China Internet Cafe Holdings Group, Inc.
Form 10-K
April 09, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

FORM 10-K

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

For the fiscal year ended December 31, 2014

or

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

For the transition period from ______________________ to _______________________

Commission file number: 000-52832

CHINA INTERNET CAFÉ HOLDINGS GROUP, INC.

(Exact name of registrant as specified in its charter)

Nevada	**98-0500738** (I.R.S. Employer Identification No.)

State of other jurisdiction of
incorporation or organization

#1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City	
Longgang District, Shenzhen	
Guangdong Province, People's Republic of China	**518172**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **86-755-8989-6008**

Securities registered pursuant to Section 12(b) of the Act: **None**

Title of each class	Name of each exchange on which registered
Not Applicable	Not Applicable

Securities registered pursuant to section 12(g) of the Act:

Common Stock, $0.00001 par value
Title of Class

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes x No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all 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.

x Yes ¨ No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 (Do not check if a smaller reporting company) ¨	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

¨ Yes x No

The aggregate market value of the voting and non-voting common stock of the issuer held by non-affiliates as of June 30, 2014 was approximately $4,674,706.75 (2,671,261 shares of common stock held by non-affiliates) based upon the closing price of $1.75 per share of common stock as quoted by OTCQB on June 30, 2014.

As of April 8, 2015, there are 5,538,002 shares of common stock, par value $0.00001 issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None

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PART I

Item 1. Business.

Overview

We operate a chain of 11 internet cafés in Shenzhen, Guangdong, the People's Republic of China ("PRC") that are generally open 24 hours a day, seven days a week. We provide internet accesses at prices that we believe are affordable to both students and migrant workers and we believe we are the largest internet café chain in Shenzhen. Although we sell snacks, drinks, and game access cards, over 98% of our revenue comes from selling access time to our computers. We sell internet café memberships to our customers. Members deposit money in their account, which will be deducted based on time usage of a computer at the internet café. We deduct the amount that reflects the access time used by a customer when the customer logs into his account on the computer.

Our History

China Internet Cafe Holdings Group, Inc. ("we", "us", or the "Company") is a Nevada holding company for our direct and indirect subsidiaries in the British Virgin Islands ("BVI") and the PRC. We own all of the issued and outstanding capital stock of Classic Bond, a BVI corporation. Classic Bond is a holding company that owns 100% of the outstanding capital stock of Shenzhen Zhonghefangda Network Technology Co., Limited ("Zhonghefangda"), a PRC company.

Current PRC laws and regulations impose substantial restrictions on foreign ownership of the internet café business in the PRC. Therefore, our principal operations and sales and marketing activities in the PRC are conducted through Shenzhen Junlong Culture Communications Co., Ltd ("Junlong"), our variable interest entity ("VIE"), which holds the licenses and approvals for conducting the internet café business in the PRC. Junlong was incorporated in the PRC in December 2003. It obtained its first licenses from the Ministry of Culture of the PRC to operate an internet café chain in 2005 and opened its first internet café in April 2006.

Our effective control over the VIE is contingent on a series of contractual arrangements. These contracts include a Management and Consulting Services Agreement, an Option Agreement, an Equity Pledge Agreement, and a Voting Rights Proxy Agreement. The Management and Consulting Services Agreement, dated June 11, 2010, is between our indirect, wholly owned subsidiary, Zhonghefangda, and our VIE. The rest of the agreements, also dated June 11, 2010, are among Zhonghefangda, our VIE and its shareholders. The terms of these agreements are summarized below. Please also refer to the full text of the contracts, which are filed as exhibits to this report.

- ***Management and Consulting Services Agreement.*** Under the Management and Consulting Services Agreement between Junlong and Zhonghefangda, Zhonghefangda provides management and consulting services to Junlong in exchange for service fees up to 100% of Junlong's Aggregate Net Profits (as defined in the agreement). In consideration for its right to receive Junlong's aggregate net profits, Zhonghefangda will reimburse to Junlong the full amount of Net Losses (as defined in the Agreement) incurred by Junlong. During the term of the agreement, Junlong may not contract with any other party to provide services that are the same or similar to the services to be provided by Zhonghefangda pursuant to the agreement. The term of this agreement is 20 years, renewable for succeeding periods of the same duration until terminated pursuant to terms of the agreement.

- ***Option Agreement.*** Under the Option Agreement, Junlong's shareholders, Mr. Dishan Guo, Mr. Jinzhou Zeng and Ms. Xiaofen Wang (the "Junlong Shareholders"), who collectively own 100% of the equity interest in Junlong, granted Zhonghefangda an exclusive, irrevocable option to purchase all or part of their equity interests in Junlong, exercisable at any time and from time to time, to the extent permitted under PRC law. The purchase price of the equity interest will be equal to the original paid-in registered capital of the transferor, adjusted proportionally if less than all of the equity interest owned by the transferor is purchased.

- ***Equity Pledge Agreement.*** The Junlong Shareholders have pledged their entire equity interest in Junlong to Zhonghefangda pursuant to the Equity Pledge Agreement. The equity interests are pledged as collateral to secure the obligations of Junlong under the Management and Consulting Services Agreement and the Junlong Shareholders' obligations under the Option Agreement and the Proxy Agreement.

- ***Voting Rights Proxy Agreement.*** Pursuant to the Voting Rights Proxy Agreement, each of the Junlong Shareholders has irrevocably granted and entrusted Zhonghefangda with all of the voting rights as a shareholder of Junlong for the maximum period of time permitted by law. Each Junlong Shareholder has also covenanted not to transfer his or her equity interest in Junlong to any party other than Zhonghefangda or a designee of Zhonghefangda.

We believe that the terms of these agreements are no less favorable than the terms that we could obtain from disinterested third parties. According to our PRC counsel, China Commercial Law Firm, our conduct of business through these agreements complies with existing PRC laws, rules and regulations.

As a result of these contractual arrangements, Junlong became our controlled VIE. A variable interest represents a contractual or ownership interest in another entity that causes the holder to absorb the changes in fair value of the other entity's net assets. Potential variable interests include: holding economic interests, voting rights, or obligations to an entity; issuing guarantees on behalf of an entity; transferring assets to an entity; managing the assets of an entity; leasing assets from an entity; and providing financing to an entity. In such cases consolidation of the VIE is required by the enterprise that controls the economic risks and rewards of the entity, regardless of ownership. We have consolidated Junlong's historical financial results in our financial statements as a variable interest entity pursuant to U.S. generally accepted accounting principles ("GAAP").

Acquisition of Classic Bond

On July 2, 2010, we completed a reverse acquisition transaction through a share exchange with Classic Bond and its shareholders, whereby we acquired 100% of the issued and outstanding capital stock of Classic Bond, in exchange for 19,000,000 shares of our common stock, which shares constituted 94% of our issued and outstanding shares on a fully-diluted basis, as of and immediately after the consummation of the reverse acquisition. As a result of the reverse acquisition, Classic Bond became our wholly owned subsidiary and the former shareholders of Classic Bond, became our controlling shareholders. The share exchange transaction with Classic Bond was treated as a reverse acquisition, with Classic Bond as the acquirer and us as the acquired party. Unless the context suggests otherwise, when we refer in this report to business and financial information for periods prior to the consummation of the reverse acquisition, we are referring to the business and financial information of Classic Bond and its consolidated subsidiaries.

Upon the closing of the reverse acquisition, Xuezheng Yuan, our sole director and officer, submitted a resignation letter pursuant to which he resigned, with immediate effect, from all offices that he held and from his position as our sole director that became effective on the August 13, 2010, ten days following the mailing by us of an information statement to our stockholders complying with the requirements of Section 14f-1 of the Exchange Act (the “Information Statement”). Also upon the closing of the reverse acquisition, our board of directors (the “Board”) increased its size from one to five members and appointed Dishan Guo, Zhenquan Guo, Lei Li, Wenbin An and Lizong Wang to fill the vacancies created by the resignation of Xuezheng Yuan and such increase. Mr. Dishan Guo’s appointment became effective upon closing of the reverse acquisition, while the remaining appointments became effective on August 23, 2010. In addition, our executive officers were replaced by the Classic Bond executive officers upon the closing of the reverse acquisition as indicated in more detail below.

As a result of our acquisition of Classic Bond, we now own all of the issued and outstanding capital stock of Classic Bond. Classic Bond was incorporated in the British Virgin Islands on November 2, 2009 to serve as an investment holding company that owns 100% of the outstanding capital stock of Zhonghefangda.

The following chart represents our organizational structure as of the date of this report:

On July 2, 2010, our Board approved a change in our fiscal year end from June 30 to December 31, which was effectuated in connection with the reverse acquisition transaction described above.

On January 20, 2011, we changed our name from “China Unitech Group, Inc.” to “China Internet Cafe Holdings Group, Inc.”

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On June 16, 2014, we effected a one-for-five reverse stock split of our common stock. As a result, the number of our authorized shares of common stock has been reduced from 100,000,000 shares to 20,000,000 shares and the total number of our issued and outstanding shares of common stock became 5,138,001.

Our Industry

Background on Internet Cafés in the PRC

According to the Survey of China Internet Café Industry by the Ministry of Culture in May 2014, the PRC had 131,013 internet cafés, with more than 478,200 employees and contributing RMB 38,794,000,000 to China's gross domestic product. According to an article entitled "*China Surpasses U.S. in Number of Internet Users*" written by David Barboza on the New York Times July 26, 2008 issue, the number of internet users in the PRC reached about 253 million in June 2008, thereby, putting China ahead of the United States as the world's biggest internet market. According to the research conducted by China Internet Network Information Center (CNNIC) in January 2014, the amount of internet users in China by the end of 2013 was 618 million, 115.57 million of which (18.7%) surf the internet via internet cafes.

The internet café market in the PRC, like most places worldwide, originally started out simply as a location to access the internet. However, PRC internet cafés have changed into full service entertainment centers where people can relax outside work and home. These cafés provide services that are different from the internet cafés initially established in the PRC. They provide decent facilities at a reasonable fee, with specific configuration for online games and audio visual entertainment. They are a source of cost effective entertainment for low-income earners who cannot afford computers, game consoles or an internet connection, such as migrant workers and students. In internet cafés, customers have access to popular online games and can either socialize or entertain themselves. Players gather together in internet cafés for games such as World of Warcraft (WOW), Cross Fire(CF) and League Of Legends (LOL), played either with their friends in the café or with users across the globe.

Due to tightened regulations on the operations of internet cafés, the number of internet cafes in the PRC decreased by 3.4% to 131,013 in 2013 from the prior year. (Source: http://zwgk.mcprc.gov.cn/auto255/201405/t20140516_30294.html). There are currently 10 chains which have licenses to operate nationally. They are CY Network Home Co., Ltd, Zhong Lu Shi Kong Co., Ltd, Digital Library of China Co., Ltd, Asia Telecommunication Network Co., Ltd, China Relic Information Consultation Center, Capital Net Co., Ltd, Great Wall Broadband Network Co., Ltd, China United Network Communications Group Co., Ltd, CECT-China Comm Communications Co., Ltd, and Read China Investment.

