrument related to the Series A Preferred Stock were re-valued at \$-0-, \$-0- and \$-0-, respectively, because of their short remaining life with expiration date on February 14, 2014 and the recent low volatility of the stock price. The aggregate change in

the fair value of the derivative liabilities between December 31, 2012 and December 31, 2013 of \$393,534 has been credited to income.

On February 14, 2014, the Warrants, the Placement Agent Warrants and the embedded derivative instrument related to the Series A Preferred Stock expired.

#### *Accounting for Series A Preferred Stock*

\$3,682,473 of the proceeds received was allocated to the carrying value of the Series A Preferred Stock host contract. The 854,940 shares of Series A Preferred Stock have a liquidation value of \$5,770,849. Because the Series A Preferred Stock has conditions for its redemption that are outside our control, it is classified outside of Stockholders' Equity, in the mezzanine section of our balance sheet, in accordance with ASC 480-10-S99-3A. Because the Series A Preferred Stock is not currently redeemable and the Company currently believes that it is not probable that it will become redeemable, no adjustment of the carrying value of the Series A Preferred Stock has been recognized. If it becomes probable that the Series A Preferred Stock will be redeemed, it will be adjusted to its redemption value.

#### *Placement Agent Fees*

The placement agent cash fees of \$545,025, other expenses related to the sale of the Units of \$181,415 and the initial fair value of the Placement Agent Warrants of \$262,966, aggregating \$989,406, have been charged to additional paid-in capital.

#### *Advisory Fees*

On November 22, 2010, the Company entered into a 12 month Advisory Agreement with an affiliate of its placement agent, under which the affiliate agreed to render on-going financial advisory and investment banking services to the Company. As compensation for its services, the Company agreed to pay a monthly fee of \$10,000, payable on the first day of each month after the completion of a Transaction, as defined in the agreement between the Company and its placement agent. Payment of these fees commenced on March 1, 2011, following completion of the sale of the Units.



**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**10. Stockholders' Equity (continued)**

The Company also agreed to place in escrow for issuance to the affiliate a total of 80,000 shares of Common Stock, with 40,000 shares to be released following the completion of a Transaction, 20,000 shares to be released six months after the completion of a Transaction and 20,000 shares to be released 12 months after the completion of a Transaction. In accordance with ASC 505-50-25-7, the Company concluded that the value of the shares should be measured at the date the Transaction was completed because the shares are effectively fully vested as of that date and non-forfeitable and the agreement does not provide for any further specific performance criteria to be met. The Company valued the shares issued at \$1.00 per share (based on the quoted market price), resulting in compensation expense for the services rendered and to be rendered of \$400,000. The expense related to the services provided and to be provided was recognized over the period from November 22, 2010, the date from which services commenced under the agreement, to the one year anniversary, when the agreement expired. At December 31, 2011, the expense has been fully recognized.

In addition to the above fees, the Company issued 10,000 shares to its legal counsel, in consideration for their introducing the Company to the placement agent. The cost of these shares, which were valued at \$5.00 per share (determined as described above) were expensed during the year ended December 31, 2011.

On January 31, 2014, the Company entered into a 12 month Consultancy Agreement with Apex Marketing holding, under which Apex Marketing holding agreed to render financial advisory, acquisitions, and related matter services to the Company. As compensation for its services, the Company issued 400,000 shares to Apex Marketing holding for paying its fees \$500,000. Payment of its fees commenced on July 10, 2014.

*Fair Value Considerations*

As required by FASB ASC 820, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement. Our derivative financial instruments that are measured at fair value on a recurring basis under FASB ASC 815 are all measured at fair value using Level 3 inputs. Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Estimating fair values of derivative financial instruments requires the development of significant and subjective estimates that may, and are likely to, change over the duration of the instrument with related changes in internal and external market factors. In addition, valuation techniques are sensitive to changes in the estimated fair value of our common stock and our estimates of its volatility. Because derivative financial instruments are initially and subsequently carried at fair values, our income will reflect the volatility in these estimate and assumption changes.