Computer Gaming Industry in China

According to the 2014 China Gaming Industry Report, the PRC gaming market rose 37.7% to RMB114.48 billion for 2014 from RMB83.17 billion for 2013. Given the relatively low rate of computer ownership in the PRC as compared to western countries, management believes that Internet cafés are the primary distribution point for games in the PRC. A substantial number of game players access online games through internet cafés and these players are crucial for survival of internet cafés. (*see*: http://blog.sina.com.cn/s/blog_4aff94ef01007zei.html).

The following diagram prepared by Morgan Stanley depicts the interdependent relations between online game developers and internet cafés. (Source: Ji Richard and Meeker, Mary. "Creating Consumer Value in Digital China" Morgan Stanley Equity Research Global. September 12, 2005.)

Given the popularity of internet cafés in China, it has been management's experience that many online game companies had been supportive to internet cafés to expand their customer base in the past. Many online game companies used to promote new products by allowing internet café customers to sample the new products in internet cafes. In this way, online game operators were provided with an outlet to present their new products as well as receive feedback from those individuals who sample the products in the internet cafes.

Prior to 2014, the Company was involved in several such promotions with game companies such as Giant Network, Sanda Network, and Tencent and received commissions for such promotions.

Recently the game companies have adopted new marketing strategy, such as implanting their game advertisements in internet cafe software, publishing game posters and giving out free gifts with their logo. As a result, we no longer received commissions from these companies.

Currently, we have 11 direct outlets in Shenzhen City, and we believe that the Company name has strong brand recognition in Shenzhen.

Partnerships between Internet Cafés and Other Online Information Providers

Besides games, internet cafés are able to develop partnerships with other online information providers. These companies provide games as well as other information services. As can be seen by the chart below, these providers have significant revenues and profits.

Company	2014 Revenue Million US$	YOY	Net Profit	% Net	Market Cap (in Billions)
Tencent	$12,899	31 %	$ 3,904	53.0 %	$ 169.28
Shanda	$121.2	-10.0%	$ 156.7	-11.8 %	$ 1.74
Netease	$2,011	28.0 %	$ 1,887	27 %	$ 13.32
ChangYou	$755.3	2.4 %	$ 338.1	26.0 %	$ 1.35
Total	$15,786		$ 6,286		$ 185.69

(Source: finance.yahoo.com, last accessed March 25, 2015)

Competitive Strengths

We believe that the following competitive strengths enable us to compete effectively in and to capitalize on growth in the internet café market in the PRC:

- ***Company-owned Cafés.*** Unlike most of our competitors who franchise their internet cafés, all of our cafés are direct outlets. This model makes it easier to carry out management decisions at each of our cafés. It also allows us to maximize operating profit and create a consistent name brand.

- ***Good Scale of Operation.*** We have a registered capital of RMB 10 million (approximately $1.47 million) with 11 cafés. The scale of operations allows us to control cost and standardize store management. In the event that we expand into additional provinces and acquire more internet cafes in the future, we will ensure the targets are local companies with good scale of operations. We will identify target companies by conducting due diligence on each target company's corporate structure, management, financials, capitalization, and equity structure, and whether or not the target company has the proper approvals, permits, and certificates to legally operate an internet café in the PRC. We intend to buy 51% of the target's company, and keep the local management. However, we will relocate an account manager and an operation manager from our headquarters in Shenzhen to any newly acquired café to join the local management and assist in the process of the acquisition in order to make sure that the acquired café operates in the same manner as our existing Shenzhen-based cafes. As a result, we believe that the efficient and effective operation of the cafes will continue and the Company's scale of operations as a whole will not be negatively affected if we are to acquire additional internet cafes in other regions.

- ***Proprietary Software.*** We developed the software "SAFLASH" that provides fast and stable internet connections. Its automatic flow control prevents users from being disconnected when there is a disruption of internet traffic. Stability is a key requirement for online gamers. Our research and development team is working constantly to improve the software.

- ***Government and Industry Relations.*** We have developed an excellent working relationship with the government that has assisted us to better comply with internet café related laws and regulations and to understand regulatory trends in our industry. Our Chief Executive Officer and Chief Financial Officer, Mr. Dishan Guo, is the executive president of Shenzhen Longgang District Internet Industry Association. This association is an associated department of the Ministry of Culture and sets the internet café industry standards. As a result of his involvement, Mr. Guo gains valuable insight into new standards and may also have the opportunity to influence industry standards. Because the Ministry of Culture is responsible for culture policies and activities throughout China, and there are regional Ministry of Culture departments in each province, Mr. Guo's government and industry relations expand beyond the Shenzhen district, which we believe will benefit the Company as we expand into provinces outside of Guangdong Province.

- ***Centralized Oversight.*** All of our café managers are trained by, and under the supervision of, our centralized operations manager, who is based at our headquarters. As a result, our local managers are able to effectively handle operational issues at the cafés. The local managers are trained to provide a service level that meets Junlong's service standards, and our operations manager is able to effectively enforce policies and procedures implemented by us.

Industry Risks

The principal risk the company faces is the risk associated with changes in government regulations regulating the internet or internet cafes. For example, in the year 2000, an arson killed twenty-four individuals and injured several more in an internet café in Beijing. After this event, the government released new regulations governing the operation of internet cafes, did not issue any new internet café operating licenses, and forced all internet cafes to temporarily close for safety purposes (http://news.sina.com.cn/z/wangba/index.shtml). This type of action by the government could cause serious disruptions in our operations. Additionally, the possibility of passing regulations limiting access to the internet could have a significant negative impact on our business. Please refer to our disclosure under the "Regulation" section on page 10 for more information on the current government regulations that may have an impact on the Internet, Internet café and online gaming industry. However, there are currently no government regulations that negatively impact our operations. On the contrary, current government regulations promote the expansion of our operations by encouraging the growth of large-scale chain internet cafes. Pursuant to the *Rules on Recognition and Management of Internet Café Chain Enterprises* promulgated by the Ministry of Culture, the PRC government encourages the internet café chain enterprises to merge, acquire or control individual internet cafés and provides simplified and convenient procedures for change of Internet Culture Operation Permit. Additionally, the PRC government requires counterparts of Ministry of Culture at all levels to give priority to the development of internet café chain enterprises when making the plan on the total number of internet cafés.

Our Growth Strategy

We are committed to enhancing our sales, profitability and cash flows through the following strategies:

We will seek to grow by business expansion. We originally planned to expand in southwestern provinces of China principally through the acquisition of local small chains, in order to meet the requirements of applying for a national chain license, which requires 30 internet cafés in three provinces. However, our expansion plan were 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 or relevance for in 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 gr the PRC were to stall or continue its decline, manufacturing demand may fall, leading to less migrant workers and a in customer demand for our services. Unfortunately, the trend is that the PRC will likely see economic expansion in decelerate to 7.1% as slowdown in real estate investment continues resulting in more factories being shuttered (Sour http://www.bloomberg.com/news/articles/2014-12-14/china-pboc-economist-says-2015-gdp-growth-to-slow-to-7-1-

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

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

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

- *We want to fully develop our wholly-owned branches through effective integration of resources. Most of our current competitors that offer franchising simply provide a franchise license to entrepreneurs to get started in exchange for fee. Junlong, on the other hand, is deeply involved in the operational management of its company-owned cafés. Afte obtain a national chain license, we will focus on developing high-end internet cafés in the more developed cities to c new concepts of internet café operation such as operating cafes that provide food and beverage service as well as ov accommodation. The high-end internet cafes that we plan to open in the future will house the most up to date compu have private rooms for movie viewing and game play with surround sound capability. These high-end cafes will cate individuals with disposable income exceeding that of our general customers, young low-income males and migrant*

- *We will seek to grow by improving our company structure. To optimize our resources and operations, we plan to improve our company structure so that 20% of our internet cafés will be large stores, each with 300 or more computers mainly focusing on movies, high-end games and entertainment; 50% of cafés will be medium stores with 150 to 300 computers and a few movie suites focusing on high-end games; 10% of cafés will be small stores in the developed cities to spread our reputation with 100 to 150 computers. In order to penetrate the less developed cities, we want to open 20% of our stores in those cities.*

- *We will seek to grow by location selection. Running internet cafés is a retail business. Internet cafés are located in highly populated areas so as to attract customers. Junlong's internet cafés are located at busy and well attended areas such as industrial zones and business quarters. We conducted research in the south-western provinces and cities including Chongqing, Sichuan, Guizhou, and Yunnan. As a result of this market research, we have identified* *the university areas in Sichuan and Chongqing, the residential areas and business quarters in Yunan and Guizhou as prime areas for the establishment of internet cafés. As such, our future expansion in the south-western region will focus on the establishment of internet cafes in these locations.*

Member Accounts

We used to issue IC cards with stored value to our members. We deducted from the stored value amount to reflect customer usage when the customers log on the computer by using the IC card. Recently we began to use the member's national ID number as their account number. Members can deposit money directly into their accounts. There is no expiration date for the member accounts, but money deposited into the accounts is not refundable.

Revenues derived from the member accounts at the internet café are recognized when services are provided.

Outstanding customer balances in the member accounts are included in deferred revenue on the balance sheets. We do not charge any service fees that cause a decrease in customer balances.

Software on the Computers

We have on average 119 computers in each location and a total of over 1,306 computers serving all 11 internet cafés. We install more than 1,000 online games on each of our computers. We also provide movies, music and online chatting software. We use Microsoft Word compatible software called "WPS," which is a freeware provided by Kingsoft, a Chinese software company, so that we do not pay for the higher priced Microsoft Office license.

Third Party Gaming Cards, Snacks and Drinks

We also sell third party on-line gaming cards, snacks and drinks. The commission for the sale of gaming cards is generally 20% of the value of the cards. Concessions (snacks and drinks) are also sold to customers.

New Products or Services

We are considering opening more "luxury" cafés in the future to meet the needs of high income groups. This strategy is only in the planning stage. Further, although this is potentially a very interesting marketing and branding tool, we do not expect these locations to significantly increase our overall revenues.

Our Customers

Our customers are individuals who come into the location to surf the internet and/or play online games with their friends locally and remotely with individuals around the world.

Internet café users are mainly young males with low incomes, mainly migrant workers. At our cafés, migrant workers are provided a convenient channel at low cost to communicate with their families and friends. For example, VOIP (Voice over IP) service at the café is much cheaper than any other telecommunications method. Low income earners can arrange a time to chat online with their friends and families in their home cities.

We estimate that at our internet café approximately 70% of computer time is spent on gaming, and 30% for other entertainment (e.g. online chatting, online movies, or online music.

In the last few years there has been a decrease in the number of internet café users as a result of increased availability of internet connections at home (*see*: http://blog.sina.com.cn/s/blog_4aff94ef01007zei.html). However, we believe that we will be able to maintain organic growth by providing quality services to our core customers. Even if someone has internet access in their home or dormitory, these locations do not provide the atmosphere and services provided by internet cafés. For example, if a computer is set up in the limited space of a dormitory, an additional internet connection would need to be purchased. A computer suitable for online gaming costs RMB 5,000 (approximately $760.47) or more. The monthly rent for an ADSL connection costs an additional RMB 100 (approximately $15.21) and even this may not be good enough for some online games such as WOW. In these types of games, there is a very important play mode called RAID, where, for example, 40 people are needed on a team to kill some monster in the dungeon. This requires all players to have very stable internet connections. A typical low-end computer and ADSL connection would suffer significant lags and cause performance issues. Internet cafés, on the other hand, can provide high speed computers and internet connections at much lower cost to the players.

If we are going to pursue our expansion plan we will open internet cafés around university areas in Sichuan and Chongqing. Students spend more time in internet cafés because their time is very flexible. We believe that major users of internet cafés in the future will be young game players.

Competition

The following describes some of our local, regional and national competitors.

Local Competitors in Shenzhen

- Shenzhen Bian Internet Co. Ltd. Although the company entered into the internet café industry in 2003, its current structure was founded on February 22, 2007 and obtained its regional internet café chain license in 2007. The company operates mostly as a franchise model with 30 registered café, only 3 of which are directly owned by the company. Each café has 80-150 computers. It also has a few large cafés with more than 200 computers. The estimated total number of computers owned by the company is 4,500. There is a significant turnover in franchise ownership with around one third of the franchise cafés transferring their licenses to other internet café owners.

- Quansu Internet Café Chain Company. Quansu was founded in 1998 as a subsidiary investment project of the Shenzhen Commercial Bank Investment Co. Ltd. The company owns 37 cafés, 8 of which are directly owned and 27 of which are franchises. Each café has 80-150 computers. The total number of computers is approximately 6,000. The cafés are located in Bao'an District, Futian District and Luohu District. In May 2009, Quansu switched its major business towards its internet cable connection business and public telephone business.

National Competitors

Currently there are ten national internet café chains:

- Zhongqing Network Home Co., Ltd.
- Beijing Cultural Development Co., Ltd.
- China Digital Library Co., Ltd.
- Yalian Telecommunication Network Co., Ltd.
- China Heritage Information Center
- Capital Networks Limited
- Great Wall Broadband Network Service Co., Ltd.
- China United Telecommunications Co., Ltd. (China Unicom)
- CLP Chinese Tong Communication Co., Ltd.

- Reid Investment Holding Company

The ten national chains generally have strong financial support. However, to our knowledge these chains have not been successful in expanding their operations.

Intellectual Property

Trademark

Junlong owns the trademark Junlong, as specified in the Registration Certificate No. 4723040 issued by the Trademark Office under the State Administration of Industry and Commerce of the PRC. The registration is valid from January 28, 2009 to January 27, 2019.

Domain Name

We own and currently utilize the domain name, **www.cncicc.com.**

Software

The main piece of intellectual property for Junlong is the SAFLASH software. This software, developed on a Microsoft Windows platform, increases internet connection stability. Its automatic flow control prevents users from being disconnected when there is a disruption in internet traffic. The stability is a key requirement for online gamers.

Although there are no patents or copyrights for this software, it is only used internally on our computer systems and is not available for download. We also entered into a confidentiality agreement with the IT manager Zhenfan Li whose team developed this software. Our competitive advantage lies in continually updating SAFLASH to assure internet connection stability. We estimate the research and development costs associated with updating SAFLASH to be approximately RMB100,000 (approximately $ 15,870) per year. This cost includes the salaries of software engineers and costs associated with testing any updates. The costs associated with research and development activities are borne by our customers in the form of increased prices.

Regulation

Because our VIE is located in the PRC, we are regulated by the national and local laws of the PRC.

In 2001, the PRC government imposed a minimum capital requirement of RMB 10 million (approximately $1.47 million) for regional café chains and RMB 50 million (approximately $7.35 million) for national café chains. On September 29, 2002, Ministry of Information Industry, Ministry of Public Security, Ministry of Culture and State Administration for Commerce and Industry issued "Regulations on the Administration of Business Sites of Internet Access Services." The regulations require a license to operate internet cafés which may not be assigned or leased to any third parties. The regulations also have detailed provisions regarding internet cafes' business operations and security control.

We have been in compliance of these regulations. In August 2004, we increased our registered capital to RMB 10 million (approximately $1.46 million). In 2005, Junlong obtained internet café licenses of operating internet café chain in Shenzhen from the local counterpart of Ministry of Culture.

The Ministry of Culture of China is in charge of regulating national internet café chains. To obtain a license to operate a national internet café chain, an applicant must, among other things, (i) have a minimum registered capital of RMB 50 million, (ii) own or control at least 30 internet cafés, which shall cover at least three provinces or municipalities under direct administration of the State Council, and (iii) have been in full compliance with administrative regulations with respect to internet cafés for at least one year before submitting the application. Other requirements include having appropriate computer and ancillary facilities, necessary and qualified personnel and sound internal policy. Application for a national internet café chain shall be first made to the provincial counterpart of the Ministry of Culture. After preliminary approval, the provincial authority will submit the application to the Ministry of Culture for final approval. In rendering its approval, the authorities consider such factors as the then existing number of the internet café chains. We believe that obtaining a national license will provide many advantages to the Company including increasing brand awareness throughout China and increasing access to profitable markets throughout China. Obtaining the national chain license will not have an impact on any other government regulations to which we are subject and there are currently no government regulations that negatively impact our operations. On the contrary, current government regulations promote the expansion of our operations by encouraging the growth of large-scale chain Internet Cafes. Pursuant to the *Rules on Recognition and Management of Internet Café Chain Enterprises promulgated by the Ministry of Culture* (http://www.ccnt.gov.cn/xxfb/zwxx/ggtz/200909/t20090917_73276.html), the PRC government encourages internet café chain enterprises to merge, acquire or control individual internet cafés and provides simplified and convenient procedures for change of Internet Culture Operation Permit. Additionally, the PRC government requires counterparts of Ministry of Culture at all levels to give priority to the development of internet café chain enterprises when making the plan on the total number of internet cafés.

In contrast, we are also aware that obtaining a national license may also negatively affect us in the future in that there is the possibility of future government regulation of Internet cafes in provinces outside of Guangdong Province, where we are located. Such additional regulations could affect our operations or cause our management standard to adapt to new regulatory environment and may consequently be a strain on our resources and abilities.

Although the Ministry of Culture suspended the issuance of new internet café licenses to individual operators in 2007, the government is encouraging presently licensed internet café chain companies to acquire and merge with smaller cafes and café chains. The government supports the growth of large internet café chains because regulation of the industry will become significantly easier with fewer large chains as opposed to hundreds of individually operated cafes. We do not view this suspension as an impediment to our plans to open new internet cafes and obtain a license to operate a national Internet café chain.

We are subject to PRC foreign currency regulations. The PRC government has controlled Renminbi reserves primarily through direct regulation of the conversion of Renminbi into other foreign currencies. Although foreign currencies, which are required for "current account" transactions, can be bought at authorized PRC banks, the proper procedural requirements prescribed by PRC law must be met. At the same time, PRC companies are also required to sell their foreign exchange earnings to authorized PRC banks, and the purchase of foreign currencies for capital account transactions still requires prior approval of the PRC government.

Under current PRC laws and regulations, Foreign Invested Entities, or FIEs, may pay dividends only out of their accumulated after-tax profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, FIEs in China are required to set aside at least 10% of their after-tax profit based on PRC accounting standards each year to their general reserves until the cumulative amount of such reserves reaches 50% of their registered capital. These reserves are not distributable as cash dividends. The Board of Directors of an FIE has the discretion to allocate a portion of the FIEs' after-tax profits to staff welfare and bonus funds, which may not be distributed to equity owners except in the event of liquidation.

Our Employees

As of April 8, 2015, we had 111 full time employees. The following table sets forth the number of employees by function:

Function	Number of Employees
Senior Management	14
Accounting	4
Staff employees	93
Total	111

As required by applicable PRC law, we have entered into employment contracts with most of our officers, managers and employees. We are working towards entering employment contracts with those employees who do not currently have employment contracts with us. We believe that we maintain a satisfactory working relationship with our employees, and we have not experienced any significant disputes or any difficulty in recruiting staff for our operations.

Item 1A. Risk Factors.

Not applicable.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

There is no private land ownership in the PRC. Individuals and companies are permitted to acquire land use rights for specific purposes. We currently do not have any land use rights. Instead we lease most of the property that we need to operate our business from third parties.

Junlong currently leases an office space of approximately 411.14 square meters for its headquarters located at #1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City, Longgang District, Shenzhen. The term of the lease is from March 15, 2015 to March 14, 2016.

Junlong also leases spaces from different entities or individuals for its 11 internet cafés. The rent we paid for leased spaces in the fiscal year ended December 31, 2014 was approximately RMB15,873,398 (approximately $2,585,875.7) in total.

Item 3. Legal Proceedings.

From time to time, we may become involved in various lawsuits and legal proceedings that arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are currently not aware of any such legal proceedings or claims that we believe will have a material adverse effect on our business, financial condition or operating results.

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Item 4. Mine Safety Disclosures.

Not applicable.

PART II

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

Market Information

Since March 20, 2013, our common stock is quoted on the OTCQB under the ticker symbol "CICC." From March 10, 2011 through March 19, 2013, our common stock was quoted on the OTC Bulletin Board under the symbol CICC.OB. The following table sets forth the high and low closing sale prices of our common stock for the periods indicated, as reported on http://www.nasdaq.com/.

	High	Low
Year ended December 31, 2013		
First Quarter	$3.00	$1.25
Second Quarter	$2.75	$1.20
Third Quarter	$3.00	$1.00
Fourth Quarter	$3.60	$1.20
Year ended December 31, 2014		
First Quarter	$3.00	$1.25
Second Quarter	$2.75	$1.20
Third Quarter	$3.00	$1.00
Fourth Quarter	$1.39	$0.53

The Securities and Exchange Commission has adopted rules that regulate broker-dealer practices in connection with transactions in penny stocks. Penny stocks are generally equity securities with a price of less than $5.00, other than securities registered on certain national securities exchanges or quoted on the NASDAQ system, provided that current price and volume information with respect to transactions in such securities is provided by the exchange or quotation system. For further information regarding rules governing penny stocks, see ***Penny Stock Regulations*** below.

Holders of Our Common Stock

As of April 8, 2015, there were approximately 201 stockholders of record of our common stock, as reported by our transfer agent. The number of record holders does not include persons who hold our common stock in nominee or "street name" accounts through brokers.