### Options

On February 27, 2014, the Board approved the Company's 2014 Incentive Stock Plan (the "2014" Plan). The 2014 Plan provides for grant of incentive stock options, non-statutory stock options, restricted stock, restricted stock purchase offers and other types of stock-based awards to the Company's employees, officers, directors and consultants. Up to 499,666 shares of common stock are issuable pursuant to awards the 2014 Plan. Unless terminated earlier by the Board, the 2014 Plan shall terminate at the close of business on February 26, 2024. As of the date of this report, 400,000 shares have been issued under the 2014 Plan.

## **11. Commitments and Contingencies**

### *Operating Leases*

In the normal course of business, the Company leases office space and internet cafes under operating leases agreements, which expire through 2017. The Company rents internet cafe venues and office space, primarily for regional sales administration offices that are conducive to administrative operations. The operating lease agreements generally contain renewal options that may be exercised in the Company's discretion after the completion of the base rental terms. In addition, many of the leases provide for regular increases to the base rental rate at specified intervals, which usually occur on an annual basis.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015 AND DECEMBER 31, 2014**

**(UNAUDITED)**

**11. Commitments and Contingencies (continued)**

As of March 31, 2015, the Company was obligated under operating leases requiring minimum rentals as follows:

Fiscal year	
Remainder of 2015	\$246,151
2017	31,308
	\$277,459

During the three months ended March 31, 2015, rent expenses amounted to \$133,074 and \$656,800, respectively, of which \$118,033 and \$639,505 was recorded as cost of sales, respectively.

**12. Concentrations**

The Company did not have any customer constituting greater than 10% of net sales for the three months ended March 31, 2015 and 2014.

At March 31, 2015 and December 31, 2014, there was one supplier of consignment snacks and drinks in the amount of \$28,203 and \$45,283, respectively, which accounted for 100% and 100% of the Company's accounts payable.

**13. Operating Risk and Uncertainties**

*Interest rate risk*

The interest rates and terms of repayment of bank and other borrowings are disclosed in Note 5. Other financial assets and liabilities do not have material interest rate risk.

*Foreign currency risk*

Most of the transactions of the Company were settled in Renminbi. In the opinion of the directors, the Company does not have significant foreign currency risk exposure.

*Company's operations are substantially in foreign countries*

Substantially all of the Company's services are provided in China. The Company's operations are subject to various political, economic, and other risks and uncertainties inherent in China. Among other risks, the Company's operations are subject to the risks of restrictions on transfer of funds; export duties, quotas, and embargoes; domestic and international customs and tariffs; changing taxation policies; foreign exchange restrictions; and political conditions and governmental regulations.

The Chinese government began tightening its regulation of internet cafes in 2001. In particular, a large number of unlicensed internet cafes have been closed. In addition, the Chinese government has imposed higher capital (RMB 10,000,000 is required for a regional internet café chain and RMB 50,000,000 is required for a national internet café chain) and facility requirements for the establishment of internet cafes. Furthermore, the Chinese government's policy, which encourages the development of a limited number of national and regional internet cafe chains and discourages the establishment of independent internet cafes, may slow down the growth of internet cafes. Recently, the Ministry of Culture, together with other government authorities, issued a joint notice suspending the issuance of new internet cafe chain licenses. Any intensified government regulation of internet cafes could restrict our ability to maintain and expand our internet cafes.

Currently, the Company uses only one internet service provider. However, there are other internet service providers available to the Company. The management of the Company believes that the risk of loss of internet services is not that high because other service providers are available to the Company.