Dividends

We currently intend to retain and use any future earnings for the development and expansion of our business and do not anticipate paying any cash dividends within one year. Our Board of Directors has complete discretion on whether to pay dividends, subject to the approval of our stockholders. Even if our Board of Directors decides to pay dividends, the form, frequency and amount will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors that the Board of Directors may deem relevant.

Securities Authorized for Issuance under Equity Compensation Plans

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, nonstatutory stock options, restricted stock, restricted stock purchase offers and other types of stock-based awards to the Company's employees, officers, directors and consultants. Pursuant to the terms of the 2014 Plan, either the Board or a board committee designated by the Board is authorized to administer the plan, including determining which eligible participants will receive awards, the number of shares of common stock subject to the awards and the terms and conditions of such awards. 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. The Company registered all the 499,666 shares of our common stock under the 2014 Plan on a registration statement on Form S-8, effective March 12, 2014. As of the date of this report, 400,000 shares have been granted under the 2014 Plan.

The following table sets forth information about the common stock available for issuance under compensatory plans and arrangements as of December 31, 2014.

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options	(b) Weighted-average exercise price of outstanding options under equity compensation plans	(c) Number of securities remaining available for future issuance under equity Compensation plans (excluding securities reflected in column (a))
Equity compensation plan approved by security holders	0	—	0
Equity compensation plans not approved by security holders	0	$ —	99,666
Total	0	—	99,666

Recent Sales of Unregistered Securities

Except as previously disclosed in reports filed under the Exchange Act, we did not issue or sell any unregistered securities during the fiscal year ended December 31, 2014.

Registrar and Stock Transfer Agent

Our stock transfer agent is VStock Transfer, LLC. Its mailing address is 18 Lafayette Place, Woodmere, New York 11598. Its phone number is 212-828-8436.

Penny Stock Regulations

Our shares of common stock are subject to the “penny stock” rules of the Securities Exchange Act of 1934 and various rules under this Act. In general terms, “penny stock” is defined as any equity security that has a market price less than $5.00 per share, subject to certain exceptions. The rules provide that any equity security is considered to be a penny stock unless that security is registered and traded on a national securities exchange meeting specified criteria set by the SEC, issued by a registered investment company, and excluded from the definition on the basis of price (at least $5.00 per share), or based on the issuer’s net tangible assets or revenues. In the last case, the issuer’s net tangible assets must exceed $3,000,000 if in continuous operation for at least three years or $5,000,000 if in operation for less than three years or the issuer’s average revenues for each of the past three years must exceed $6,000,000.

Trading in shares of penny stock is subject to additional sales practice requirements for broker-dealers who sell penny stocks to persons other than established customers and accredited investors. Accredited investors, in general, include individuals with assets in excess of $1,000,000 or annual income exceeding $200,000 (or $300,000 together with their spouse), and certain institutional investors. For transactions covered by these rules, broker-dealers must make a special suitability determination for the purchase of the security and must have received the purchaser’s written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, the rules require the delivery, prior to the first transaction, of a risk disclosure document relating to the penny stock. A broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, and current quotations for the security. Finally, monthly statements must be sent disclosing recent price information for the penny stocks. These rules may restrict the ability of broker-dealers to trade or maintain a market in our common stock, to the extent it is penny stock, and may affect the ability of shareholders to sell their shares.

Repurchase of Equity Securities

None.

Item 6. Selected Financial Data.

Not Applicable.

Item 7. 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

Prior to the consummation of the share exchange transaction described below, we were a shell company with nominal operations and nominal assets. Currently, through our wholly-owned subsidiary, Junlong Culture Communication Co. Ltd. (“Junlong”), we 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 98% of our revenue comes directly from selling internet access time to our computers.

During our fiscal year of 2014, our business environment had been very challenging. We started to gradually lose 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. During the third quarter of 2014, the Ministry of Public Security ("MPS") issued temporary suspension order to 37 of our internet cafes as a result of their incompliance with fire control regulations and rules. As the buildings where these internet cafes were located were built without necessary fire control facilities and may not be renovated or restructured to meet the fire control regulations and rules, we eventually closed these internet cafes in the fourth quarter of 2014 to save expenses such as rent, salaries and utilities, etc. In addition, nine more internet cafes were closed in December 2014 as we decided their network and fire control facilities could not be upgraded pursuant to the requirements of MPS. In light of these changes described above, we have been evaluating and adjusting our business strategy and are currently focusing on upgrading our existing internet cafes to offer better services and stay competitive. 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 fiscal year ended December 31, 2014, our revenue was approximately $15.8 million and our net loss was roughly $19.8 million, representing decreases of 44% and 337% respectively, from the revenue of roughly $28.4 million and net income of approximately $8.3 million for the fiscal year ended December 31, 2013.

The discussion below of our performance is based upon our audited financial statements for the fiscal year ended December 31, 2014 and 2013, 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 was to acquire existing internet cafes by purchasing them through cash and/or stock. We also planned to organically grown our own network of cafes. Accordingly, whether or not we were successful in our expansion plans would have depended on the availability of cash from our revenues and the price of our stock.

However, our expansion plans were affected by the following trends:

- o 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.

- o Slowdown in Economy. Because most of our customers comprise migrant, low income workers, if the GDP growth in the PR to stall or continue its decline, manufacturing demand may fall, leading to less migrant workers and a decline in customer den our services. Unfortunately, the trend is that the PRC will likely see economic expansion in 2015 decelerate to 7.1% as slowd 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-p*

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o 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 Years Ended December 31, 2014	As percentage of revenue		2013	As percentage of revenue		Amount change	% change	
Revenue	$15,823,565	100	%	$28,424,318	100	%	(12,600,753)	-44	%
Cost of revenue	18,487,950	117	%	16,825,336	59	%	1,662,614	10	%
Gross profit	(2,664,385)	-17	%	11,598,982	41	%	(14,263,367)	-123	%
Operating Expenses									
General and administrative expenses	1,095,060	7	%	899,688	3	%	195,372	22	%
	15,084,137	95	%	68,644	0	%	15,015,493	10	%

Loss on disposal of property and equipment										
Loss on disposal of intangible assets	19,209			-	-		19,209		100	%
Total operating expenses	16,198,406	102	%	968,332	3	%	15,230,074		1573	%
Income (loss) from operations	(18,862,791)	-119	%	10,630,650	37	%	(29,493,441)		-277	%
Non-operating income										
Change in fair value of derivative financial instrument - preferred stock	-	-		64,280	0	%	(64,280	)	-100	%
Change in fair value of derivative financial instrument - warrants	-	-		329,254	1	%	(329,254	)	-100	%
Interest income	109,953	1	%	114,120	-		(4,167	)	-4	%
Interest expenses	(7,040)	0	%	(12,825)	-		5,785		-45	%
Other expenses	(46,065)	0	%	16,586	-		(62,651	)	-378	%
Total non-operating income	56,848	0	%	511,415	2	%	(454,567	)	-89	%
Net income (loss) before income taxes	(18,805,943)	-119	%	11,142,065	39	%	(29,948,008)		-269	%
Income taxes	981,868	6	%	2,800,291	10	%	(1,818,423	)	-65	%
Net income (Loss) attributable to China Internet Cafe Holdings Group, Inc.	(19,787,811)	-125	%	8,341,774	29	%	(28,129,585)		-337	%
Dividend on preferred stock	-	-		(113,836)	0	%	-		100	%
Net income (Loss) attributable to China Internet Cafe Holdings Group, Inc. Common stockholders	$(19,787,811)	-125	%	$8,227,938	29	%	(28,015,749)		-340	%
Other comprehensive income (loss)										
Net income (loss)	$(19,787,811)	-125	%	8,341,774	29	%	(28,129,585)		-337	%
Foreign currency translation	(217,260)	-1	%	1,209,976	-		(1,427,236	)	-118	%
Net Comprehensive income (loss)	$(20,005,071)	-126	%	$9,551,750	34	%	(29,556,821)		-309	%

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Comparison of Fiscal Years Ended December 31, 2014 and 2013

Revenue

Our revenue is primarily generated from prepaid fees of IC cards and member's accounts which include stored value that will be deducted based on time usage of computers at our internet cafes. Our revenue decreased approximately $12.6 million, or 44%, from approximately $28.4 million for the fiscal year ended December 31, 2013 to $15.8 million for the fiscal year ended December 31, 2014. The decrease in revenue was due to a substantial decrease in our business resulting from the temporary suspension and shutdown of internet cafes in the year of 2014 compared with 2013. 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. As a result, we expect our revenue for 2015 to be substantially less than the prior year due to the substantial decrease in the number of our internet cafes. In order to adapt to market changes and optimize our profitable internet cafes, we will focus on optimizing our existing internet cafes and expanding our businesses to other cities and provinces during 2015.

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 increased approximately $1.7 million, or 10%, to approximately $18.5 million for the fiscal year ended December 31, 2014 from approximately $16.8 million for 2013. The increase was mainly attributed to increase in depreciation expenses as a result of the acceleration of computers' deprecation period from 5 years to 2 years due to the rapid development of computer technology.

Gross Profit (Loss)

Gross profit (loss) is the difference between revenue and cost of revenue. Our gross profit decreased by approximately $14.3 million, or 123%, to a loss approximately $2.7 million for the fiscal year ended December 31, 2014 from a profit approximately $11.6 million for the same period in 2013. Gross loss margin was 17% for the fiscal year ended December 31, 2014, as compared to a gross profit margin of 41% for the fiscal year of 2013. The decrease in our gross profit margin was mainly attributable to the substantial decrease in revenue and comparatively.

Operating Expenses

Operating expenses are composed of general and administrative expenses, loss on disposal of fixed assets, and disposal of intangible assets. General and administrative expenses mainly consist of overheads of our headquarters in Shenzhen and fees paid to legal counsel, auditor, and consultants. Our operating expenses increased by approximately $15.2 million, or 1,573%, to approximately $16.2 million for the fiscal year ended December 31, 2014 from approximately $1.0 million for the same period in 2013.

The increase was primarily due to an increase of approximately $15.0 million in loss on disposal of property and equipment and an increase of approximately $0.2 million in general and administrative expenses. The increase in loss on disposal of property and equipment was a result of the shutdown of 51 internet cafes in 2014. We expect that our operating expenses will decrease in 2015 based on a smaller number of internet cafes as compared with last year.

Non-operating Income/Expenses

Our other income decreased by approximately $0.45 million, or 89%, to approximately $0.06 million non-operating income for the fiscal year ended December 31, 2014 from approximately $0.5 million non-operating expenses for 2013. The decrease was due to the decrease of approximately $0.4 million in the change in fair value of derivative financial instrument - warrants and the decrease of approximately $0.06 million in other income.

Income (loss) before Income Taxes

Income before income taxes decreased by approximately $29.9 million, or 269%, to a loss approximately $18.8 million for the fiscal year ended December 31, 2014 from an income approximately $11.1 million for 2013. The decrease in income before income tax was mainly attributable to the decrease in revenue of approximately $12.6 million due to suspension and closure of our internet cafes throughout the year, the increase in cost of revenue of approximately $1.7 million, and loss on disposal of fixed assets of approximately $15.0 million resulting from the closure of our internet cafes in 2014.