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2015 AND DECEMBER 31, 2014****(UNAUDITED)****14. Earnings (loss) per Share**

Basic earnings(loss) per share is computed by dividing net income(loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings(loss) per share reflects the potential dilution of securities by including other potential common stock, including convertible preferred stock, stock options and warrants, in the weighted average number of common shares outstanding for the period, if dilutive. The numerators and denominators used in the computations of basic and dilutive earnings (loss) per share are presented in the following table:

	<b>For The Three Months Ended March 31,</b>		
	<b>2015</b>	<b>2014</b>	
<b>BASIC</b>			
Numerator for basic earnings (loss) per share attributable to the Company's common stockholders:			
Net income (loss)	\$ (550,332	) \$ 2,609,766	
Net income (loss) used in computing basic earnings per share	\$ (550,332	) \$ 2,609,766	
Basic weighted average shares outstanding	5,538,002	5,137,905	#
<b>Basic earnings (loss) per share</b>	<b>\$ (0.10</b>	<b>) \$ 0.51</b>	<b>#</b>
	<b>For The Three Months Ended March 31,</b>		
	<b>2015</b>	<b>2014</b>	
<b>DILUTED</b>			
Numerator for diluted earnings (loss) per share attributable to the Company's common stockholders:			
Net income (loss)	\$ (550,332	) \$ 2,609,766	
Net income (loss) used in computing diluted earnings per share	\$ (550,332	) \$ 2,609,766	
Diluted weighted average shares outstanding	5,538,002	5,137,905	#
<b>Diluted earnings (loss) per share</b>	<b>\$ (0.10</b>	<b>) \$ 0.51</b>	<b>#</b>

# The earnings (loss) per share and weighted average number of common shares for September 30, 2013 were retroactively restated to reflect the one-for-five reverse stock split effective on June 16, 2014.

## **15. Segment Information**

The Company applies the provisions of ASC 280, "Disclosures about Segments of an Enterprise and Related Information". The Company views its operations and manages its business as one segment: the operation of internet cafe chains. Factors used to identify the Company's single operating segment include the organizational structure of the Company and the financial information available for evaluation by the chief operating decision-maker in making decisions about how to allocate resources and assess performance. The Company operates in one geographical area, the PRC.

## **16. Subsequent Events**

As of the date of this report, the Company has evaluated subsequent events for potential recognition and disclosure through the date of the financial statement issuance.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion and analysis of our financial condition and result of operations contains forward-looking statements and involves numerous risks and uncertainties, including, but not limited to, those described in the "Risk Factors" section of the other reports we file with the Securities and Exchange Commission. Actual results may differ materially from those contained in any forward-looking statements.*

### **Overview**

We, through our wholly-owned subsidiary, Junlong Culture Communication Co. Ltd. ("Junlong"), operate an internet café chain in Shenzhen city, People's Republic of China ("PRC"), consisting of 11 internet cafes in high traffic areas. Our focus is on providing top quality internet café facilities that offer a one-stop entertainment and media venue for customers, typically mature students and migrant workers, at reasonable prices. Although our cafes do sell snacks, drinks, and game access cards, more than 96% of our revenue comes directly from selling internet access time to our computers.

During our first quarter of 2015, our focus was on our existing cafes. However, our business environment had been very challenging. We gradually lost members due to the expanded coverage of 4G network and free Wi-Fi services, the availability of smart phones and tablets and the increasing popularity of mobile games. We expect our future growth to be driven by a number of factors and trends including:

1. Our ability to improve our service to our customers by providing enjoyable entertainment environment.
2. Our ability to optimize our existing internet cafes.
3. Our ability to identify and acquire target companies for joint venture in the coming years.
4. Our ability to identify and invest in other business opportunities.

For the first quarter ended March 31, 2015, our revenue was approximately \$0.38 million and our net loss was roughly \$0.55 million, representing decreases of 95% and 121% respectively, from the revenue of roughly \$7.66 million and net income of approximately \$2.61 million for the first quarter ended March 31, 2014.

The discussion below of our performance is based upon our unaudited financial statements for the first quarter ended March 31, 2015 and 2014, which are included in this report.

We believe that the following factors will continue to affect our financial performance:

**Improved Disposable Income.** We believe as the Shenzhen municipal government increases the minimum wage, migrant workers, who are our major customers, will have more disposable income. We are expecting the inflow of migrant workers to continue to contribute to our revenue growth.

**Continued Internet Café Use.** Our business may be adversely affected by increased 4G network. We believe, however, people prefer to play video and game in a computer's screen than in the small screen of a cell phone. In addition, young people in the PRC prefer internet cafes since it is a social place for them. We expect the preference will continue and provide sustainable business.

**Customer Loyalty.** As we continue to expand our operations, developing and maintaining customer loyalty will be critical to continued revenue growth.

**Expansion into South Western Provinces.** The Company currently holds an internet café chain license. Because the Company believes that a national license is imperative for its goal to develop a national market, the Company's original primary objective was to acquire and open at least 20 internet cafes in two provinces other than Guangdong province by the end of calendar year 2015. The Company conducted research in the south-western provinces and cities including Chongqing, Sichuan, Guizhou, and Yunnan and targeted internet cafes in these areas for acquisition purposes. Our plan is to acquire existing internet cafes by purchasing them through cash and/or stock. We also plan to organically grow our own network of cafes. Accordingly, whether or not we will be successful in our expansion plans will depend on the availability of cash from our revenues and the price of our stock.



However, our expansion plans have been affected by the following trends:

Internet Café Industry Recession. Since 2013, the PRC has experienced a recession in the internet café industry resulting in a decrease of customers (Source: <http://www.cnnic.cn/gywm/xwzx/rdxw/2014/201401/W020140116475324694244.pdf>, page 26). We believe that this recession stems from the availability of more modern and affordable information and technology and communication tools such as mobile phones. If this trend were to continue and there is no discernible value proposition in or relevance for internet cafes, then the demand for them will fall and we will not pursue our acquisition plans as aggressively.

Slowdown in Economy. Because most of our customers comprise migrant, low income workers, if the GDP growth in the PRC were to stall or continue its decline, manufacturing demand may fall, leading to less migrant workers and a decline in customer demand for our services. Unfortunately, the trend is that the PRC will likely see economic expansion in 2015 decelerate to 7.1% as slowdown in real estate investment continues resulting in more factories being shuttered (Source: <http://www.bloomberg.com/news/articles/2014-12-14/china-pboc-economist-says-2015-gdp-growth-to-slow-to-7-1-pe>)

The Surge of Non-licensed Internet Cafes. Recently we have noticed a surge in non-licensed internet cafes which are a direct threat to our business. These unlicensed cafes offer a cheaper alternative to our services because of lower overheads and if they are allowed to continue to proliferate, this will result in less customer demand for our services and accordingly impact our growth plans.

At present, we have shelved our expansion plans temporarily but shall continue to monitor the market for our services and adjust our plans accordingly. We shall err on the side of caution as our expansion plans are cost-intensive. If the demand for our services decreases, we will pursue our expansion plans less aggressively and/or perhaps extend our original deadline.

We have also started exploring the possibility of acquiring profitable businesses that are complementary to our business. We are still in the exploratory stages but suffice it to say, any future acquisition will be premised on (i) synergies between both businesses, (ii) the potential to cross market services and products, (iii) lowering our operating costs and (iv) increasing our profit margins.

## Results of Operations

The following tables set forth key components of our results of operations for the periods indicated, in dollars and as a percentage of revenue.

## CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	For The Three Months Ended						Amount	%	
	2015			2014					
		As percentage of revenue			As percentage of revenue		change	change	
Revenue	376,864	100	%	7,659,342	100	%	(7,282,478)	-95	%
Cost of revenue	804,711	214	%	4,087,552	53	%	(3,282,841)	-80	%
Gross profit (loss)	(427,847)	-114	%	3,571,790	47	%	(3,999,637)	-112	%
Operating Expenses									
General and administrative expenses	142,398	38	%	110,529	1	%	31,869	29	%
Total operating expenses	142,398	38	%	110,529	1	%	31,869	29	%
Income (loss) from operations	(570,245)	-151	%	3,461,261	45	%	(4,031,506)	-116	%
Non-operating income									
Interest income	19,938	5	%	35,366	-		(15,428 )	-44	%
Interest expenses	-	0	%	(3,679 )	-		3,679	-100	%
Other expenses	(25 )	0	%	(317 )	-		292	-92	%
Total non-operating income	19,913	5	%	31,370	0	%	(11,457 )	-37	%
Net income (loss) before income taxes	(550,332)	-146	%	3,492,631	46	%	(4,042,963)	-116	%
Income taxes	-	0	%	882,865	12	%	(882,865 )	-100	%
Net income (Loss) attributable to China Internet Cafe Holdings Group, Inc.	(550,332)	-146	%	2,609,766	34	%	(3,160,098)	-121	%
Net income (Loss) attributable to China Internet Cafe Holdings Group, Inc. Common stockholders	(550,332)	-146	%	2,609,766	34	%	(3,160,098)	-121	%
Other comprehensive income (loss)									
Net income (loss)	(550,332)	-146	%	2,609,766	34	%	(3,160,098)	-121	%
Foreign currency translation	118,212	31	%	(390,114 )	-		508,326	-130	%
Net Comprehensive income (loss)	(432,120)	-115	%	2,219,652	29	%	(2,651,772)	-119	%

## **Comparison of Three Months Ended March 31, 2015 and 2014**

### **Revenue**

Our revenue is primarily generated from prepaid fees in IC cards and member accounts which include stored value that will be deducted based on time usage of computers at our internet cafes. Our revenue decreased approximately \$7.28 million, or 95%, from approximately \$7.66 million for the three months ended March 31, 2014 to \$0.38 million for the three months ended March 31, 2015. The decrease in revenue was due to a substantial decrease in the number of our internet cafes. During the year of 2014, we closed five internet cafes located in areas with many new internet cafes in April due to deteriorating business resulting from fierce competitions from these new internet cafes, and temporarily closed 17 internet cafes for renovation during the second quarter which were further suspended in the third quarter for incompliance with fire control regulations along with additional 20 internet cafes. As of December 2014, we had closed an aggregate of 51 internet cafes. In order to adapt to market changes and improve our revenue, we will focus on optimizing our existing profitable internet cafes and expanding our businesses to other cities and provinces during 2015. We expect a recover in revenue once the optimization and expansion of our business take effect.

### **Cost of Revenue**

Cost of revenue is primarily composed of depreciation and amortization, salary, rent, utility value added tax and surcharge. Among the components of cost of revenue, depreciation and amortization, salary and rent are fixed costs while utility and value added tax and surcharge are variable costs, which change in proportion to the change in revenue. Our cost of sales for the three months ended March 31, 2015 decreased approximately \$3.28 million, or 80%, to approximately \$0.80 million for the three months ended March 31, 2015 from approximately \$4.09 million for the same period in 2014. The decrease was mainly attributed to decrease in the number of our internet cafes.

### **Gross Profit**

Gross profit is the difference between revenue and cost of revenue. Our gross profit decreased by approximately \$4.0 million, or 112%, to a loss of approximately \$0.43 million for the three months ended March 31, 2015 from a profit of approximately \$3.57 million for the same period in 2014. Gross loss as a percentage of sales was 114% for the three months ended March 31, 2015, as compared to gross profit margin of 47% for 2014. The decrease in our gross profit margin was mainly attributable to the substantial decrease in revenue.



### **Operating Expenses**

Operating expenses are composed of general and administrative expenses. General and administrative expenses mainly consist of overhead of our headquarters in Shenzhen and fees paid to legal counsel, auditor, and consultants. Our operating expenses increased by approximately \$0.03 million, or 29%, to approximately \$0.14 million for the three months ended March 31, 2015 from approximately \$0.11 million for the same period in 2014.