Income Taxes

Our income taxes decreased by approximately $1.8 million to approximately $1.0 million for the fiscal year ended December 31, 2014 from approximately $2.8 million for the same period in 2013. The primary reason for the decrease in income taxes was the decrease in income before income tax as a result of decreased revenue and increased operating expenses in 2014.

Net Income (loss)

Our net loss was approximately $19.8 million for the fiscal year ended December 31, 2014, a decrease of approximately $28.0 million, or 337%, from an income approximately $8.3 million for 2013 as a result of the factors described above.

Liquidity and Capital Resources

As of December 31, 2014, we had cash and cash equivalents of approximately $23.8 million. The following table provides detailed information about our cash flow for each financial statement period presented in this report.

	Fiscal Years Ended December 31,	
	2014	2013
Net cash provided (used) by operating activities	$(1,066,419)	$13,493,197
Net cash used by investing activities	(15,026,467)	(67,958)
Net cash used by financing activities	(162,782)	-
Effect of foreign currency translation on cash and cash equivalents	(196,580)	998,179
Net cash flows	(16,452,248)	14,423,418

Operating Activities

Net cash used by operating activities was approximately $1.1 million for the fiscal year ended December 31, 2014 as compared to net cash provided by operating activities of approximately $13.5 million. The change was mainly attributable to the net loss in operations in 2014.

Investing Activities

Net cash used by investing activities was approximately $15.0 million for the fiscal year ended December 31, 2014. We purchased 12,659 new computers and equipment for approximately $16.8 million to upgrade our café computers and renovated our 17 internet cafes for approximately $1.3 million in the second quarter of 2014. We disposed of 51 internet cafes in 2014 and received an aggregate of proceeds on disposal of approximately $3.0 million.

Financing Activities

Net cash provided by financing activities was approximately $0.16 million for the fiscal year ended December 31, 2014. In June of 2014, we paid off our short-term loan of approximately $0.16 million (RMB 1,000,000) on its due date.

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 member purchase prepaid IC cards which include stored value or deposit money into member's accounts 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 ID member accounts. During 2014, the company began to use member accounts instead of prepaid IC cards.

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 years ended December 31, 2014 and 2013, the commission income was $263,476 and $452,837, less than 2% of total revenue.

Cost of goods sold

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

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 equipment	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 from the IC cards or members' accounts that are unused balance. The outstanding customer balances are $131,013 and $2,293,794 as at December 31, 2014 and 2013, 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 as of the fiscal year ended December 31, 2014.

Comprehensive income

The Company follows the FASB's accounting standards. Comprehensive income 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 for the periods presented includes net income 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. Deferred income tax liabilities or assets are recorded to reflect the tax consequences in future differences between the tax basis of assets and liabilities and the financial reporting amounts at each year-end. A valuation allowance is recognized if it is more likely than not that some portion, or all, of a deferred tax asset will not be realized.

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 consolidated financial statements were as follows:

	2014	2013
Year-end RMB : USD exchange rate	6.1385	6.1104

Average yearly RMB : USD exchange rate	6.1432	6.1905

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 7A. Quantitative and Qualitative Disclosures about Market Risk.

Not Applicable.

Item 8. Financial Statements and Supplementary Data.

The financial statements required by this item are presented commencing on page F-1.

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

None.

Item 9A. Control 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 fiscal year ended December 31, 2014. 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 of December 31, 2014 as a result of the material weaknesses identified in our internal control over financial reporting. These material weaknesses are discussed in "Management's Report on Internal Control over Financial Reporting" below. Our management considers our internal control over financial reporting to be an integral part of our disclosure controls and procedures.

Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over our financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act. The Company's management is also required to assess and report on the effectiveness of the Company's internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404").   Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of the Company's financial reporting for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that: (i) pertain to maintaining records that in reasonable detail accurately and fairly reflect the Company's transactions; (ii) provide reasonable assurance that transactions are recorded as necessary for preparation of the Company's financial statements and that receipts and expenditures of company assets are made in accordance with management authorization; and (iii) provide reasonable assurance that unauthorized acquisition, use or disposition of company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The Company's management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework* , including the following five framework components: i) control environment, ii) risk assessment, iii) control activities, iv) information and communications, and v) monitoring.

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 as of December 31, 2014, 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 our complexity and 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.

As a result of the material weakness identified above, our internal control over financial reporting was not effective as of December 31, 2014.

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.

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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 Control over Financial Reporting

No changes in the Company's internal control over financial reporting have come to management's attention during the Company's last fiscal quarter that have materially affected, or are likely to materially affect, the Company's internal control over financial reporting.

Limitations on Controls

Management does not expect that the Company's disclosure controls and procedures or the Company's internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and the Company's chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures are effective at that reasonable assurance level.

Item 9B. Other Information.

None.

Part III

Item 10. Directors, Executive Officers and Corporate Governance.

The names of our current officers and directors, as well as certain information about them, are set forth below:

NAME	AGE	POSITION
Dishan Guo	50	Chairman, Chief Executive Officer and Chief Financial Officer
Jinzhou Zeng	35	Director
Bingchang Chen	51	Director
Wenbin An	75	Director
Fuquan Guo	35	Director

Dishan Guo. Mr. Guo became our Chairman and Chief Executive Officer on July 2, 2010, the day that we consummated our reverse acquisition of Classic Bond. As the founder of Junlong, Mr. Guo has served as the Managing Director and Chief Executive Officer of Junlong for over 7 years since 2003. He is responsible for the strategic planning of the company's business and growth and overseeing the operations of the company. He has extensive experience and contacts in the industry. He is the executive president of Shenzhen Longgang District Internet Industry Association, which is the associate department of the ministry of culture and sets the internet café industry standards, and a director of Guangdong High-Tech Industry Association. Mr. Guo graduated from Administrative Management Institute in Guangdong province in 1996, holding a college degree in business management. Mr. Guo's foregoing experience, qualifications, attributes and skills led us to the conclusion that he should serve as a director of our company, in light of our business and structure. Mr. Guo became our Chief Financial Officer on September 27, 2010.

Jinzhou Zeng. Mr. Zeng became our director on May 12, 2014. He has been employed by the Junlong since May 2006, as Marketing Manager and Vice-General Manager from 2006 to 2009, and as director of network technology and e-commerce since 2010. From June 2004 to 2005, he was employed by the Shenzhen Longgong Industrial Company as development manager. Mr. Zeng graduated from Jiangxi GanNan Normal University with a bachelor's degree. Mr. Zeng brings to the Board of Directors his extensive knowledge of the Company's business.

Binchang Chen. Mr. Chen became our director on May 12, 2014. He has serving as Executive Vice Secretary-General in the Shenzhen Social Organization Federation since 2008. From 2006 to 2007, he was an office manager of Guangdong High-tech Industries Chamber of Commerce in Heyuan City. From 1988 to 2006, he was the Chief Financial Officer at Heyuan Pharmaceutical Factory, responsible for reviewing the financial reports and supervising the internal control. From 1986 to 1987, he was the Chief Financial Officer in Guangdong Peace Pharmaceutical Factory, responsible for the adjustment of the quarter and annual financial statements, and making and carrying out the investment plan and other important strategy. Mr. Chen graduated from China Pharmaceutical University with a bachelor's degree in financial management and is a stated approved Assistant Economist. Mr. Chen's foregoing experience, qualifications and skills led us to the conclusion that he should serve as a director of our Company.

Wenbin An. Mr. Wenbin An joined our board on August 23, 2010. Mr. An was a diplomat before retiring in 2002. He was deputy consul general in the PRC Consulate in Los Angeles from 1987 to 1994. In 1995, after returning to Beijing, he served as the Ministry of Foreign Affairs' Chief of Protocol for seven years, during which time he organized many high profile events, including the Fourth World Conference on Women in Beijing in 2005 and the celebration of the handover of Hong Kong in 1997, and he accompanied PRC leaders in visits to more than 30 foreign countries. Mr. An graduated from Zhongshan University in Guangzhou, where he majored in English language. Since retirement, Mr. An has been serving as a business consultant to PRC companies. Mr. An's foregoing experience, qualifications, attributes and skills led us to the conclusion that, in light of our business and structure, he should serve as a director of our company.

Fuquan Guo. Mr. Fuquan Guo joined our board on March 18, 2015. Mr. Guo joined Junlong in 2003, working in a variety of roles, including assistant to financial manager. From 2007 to 2013, he was the assistant to the Operation Director of Junlong and was promoted to Operation Director in 2013. He is currently in charge of the daily operations of Junlong's wholly owned internet cafés. Over the past few years, he has been involved in all the aspects of the internet cafe businesses and has gained extensive experience in the internet cafe industry. Mr. Guo obtained his bachelor's degree in marketing from Shenzhen University in 2007. Mr. Guo's foregoing experience, qualifications, attributes and skills led us to the conclusion that he should serve as a director of our company.

Except as noted above, there are no agreements or understandings for any of our executive officers or directors to resign at the request of another person and no officer or director is acting on behalf of nor will any of them act at the direction of any other person.

Directors are elected until their successors are duly elected and qualified.

The company is conducting a search for candidates to serve as chief financial officer but for the time being, Mr. Dishan Guo, our chief executive officer will function as our principal accounting and financial officer.

Family Relationships

There are no family relationships between any of our directors or executive officers except that Mr. Fuquan Guo is the nephew of Mr. Dishan Guo.

Board Committees

<u>Audit Committee</u>

Our Audit Committee is led by Bingchang Chen as the chairperson. Jinzhou Zeng, Wenbin An, Fuquan Guo and Dishan Guo are also members of our Audit Committee. The Audit Committee is primarily responsible for reviewing the services performed by our independent auditors and evaluating our accounting policies and system of internal controls. We do not have an "audit committee financial expert" as defined under applicable SEC rules.

<u>Compensation Committee</u>

Our Compensation Committee is led by Wenbin An as the chairperson. Bingchang Chen, Jinzhou Zeng, Fuquan Guo and Dishan Guo are also members of our Compensation Committee. The Compensation Committee is primarily responsible for reviewing and approving our salary and benefits policies (including stock options) and other compensation of our executive officers.

<u>Nominating Committee</u>

Our Nominating Committee is led by Bingchang Chen as the chairperson. Jinzhou Zeng, Wenbin An, Fuquan Guo and Dishan Guo are also members of our Nominating Committee. The Nominating Committee is primarily responsible for nominating directors and setting policies and procedures for the nomination of directors. The Nominating Committee is also responsible for overseeing the creation and implementation of our corporate governance policies and procedures.

A current copy of the Audit Committee charter, the Compensation Committee charter, and the Nominating Committee charter are available on the Company's website, www.cncicc.com.

Compensation Committee Interlocks and Insider Participation

Wenbin An and Dishan Guo were the members of the Compensation Committee during the whole year of 2014. On May 12, 2014, Lei Li and Lizong Wang resigned from our Board of Directors and all the board committees and Bingchang Chen and Jinzhou Zeng were appointed to fill the vacancies created by the resignation of Messrs. Li and Wang. Except that Mr. Dishan Guo served as our Chief Executive Officer and Chief Financial Officer and Jinzhou Zeng has been employed by Junlong since May 2006, none of the members of the Compensation Committee is or has been an executive officer of the Company, and no director who served on the Compensation Committee during 2014 had any relationships requiring disclosure by the Company under the SEC's rules requiring disclosure of certain relationships and related-party transactions. None of the Company's executive officers served as a director or a member of a compensation committee (or other committee serving an equivalent function) of any other entity, the executive officers of which served as a director of the Company or member of the Compensation Committee during 2014.

Code of Ethics

We have adopted a corporate code of ethics. We believe our code of ethics is reasonably designed to deter wrongdoing and promote honest and ethical conduct; provide full, fair, accurate, timely and understandable disclosure in public reports; comply with applicable laws; ensure prompt internal reporting of code violations; and provide accountability for adherence to the code. The code can be found on the Company's website, www.cncicc.com. Additionally upon written request, the Company will provide any person a copy of the code of ethics without charge. Request should be sent to: China Internet Cafe Holdings Group, Inc., #1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City, Longgang District, Shenzhen, Guangdong Province, PRC 518172.

Director Independence

The Board of Directors believes Mr. Wenbin An and Mr. Bingchang Chen are independent directors, as the term "independent" is defined by the rules of the Nasdaq Stock Market.

Board Leadership Structure and Role in Risk Oversight

Mr. Dishan Guo is our chairman, chief executive officer and chief financial officer. We have two independent directors. Our Board has three standing committees. The Board believes that the Company's chief executive officer is best situated to serve as Chairman of the Board because he is the director most familiar with our business and industry and the director most capable of identifying strategic priorities and executing our business strategy. In addition, having a single leader eliminates the potential for confusion and provides clear leadership for the Company. We believe that this leadership structure has served the Company well.

Our Board of Directors has overall responsibility for risk oversight. The Board has delegated responsibility for the oversight of specific risks to Board committees as follows:

- The Audit Committee oversees the Company's risk policies and processes relating to the financial statements and financial reporting processes, as well as key credit risks, liquidity risks, market risks and compliance, and the guidelines, policies and processes for monitoring and mitigating those risks.

- The Nominating Committee oversees risks related to the Company's governance structure and processes.

Our Board of Directors is responsible to approve all related party transactions. We have not adopted written policies and procedures specifically for related person transactions.

Section 16(a) of the Securities Exchange Act of 1934

Section 16(a) of the Exchange Act requires our executive officers and directors and persons who own more than 10% of a registered class of our equity securities to file with the SEC initial statements of beneficial ownership, reports of changes in ownership and annual reports concerning their ownership of our common stock and other equity securities, on Form 3, 4 and 5 respectively. Executive officers, directors and greater than 10% shareholders are required by the SEC regulations to furnish our company with copies of all Section 16(a) reports they file.

Based solely on our review of the copies of such reports received by us and on written representations by our officers and directors regarding their compliance with the applicable reporting requirements under Section 16(a) of the Exchange Act, we believe that with respect to the fiscal year ended December 31, 2014, our directors, executive officers and 10% stockholders complied with all Section 16(a) filing requirements except that each of Jinzhou Zeng and Bingchang Chen was late in filing of a Form 4.

Item 11. Executive Compensation.

The following Summary Compensation Table sets forth, for the years indicated, all cash compensation paid, distributed or accrued for services, including salary and bonus amounts, rendered in all capacities by our chief executive officer and all other executive officers who received or are entitled to receive remuneration during the stated periods.

Summary Compensation Table

Name and Principal Principal Position	Year	Salary	Bonus	Stock Awards	Option Awards	Non-Equity Incentive Plan	Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
Dishan Guo	2013	$49,096	0	0	0	0	0	0	$49,096
Chief Executive Officer and Chief Financial Officer(1)	2014	$46,510	0	0	0	0	0	0	$46,510

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(1) Mr. Guo has been serving as our Chief Executive Officer since July 2, 2010. He was appointed as our Chief Financial Officer on September 27, 2010.

Employment Agreements

All of our employees, including Mr. Dishan Guo, our Chief Executive Officer, have executed our standard employment agreement. Our employment agreements with our executives provide the amount of each executive officer's salary and establish their eligibility to receive a bonus. Mr. Guo's employment agreement provides for an annual salary of RMB 300,000 (approximately $49,096).

Other than the salary and necessary social benefits required by the government, which are defined in the employment agreement, we currently do not provide other benefits to our officers at this time. Our executive officers are not entitled to severance payments upon the termination of their employment agreements or following a change in control.

Outstanding Equity Awards at Fiscal Year End

None of our executive officers received any equity awards, including, options, restricted stock or other equity incentives during the fiscal year ended December 31, 2014.

Compensation of Directors

The following table sets forth a summary of compensation paid to our directors who are not listed in the Summary Compensation Table during the fiscal year ended December 31, 2014:

Director Compensation

Name and Principal Position	Year	Fees Earned or Paid in Cash	Stock Awards ($)	Option Awards ($)(5)	Non-Equity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings($)	All Other Compensation ($)	Total ($)

		($)						
Lei Li (1)	2014	$19,044	-	-	-	-	-	19,044
Lizong Wang (1)	2014	$19,044	-	-	-	-	-	19,044
Wenbin An	2014	$19,044	-	-	-	-	-	19,044
Zhenquan Guo (2)	2014	$-	-	-	-	-	-	-
Bingchang Chen (3)	2014	$9,375						9,375
Jinzhou Zeng (3)	2014	$9,375						9,375
Luke Liu (4)	2014	$13,750						13,750

(1) Lei Li and Lizong Wang resigned as director of the Company on May 12, 2014.

(2) Mr. Zhenquan Guo resigned as director of the Company on January 27, 2014 and did not receive any compensation for his service.

(3) Bingchang Chen and Jinzhou Zeng were appointed director of the Company on May 12, 2014.

(4) Luke Liu was appointed a director of the Company on January 27, 2014.

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

The following table sets forth information regarding beneficial ownership of our common stock as of April 8, 2015 (i) by each person who is known by us to beneficially own more than 5% of our common stock; (ii) by each of our officers and directors; and (iii) by all of our officers and directors as a group. Unless otherwise specified, the address of each of the persons set forth below is in care of Junlong, #1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City, Longgang District, Shenzhen, Guangdong Province, People's Republic of China.

Name and Address of Beneficial Owner	Position	Amount and Nature of Beneficial Ownership (1)	Percent of Class (2)	
Directors and Officers:				
Dishan Guo	Chairman, Chief Executive Officer and Chief Financial Officer	2,401,750	43.37	%
Fuquan Guo	Director	101,004	1.82	%
Bingchang Chen	Director	2,000	*	
Wenbin An	Director	—	—	
Jinzhou Zeng	Director	62,990	1.14	%
All officers and directors as a group (5 persons named above)		2,504,754	45.23	%
Owners of More than 5%:				

Dishan Guo	2,401,750	43.37 %

(1) Under applicable SEC rules, a person is deemed to beneficially own securities which the person has the right to acquire within 60 days through the exercise of any option or warrant or through the conversion of a convertible security. Also under applicable SEC rules, a person is deemed to be the “beneficial owner” of a security with regard to which the person directly or indirectly, has or shares (a) voting power, which includes the power to vote or direct the voting of the security, or (b) investment power, which includes the power to dispose, or direct the disposition, of the security, in each case, irrespective of the person’s economic interest in the security.

In determining beneficial ownership of our common stock as of a given date, the number of shares shown includes shares of common stock which may be acquired on exercise of warrants or options or conversion of convertible securities within 60 days of that date. In determining the number of shares of the class beneficially owned by such person or entity on April 8, 2015, (a) the numerator is the number of shares of the class beneficially owned by such person or entity, including shares which may be acquired within 60 days on exercise of warrants or options and conversion of convertible securities, and (b) the denominator is the sum of (i) the total number of shares of common stock outstanding on April 8, 2015, which is 5,538,002, and (ii) the total number of shares that the beneficial owner may acquire upon conversion of the preferred an on exercise of the warrants and options. Unless otherwise stated, each beneficial owner has sole power to vote and dispose of its shares.

(2) A total of 5,538,002 shares of our common stock are considered to be outstanding pursuant to SEC Rule 13d-3(d)(1) as of April 8, 2015 .

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

The following includes a summary of transactions, or any currently proposed transaction, in which we were or are to be a participant and the amount involved exceeded or exceeds the lesser of $120,000, and in which any related person had or will have a direct or indirect material interest (other than compensation described under “Executive Compensation”) since the beginning of our last fiscal year.

As of December 31, 2014, we had $1,711,061 due to Mr. Dishan Guo, our Chairman, Chief Executive Officer and Chief Financial Officer, which amount were accumulated since 2007 and used to pay daily operating expenses and professional fees. The amount due is unsecured with no stated interest and is payable on demand. In May of 2014, $1,507,429 was paid to Mr. Dishan Guo upon his demand.

Our Board of Directors is responsible to approve all related party transactions. We have not adopted written policies and procedures specifically for related person transactions.

Director Independence

Our Board determines that Mr. Wenbin An and Mr. Bingchang Chen are independent directors, as the term "independent" is defined by the rules of the Nasdaq Stock Market.

Item 14. Principal Accountant Fees and Services.

Audit Fees

The aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for our audit of annual financial statements and review of financial statements included in our Form 10-K or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years were:

2013	$100,000	Albert Wong & Co.
2014	$100,000	AWC (CPA) Limited

Audit Related Fees

The aggregate fees billed in each of the last two fiscal years for assurance and related services by the principal accountant that are reasonably related to the performance of the audit or review of the registrant's financial statements and are not reported under Item 9(e)(1) of Schedule 14A are:

2013	$24,000	EFP Rotenberg LLP
	$12,000	Albert Wong & Co.
2014	$39,600	AWC (CPA) Limited

Tax Fees

For the Company's fiscal years ended December 31, 2013 and 2014, we were not billed by our principal accountants for professional services rendered for tax compliance, tax advice, and tax planning.

All Other Fees

None.

Preapproval Policy and Procedures

Our Audit Committee annually reviews the audit and non-audit services to be performed by our principal accounting firms and reviews and approves the fees charged by our principal accounting firms. Our principal accounting firms may not perform any service unless the approval of the Audit Committee is obtained prior to the performance of the services, except as may otherwise be provided by law or regulation. All services described above were approved by the Audit Committee.

PART V

Item 15. Exhibits, Financial Statement Schedules.