The increase was primarily due to an increase of approximately \$0.03 million in general and administrative expenses, which was a result of increase in professional fees, mainly fees paid to the auditor.

### **Non-operating Income/Expenses**

Our other income decreased by approximately \$0.01 million, or 37%, to approximately \$0.02 million non-operating income for the three months ended March 31, 2015 from approximately \$0.03 million non-operating income for the same period in 2014. The decrease was due to the decrease in the interest income resulting from decrease in bank deposits.

### **Income before Income Taxes**

Income before income taxes decreased by approximately \$4.04 million, or 116%, to approximately \$0.55 million for the three months ended March 31, 2015 from approximately \$3.5 million for the same period in 2014. The decrease in income before income tax was mainly attributable to the decrease in revenue.

### **Income Taxes**

Our income taxes decreased by approximately \$0.88 million to approximately \$0 for the three months ended March 31, 2015 from approximately \$0.88 million for the same period in 2014, primarily due to the loss from operations.

### **Net Income**

Our net income decreased by approximately \$3.16 million, or 121%, to net loss of approximately \$0.55 million for the three months ended March 31, 2015 from net income of approximately \$2.61 million for the same period in 2014 as a result of the factors described above.

## Liquidity and Capital Resources

As of March 31, 2015, we had cash and cash equivalents of approximately \$23.4 million. The following table provides detailed information about our cash flow for each financial statement period presented in this report.

### Cash Flow

	<b>Three Months Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
Net cash provided by operating activities	\$(502,365)	\$4,102,609
Effect of foreign currency translation on cash and cash equivalents	112,169	(367,059 )
Net cash flows	(390,196)	3,735,550

### *Operating Activities*

Net cash used in operating activities was approximately \$0.5 million for the three months ended March 31, 2015 as compared to net cash provided by operating activities of approximately \$4.1 million for the same period in 2014. The change was mainly attributable to the net loss in operations in the first quarter of 2015.

We did not have any cash flow in our financing and investing activities.

### ***Critical Accounting Policies***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires our management to make assumptions, estimates and judgments that affect the amounts reported, including the notes thereto, and related disclosures of commitments and contingencies, if any. We have identified certain accounting policies that are significant to the preparation of our financial statements. These accounting policies are important for an understanding of our financial condition and results of operations. Critical accounting policies are those that are most important to the portrayal of our financial conditions and results of operations and require management's difficult, subjective, or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Certain accounting estimates are particularly sensitive because of their significance to financial statements and because of the possibility that future events affecting the estimate may differ significantly from management's current judgments. We believe the following critical accounting policies involve the most significant estimates and judgments used in the preparation of our financial statements.

### ***Revenue recognition***

Internet café members purchase prepaid IC cards which include stored value or deposit money into member's accounts associated with their ID cards directly that will be deducted based on time usage of computers at the internet cafe. Revenues derived from the prepaid IC cards and member accounts at the internet café are recognized when services are provided. This is based upon the usage of computer time at the internet cafe. Outstanding customer balances in the IC cards and member accounts are included in deferred revenue on the balance sheets. The Company does not charge any service fees that cause a decrease to customer balances. There is no expiration date for IC cards and member accounts. During 2014, the company began to use member accounts instead of prepaid IC cards.

In 2005, Junlong obtained internet cafe licenses to operate an internet café chain from the Ministry of Culture, and opened its first internet cafe in April, 2006 and our members can access the internet at our venues. As of March 31, 2015, the Company owned 11 internet cafes within Shenzhen, Guangdong.

The Company also records revenue from commissions received from the sale of third parties on-line gaming cards, snacks and drinks. Commission revenue amounting to 20% of the value of the on-line gaming cards, snacks and drinks is recognized at the time the gaming cards, etc. are sold to customers. During the three months ended March 31, 2015 and 2014, the commission income was \$13,132 and \$118,445, respectively, less than 4% and 1% of total revenue.

### ***Cost of goods sold***

Cost of revenue consists primarily of depreciation of each internet café's computer equipment and hardware and overhead associated with the internet cafes including rental payments, utilities, value added taxes, and surcharges. Our value added taxes is 3% on gross revenue generated from selling time of internet surfing in our internet cafes. Our other surcharges are an education surcharge of 3% of value added tax amount, city development surcharge of 7% of value added tax amount, a culture development surcharge of 3% of gross revenue, and a snacks and drinks business tax of 5% of gross revenue.

***Property, plant and equipment***

Property and equipment, comprising computer equipment and hardware, leasehold improvements, office furniture and vehicles are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives listed below.

	Estimated Useful Lives
Leasehold improvement	5 years
Café computer equipment and hardware	2-5 years
Café furniture and fixtures	5 years
Office furniture, fixtures and equipments	5 years
Motor vehicles	5 years



Leasehold improvements mainly result from decoration expenses. All of our lease contracts state that lease terms are for 5 years and leasehold improvements are amortized over 5 years, which represents the shorter of useful life and lease term.

### ***Deferred Revenue***

Deferred revenue represents unused balances of the prepaid amounts received for IC cards and member accounts. The outstanding customer balances are \$170,927 and \$131,013 as of March 31, 2015 and December 31, 2014, respectively, and are included in deferred revenue on the balance sheets. Management has evaluated the deferred revenue balance and has determined any potential revenue from the unused balance to be immaterial at the quarter ended March 31, 2015.

### ***Comprehensive income***

The Company follows the FASB's accounting standard. Comprehensive income (loss) is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investments from owners and distributions to owners. For the Company, comprehensive income (loss) for the periods presented includes net income (loss) and foreign currency translation adjustments.

### ***Income taxes***

Income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Current tax is based on the profit or loss from ordinary activities adjusted for items that are non-assessable or disallowable for income tax purpose and is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date. Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 740-10-50-2 requires that deferred tax assets and liabilities be recognized for future tax consequence attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of income in the period that includes the enactment date. 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. Losses incurred by the Company in prior years provide for a net operating loss carry-forward. However, all net operating

losses are from the U.S. shell company and we currently anticipate insufficient income to utilize these losses in the future, so the asset balance has been fully reserved for.

***Foreign currency translation***

Assets and liabilities of a company with a functional currency other than US\$ are translated into US\$ using period end exchange rates. Income and expense items are translated at the average exchange rates in effect during the period. Foreign currency translation differences are included as a component of Accumulated Other Comprehensive Income in Stockholders' Equity.

The exchange rates used to translate amounts in RMB into USD for the purposes of preparing the consolidated financial statements were as follows:

	March 31, 2015	March 31, 2014	December 31, 2014
Period-end RMB : USD exchange rate	6.1091	-	6.1385
Three months average RMB : USD exchange rate	6.1358	6.1156	-

The RMB is not freely convertible into foreign currency and all foreign exchange transactions must take place through authorized institutions. No representation is made that the RMB amounts could have been, or could be, converted into USD at the rates used in translation.

### **Recently issued accounting pronouncements**

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which are intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. It lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This amendment provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes.

The amendment is effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. Currently, the Company is evaluating the impact of the pending adoption of ASU 2014-14 on the disclosure of the consolidated financial statements.

In January 2015, the FASB issued ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. It eliminates from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item.

The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The adoption of ASU 2015-01 is not expected to have any material impact on the Company's consolidated financial statements.