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
10.1(1)	Management Consulting Service Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.2(1)	Equity Pledge Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.3(1)	Option Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.4(1)	Proxy Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.5(1)	English Translation of Form of Non-disclosure and Non-competition Agreement, dated March 11, 2010, between Junlong and its employees.
10.6	Lease Agreement, dated March 15, 2015, by and between Junlong and Shenzhen Jincheng Industrial Co., Ltd. [Unofficial Translation]*

14.1(4)	Code of Ethics.
21(1)	Subsidiaries of the Company.
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 *

101.PRE XBRL Presentation Linkbase Document*

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

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

Date: April 9, 2015

CHINA INTERNET CAFÉ HOLDINGS GROUP, INC.

By: /s/ Dishan Guo
Dishan Guo
Chief Executive Officer & Chief Financial Officer
(Principal Executive Officer & Principal Financial and Accounting Officer

In accordance with the Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on April 9, 2015.

Name	Title
/s/ Dishan Guo Dishan Guo	Chief Executive Officer, Chief Financial Officer, and Chairman of the Board (principal executive officer and principal financial and accounting officer)
/s/ Fuquan Guo Fuquan Guo	Director
/s/ Bingchang Chen Bingchang Chen	Director
/s/ Wenbin An Wenbin An	Director
/s/ Jinzhou Zeng Jinzhou Zeng	Director

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

To: The board of directors and stockholders of

China Internet Cafe Holdings Group, Inc.

Report of Independent Registered Public Accounting Firm

We have audited the accompanying consolidated balance sheets of China Internet Cafe Holdings Group, Inc. and subsidiaries ("the Company") as of December 31, 2014 and 2013 and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were not engaged to examine management's assertion about the effectiveness of the Company's internal control over financial reporting as of December 31, 2014 included in the Company's Item 9A "Controls and Procedures" in the Annual Report on Form 10-K and, accordingly, we do not express an opinion thereon.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of China Internet Cafe Holdings Group, Inc. and subsidiaries as of December 31, 2014 and 2013 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Hong Kong, China /s/ AWC (CPA) Limited
April 9, 2015 Certified Public Accountants

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 23,789,211	$ 40,241,459
Rental deposit	62,222	6,606
Equipment deposit	3,226	3,240
Inventory	-	36,200
Deferred tax assets	-	77,646
Total current assets	23,854,659	40,365,151
Property, plant and equipment, net	1,882,823	9,463,573
Intangible assets, net	-	62,007
Rental deposit-long-term portion	32,255	456,940
Total assets	$ 25,769,737	$ 50,347,671
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Short term loan	$ -	$ 163,655
Accounts payable	45,283	227,981
Registration penalties payable	641,200	641,200
Deferred revenue	131,013	2,293,794
Payroll and payroll related liabilities	349,866	366,619
Income and other taxes payable	134,773	1,011,814
Accrued expenses	287,666	605,029
Amount due to a shareholder	1,711,061	3,063,633
Dividend payable on preferred stock	186,565	186,565
Total current liabilities	3,487,427	8,560,290
Stockholders' Equity:		
Common stock ($0.00001 par value, 20,000,000 shares authorized, 5,538,002 and 5,138,002 shares issued and outstanding as of December 31, 2014 and 2013, respectively)	55	51
Additional paid-in capital	6,232,961	5,732,965
Statutory surplus reserves	718,744	718,744
Retained earnings	12,760,296	32,548,107
Accumulated other comprehensive income	2,570,254	2,787,514
Total stockholders’ equity	22,282,310	41,787,381
Total liabilities and stockholders’ equity	$ 25,769,737	$ 50,347,671

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

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

	For The Years Ended December 31,	
	2014	2013
Revenue	$15,823,565	$28,424,318
Cost of revenue	18,487,950	16,825,336
Gross profit (loss)	(2,664,385)	11,598,982
Operating Expenses		
General and administrative expenses	1,095,060	899,688
Loss on disposal of property and equipment	15,084,137	68,644
Loss on disposal of Intangible assets	19,209	-
Total operating expenses	16,198,406	968,332
Income (loss) from operations	(18,862,791)	10,630,650
Non-operating income		
Change in fair value of derivative financial instrument - preferred stock	-	64,280
Change in fair value of derivative financial instrument - warrants	-	329,254
Interest income	109,953	114,120
Interest expense	(7,040)	(12,825)
Other expenses	(46,065)	16,586
Total non-operating income	56,848	511,415
Income (Loss) before income taxes	(18,805,943)	11,142,065
Income taxes	981,868	2,800,291
Net income/(loss)	(19,787,811)	8,341,774
Dividend on preferred stock	-	(113,836)
Net income (loss) attributable to China Internet Cafe Holdings Group, Inc. common stockholders	$(19,787,811)	$8,227,938
Other comprehensive income (loss)		
Net income (loss)	$(19,787,811)	$8,341,774
Foreign currency translation	(217,260)	1,209,976
Total comprehensive income (loss)	$(20,005,071)	$9,551,750
Earnings (loss) per share		
- Basic	$(3.71)	$1.64 #
- Diluted	$(3.71)	$1.61 #
Weighted average common stock outstanding		
- Basic	5,328,686	5,016,105
- Diluted	5,328,686	5,178,357

The earnings per share and weighted average number of common shares for December 31, 2013 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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

	Common Stock						
	Number of Shares	Amount	Additional Paid-in Capital	Statutory Reserves	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at January 1, 2013	4,283,061	$ 43 #	$2,050,500#	$718,744	$24,320,169	$ 1,577,538	$28,666,994
Converted preferred stock	854,941	8	3,682,465	-	-	-	3,682,473
Preferred stock dividend	-	-	-	-	(113,836)	-	(113,836)
Net income for the period	-	-	-	-	8,341,774	-	8,341,774
Foreign currency translation difference	-	-	-	-	-	1,209,976	1,209,976
Balance at December 31, 2013	5,138,002#	$ 51 #	$5,732,965#	$718,744	$32,548,107	$ 2,787,514	$41,787,381
Net income (loss) for the period	-	-	-	-	(19,787,811)	-	(19,787,811)
Issuance of common stock	400,000	4	499,996	-	-	-	500,000
Foreign currency translation difference	-	-	-	-	-	(217,260)	(217,260)
Balance at December 31, 2014	5,538,002#	$ 55 #	$6,232,961#	$718,744	$12,760,296	$ 2,570,254	$22,282,310

The issued common stock and additional paid-in capital as of January 1, 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 unaudited condensed consolidated financial statements.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For The Years Ended December 31, 2014	2013
Cash flows from operating activities		
Net income (loss)	$(19,787,811)	$8,341,774
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Change in fair value of derivative financial instrument - preferred stock	-	(64,280)
Change in fair value of derivative financial instrument- warrants	-	(329,254)
Advisory fee	500,000	-
Depreciation	7,473,992	3,620,768
Amortization	42,468	65,290
Loss on disposal of property and equipment	15,084,137	68,644
Loss on disposal of intangible assets	19,209	-
Deferred tax assets	77,231	1,716
Changes in operating assets and liabilities:		
Rental deposit	366,679	582
Inventory	36,006	14,837
Accounts payable	(181,514)	225,029
Deferred revenue	(2,150,634)	731,514
Payroll and payroll related liabilities	(15,063)	5,339
Income and other taxes payable	(871,741)	230,530
Accrued expenses	(315,009)	196,869
Amount due to a shareholder	(1,344,369)	383,839
Net cash provided (used) by operating activities	(1,066,419)	13,493,197
Cash flows from investing activities		
(Increase)/Decrease of property, plant and equipment	(18,065,313)	(72,320)
Proceeds from the sale of equipment	3,038,846	-
Deposits paid for property, plant and equipment	-	4,362
Net cash used by investing activities	(15,026,467)	(67,958)
Cash flows from financing activities		
Proceeds from short term loan	-	161,991
Short term loan repayments	(162,782)	(161,991)
Net cash flows used by financing activities:	(162,782)	-
Effect of foreign currency translation on cash	(196,580)	998,179
Net increase (decrease) in cash and cash equivalents	(16,452,248)	14,423,418
Cash and cash equivalents - beginning of year	40,241,459	25,818,041
Cash and cash equivalents - end of year	$23,789,211	$40,241,459

Cash paid during the year for:		
Interest paid	$7,040	$12,825
Income taxes paid	$1,446,248	$3,056,693
Supplemental disclosures of non-cash transactions:		
Dividend payable on preferred stock	$-	$186,565

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

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 19,000,000 newly issued shares of the Company's common stock, which represented approximately 94% of the 20,200,000 issued and outstanding shares of common stock after the transaction and after the coincident cancellation of 4,973,600 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 20,200,000 common shares, as of July 2, 2010. Each share of Classic Bond is restated to 10.10 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.

<u>Classic Bond Development Limited ("Classic Bond</u>")

Classic Bond Development Limited was incorporated on November 2, 2009 in the British Virgins Islands ("BVI") with 50,000 authorized common stock with no par value. On November 2, 2009, 50,000 common stock at $0.129 (HK$1) each were issued for cash at $6,452 (HK$50,000) 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 further issued 1,950,000 shares of common stock of classic bond to 42 individuals to raise fund 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.

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

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 during the year 2012. The Company closed 51 internet cafes in 2014. In total, as of December 31, 2014, the Company owned 11 internet cafes within Shenzhen, Guangdong.

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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

2. Summary of Significant Accounting Policies (continued)

(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 of America, 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 vale 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 17.

(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.

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 years ended December 31, 2014 and 2013, the commission income was $263,476 and $452,837, less than 2% of total revenue.

(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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

2. Summary of Significant Accounting Policies (continued)

(h) Inventory

Inventory represented the IC cards we purchased from IC cards manufacturer. Inventories are stated at the lower of cost or market value. Cost is determined using the first-in, first-out (FIFO) method.

(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. As of December 31, 2014, the fair value of cash and cash equivalents, accounts payable, short-term loans, and accrued expenses approximated carrying value due to the short maturity of the instruments, or are based on quoted market prices or interest rates which fluctuate with market rates except for related party debt or receivables for which it is not practicable to estimate fair value.

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 then 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:

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 $3,226 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 December 31, 2014.

(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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

2. Summary of Significant Accounting Policies (continued)

	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 equipments	5 years
Motor vehicles	5 years

Leasehold improvements mainly result from decoration expense. All of the Company's lease contracts state lease 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 amortized the customer lists over 5 years. We calculate amortization of the definite-lived intangible assets on a straight-line basis over the useful lives of the related 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 from the IC cards that are unused balance. The Outstanding customer balances are $131,013 and $2,293,794 as of December 31, 2014 and 2013, 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 year ended December 31, 2014.

(o) Comprehensive income

The Company follows the FASB's accounting standard. Comprehensive income 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 for the periods presented includes net income and foreign currency translation adjustments.

(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 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, due to the fact that all net operating losses are from the U.S. shell company which we currently anticipate insufficient income to utilize in the future, the assets 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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

2. Summary of Significant Accounting Policies (continued)

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

	December 31, 2014	December 31, 2013
Current assets and Long term rental deposit	$ 23,871,651	$ 40,805,688
Property, plant and equipment	1,882,823	9,463,574
Intangible assets	-	62,008
Total assets	25,754,474	50,331,270
Total liabilities	(6,453,674)	(11,793,939)
Net assets	$ 19,300,800	$ 38,537,331

(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:

	December 31, 2014	December 31, 2013
Year-end RMB : USD exchange rate	6.1385	6.1104
Average yearly RMB : USD exchange rate	6.1432	6.1905

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.

(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 per share (EPS)

Earnings 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 13 for details.

(u) Retained earnings-appropriated

In accordance with the relevant PRC regulations and Zhonghefangda and Junlong's articles of association, Junlong is 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 the Company, Junlong is required to allocate 10% of their 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 subsidiaries, any further allocation is optional.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

2. Summary of Significant Accounting Policies (continued)

As of December 31, 2014 and 2013, the statutory surplus reserves of the subsidiary already 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.

(x) 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.

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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

3. Cash and cash equivalents

Cash and cash equivalents are summarized as follows:

	December 31, 2014	December 31, 2013
Cash and cash equivalents at bank	$ 23,770,744	$ 40,217,223
Cash in hand	18,467	24,236
	$ 23,789,211	$ 40,241,459

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents (Note 2). As of December 31, 2014 and 2013, $23,758,813 and $40,204,156 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 $528 and $2,534 of the Company's cash and cash equivalents were held by Chase bank and JP Morgan Chase bank in USA, respectively.

4. Inventory

Inventory consists of:

	December 31, 2014	December 31, 2013
Purchased IC cards	$ -	$ 36,200

There was no allowance made for obsolete or slow moving inventory as of December 31, 2013. During 2014, the company began to use members’ SIM cards in their cell phones instead of prepaid IC cards.

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

5. Property, Plant and Equipment, net

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

	December 31, 2014	December 31, 2013
Leasehold improvement	$ 774,906	$ 4,234,152
Cafe computers equipment and hardware	2,224,223	17,307,427
Cafe furniture and fixtures	185,225	2,176,149
Office furniture, fixtures and equipment	139,541	355,974
Motor vehicles	484,475	486,703
	$ 3,808,370	$ 24,560,405
Less: Accumulated depreciation	(1,925,547)	(15,096,832)
Property, plant and equipment, net	$ 1,882,823	$ 9,463,573

During the year ended December 31, 2014, depreciation expenses amounted to $7,473,992, of which $7,389,107 and $84,885 were recorded as cost of sales and general and administrative expense, respectively.

During the year ended December 31, 2013, depreciation expenses amounted to $3,357,900, of which $3,250,521 and $107,379 were recorded as cost of sales and general and administrative expense, respectively.

6. Loss on Disposal of Property and Equipment

In the second quarter of 2014, the Company has disposed all of its café computers purchased before 2012 and installed 12,659 new café computers. All disposed café computers were sold for RMB 200 each. The proceeds from the disposal of café computers were $458,490 in total.

In the fourth quarter, the Company closed its 51 internet cafes and disposed all computers, equipment, furniture, and long lived assets. The proceeds from the disposal of property and equipment were $2,580,356

As of December 31, 2014, the loss of disposal of property and equipment as following:

	December 31, 2014
Disposal of café computers and equipment	$ 34,151,977
Disposal of long lived assets	4,993,428
Accumulated deprecation	(21,022,422)
Disposal of property and equipment, net	18,122,983
Proceeds from disposal of café computers and equipment	3,038,846
Loss on disposal of property and equipment	$ 15,084,137

7. Intangible Assets

Intangible assets are summarized as follows:

	December 31, 2014	December 31, 2013
Business Licenses	$ -	$ 102,723
Customer Lists	-	130,158
	-	232,881
Less: Accumulated Amortization	-	(170,874)
Total	$ -	$ 62,007

During the years ended December 31, 2014 and 2013, amortization expenses amounted to $42,468 and $66,145 respectively which was recorded under cost of sales.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

8. Loss on Disposal of intangible assets

During 2014, the company closed its 51 internet cafes and disposed all intangible assets on its licenses and customer lists. As of December 31, 2014, the loss of intangible assets as following:

	December 31, 2014
Disposal of intangible assets	$ 231,638
Accumulated amortization	212,429
Loss on disposal of intangible assets	$ 19,209

9. Short Term Loan

The short term loan due within one year as of December 31, 2014 and 2013 consist of the following:

Bank	Loan Period	Interest rate	December 31, 2014	December 31, 2013
China Construction Bank	June 13, 2013 to June 12, 2014	9 %	$ -	$ 163,655

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 years ended December 31, 2014 and 2013, interest expense on the loan was $7,040 and $12,825, respectively.

10. Income and Other Taxes Payable

Income and other tax payables consist of the following:

	December 31, 2014	December 31, 2013
Value added taxes	$ 60,917	$ 218,231
Income tax	-	567,419
Withhold individual income tax payable	5,629	4,064
Other tax payable	68,227	222,100
Total	$ 134,773	$ 1,011,814

11. Due To A Shareholder

	December 31, 2014	December 31, 2013
Mr. Guo Di Shan, a shareholder of the Company	$ 1,711,061	$ 3,063,633

The amount due to Mr. Di Shan Guo is unsecured with no stated interest and is payable on demand. The amount due as of December 31, 2014, represents amounts accumulated since 2007 and 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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

12. Cost of Revenue

Cost of revenue consists of the following:

	For The Years Ended December 31, 2014	2013
Depreciation and amortization	$7,431,575	$3,607,119
Salary	3,522,627	3,458,182
Rent	2,446,590	2,752,109
Utility	1,317,418	2,107,666
Business taxes	1,006,380	1,807,787
Others	2,763,360	3,092,473
	$18,487,950	$16,825,336

13. 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 years ended December 31, 2014 and 2013, the Company did not record any uncertain tax benefits.

Aggregate undistributed earnings of approximately $15.8 million as of December 31 2014 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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

14. Earnings per Share

Basic earnings per share is computed by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings 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 per share are presented in the following table:

	For The Years Ended December 31, 2014	2013
BASIC		
Numerator for basic earnings (loss) per share attributable to the Company's common stockholders:		
Net income (loss)	$(19,787,811)	$8,341,774
Dividend on preferred stock	-	(113,836)
Net income (loss) used in computing basic earnings per share	$(19,787,811)	$8,227,938
Basic weighted average shares outstanding	5,328,686 #	5,016,105#
Basic earnings per share	$(3.71)#	$1.64 #

	For The Years Ended December 31, 2014	2013
DILUTED		
Numerator for diluted earnings (loss) per share attributable to the Company's common stockholders:		
Net income (loss)	$(19,787,811)	$8,227,938
Dividend on preferred stock	-	113,836
Net income (loss) used in computing diluted earnings per share	$(19,787,811)	$8,341,774
Weighted average outstanding shares of common stock	5,328,686	5,016,105
Weighted average preferred stock	-	162,252
Diluted weighted average shares outstanding	5,328,686 #	5,178,357#

Diluted earnings (loss) per share	$(3.71)#	$1.61 #
Potential common shares outstanding as of December 31:		
Warrants	-	499,665

The earnings (loss) per share and weighted average number of common shares for the years ended December 31, 2014 and 2013 were retroactively restated to reflect the one-for-five reverse stock split effective on June 16, 2014.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

15. 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 $12,843 and $12,851 for the years ended December 31, 2014 and 2013, respectively.

16. 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 19,000,000 newly issued shares of the Company's common stock, which represented approximately 94% of the 20,200,000 issued and outstanding shares of common stock after the transaction and after the coincident cancellation of 4,973,600 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 December 31, 2014 and 2013, there were 5,538,002 and 5,138,002 shares of Common Stock issued and outstanding, respectively.

<u>Series A Preferred Stock</u>

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 4,274,703 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 December 31, 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 converted 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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

16. Stockholders' Equity (continued)

On February 22, 2013, in accordance with its terms, all 4,274,703 shares of Series A Preferred Stock outstanding automatically converted into 4,274,703 shares of common stock.

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).

17. Sale of Common Stock, Series A Preferred Stock and Warrants

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 75,000 shares per day.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

17. Sale of Common Stock, Series A Preferred Stock and Warrants (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 December 31, 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 expense 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 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) 427,740 Warrants - $1.35 per share (ii) 85,494 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 427,740 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 CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

17. Sale of Common Stock, Series A Preferred Stock and Warrants (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 they directly or indirectly own (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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

17. Sale of Common Stock, Series A Preferred Stock and Warrants (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 4,274,703 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 CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

17. Sale of Common Stock, Series A Preferred Stock and Warrants (continued)

The Company also agreed to place in escrow for issuance to the affiliate a total of 400,000 shares of Common Stock, with 200,000 shares to be released following the completion of a Transaction, 100,000 shares to be released six months after the completion of a Transaction and 100,000 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 50,000 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 $1.00 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.

18. 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 2016. The Company rents internet cafes venues and office space, primarily for regional sales administration offices that are conducive to administrative operations. The operating leases 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.

As of December 31, 2014, the Company was obligated under operating leases requiring minimum rentals as follows:

Fiscal year	
2015	$377,409
2016	31,159
	$408,568

During the year ended December 31, 2014, rent expenses amounted to $2,446,590, of which $2,385,702 and $60,888 were recorded as cost of sales and general and administrative expense, respectively.

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18. Commitments and Contingencies (continued)

During the year ended December 31, 2013, rent expenses amounted to $2,815,315, of which $2,747,167 and $68,148 were recorded as cost of sales and general and administrative expense, respectively.

Social Benefits Coverage

We have obtained social benefits coverage for employees who work at the Junlong headquarters. For other employees, because of the high mobility of their work, and the difficulty of transferring social benefits coverage from one province to another, they usually work on a probationary basis and do not enter into long employment relationships with us. Because the cost of social benefits coverage is considerable compared to their total monthly income, the Company allows the employees to decide whether or not to pay the social benefits coverage. It is reasonable to assume that the company is subject to administrative fines and penalties as a result of its failure to obtain social insurance for these employees.

19. Concentrations

The Company did not have any customer constituting greater than 10% of net sales for the years ended December 31, 2014 and 2013.

At December 31, 2014 and 2013, there was one supplier of consignment snacks and drinks with amounts due from the Company of $45,282 and $227,981 respectively, which accounted for 100% and 100% of the Company’s account payable.

20. Operating Risk and Uncertainties

Interest rate risk

The interest rates and terms of repayment of bank and other borrowings are disclosed in Note 9. 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 (RMB10,000,000 is required for a regional internet café chain and RMB50,000,000 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.

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21. 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 an internet café chain. 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 predominantly in one geographical area, the PRC.

22. 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.

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