**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Not applicable.

**Item 4. Controls and Procedures.**

*Evaluation of Disclosure Controls and Procedures*

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed by the Company in the reports filed under the Securities Exchange Act, is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls are also designed with the objective of ensuring that this information is accumulated and communicated to the Company's management, including the Company's chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(b) under the Exchange Act, the Company carried out an evaluation with the participation of the Company's management, including Dishan Guo, the Company's chief executive officer and chief financial officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the quarter ended March 31, 2015. Based upon that evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were not effective as a result of the material weakness identified in our internal control over financial reporting disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

Specifically, our management identified certain matters involving internal control and our operations that it considered to be material weaknesses. As defined in the Exchange Act, a material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness identified by our management is described below:

We did not maintain sufficient personnel with an appropriate level of technical accounting knowledge, experience, and training in the application of GAAP commensurate with the complexity of our financial accounting and reporting requirements. This control deficiency is pervasive in nature. Further, there is a reasonable possibility that material misstatements of the financial statements including disclosures will not be prevented or detected on a timely basis as a result.

***2015 Planned Remediation***

We are committed to improving our financial organization. As part of this commitment, we will look to increase our personnel resources and technical accounting expertise within the accounting function by the end of fiscal year 2015 to resolve non-routine or complex accounting matters. We have in the past, and will continue to engage outside consultants in the future as necessary in order to ensure proper treatment of non-routine or complex accounting matters.

Management believes that hiring additional knowledgeable personnel with technical accounting expertise will remedy the material weakness of having insufficient personnel with an appropriate level of technical accounting knowledge, experience, and training in the application of GAAP commensurate with our complexity and our financial accounting and reporting requirements.

We will continue to monitor and evaluate the effectiveness of our disclosure controls and procedures and our internal controls over financial reporting on an ongoing basis and are committed to taking further action and implementing additional enhancements or improvements, as necessary and as funds allow.

*Changes in Internal Controls over Financial Reporting*

There have been no changes in our internal control over financial reporting during the quarter ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

None.

**Item 1A. Risk Factors**

Not applicable.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

Not applicable.

**Item 6. Exhibits.**

**Exhibit No. Description**

3.1(2)	Amended and Restated Articles of Incorporation of China Internet Café Holdings Group, Inc.
3.2(3)	Amended and Restated Bylaws, adopted on July 30, 2010
3.3(2)	Certificate of Designations Preferences and Rights of the 5% Series A Convertible Preferred Stock of China Internet Café Holdings Group, Inc.
3.4 (6)	Certificate of Change
3.5 (7)	Certificate of Correction
4.1 (8)	China Internet Café Holdings Group, Inc. 2014 Incentive Stock Plan
31.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document*
101.SCH	XBRL Schema Document*
101.CAL	XBRL Calculation Linkbase Document*
101.LAB	XBRL Label Linkbase Document *



XBRL Presentation Linkbase Document\*

101.PRE

101.DEF XBRL Definition Linkbase Document\*

\*File herewith.

\*\*Furnished herewith.

- (1) Incorporated by reference to our Current Report on Form 8-K filed with the SEC on July 9, 2010.
- (2) Incorporated by reference to our Current Report on Form 8-K filed with the SEC on February 23, 2011.
- (3) Incorporated by reference to our Current Report on Form 8-K filed with the SEC on August 3, 2010.
- (4) Incorporated by reference to our Annual Report on Form 10-K filed with the SEC on June 30, 2008.
- (5) Incorporated by reference to our Annual Report on Form 10-K filed with the SEC on April 19, 2013. (6) Incorporated herein by reference to Exhibit 3.01 to our Current Report on Form 8-K filed with the SEC on April 29, 2014.
- (7) Incorporated herein by reference to Exhibit 3.01 to our Current Report on Form 8-K filed with the SEC on May 15, 2014.
- (8) Incorporated herein by reference to Exhibit 4.1 to our Registration Statement on Form S-8 filed with the SEC on March 12, 2014.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CHINA INTERNET CAFÉ HOLDINGS GROUP, INC.**

Date: May 15, 2015 By: */s/ Dishan Guo*

Dishan Guo

Chief Executive Officer and Chief Financial Officer

(Principal Executive Officer and Principal Accounting and Financial Officer)