

CTX Virtual Technologies, Inc. and Subsidiaries

Consolidated Financial Statements
As of September 30, 2013 and December 31, 2012 and
For the Three and Nine months Ended September 30, 2013 and 2012 (Unaudited)

CTX Virtual Technologies, Inc. and Subsidiaries

Contents

Report of Independent Registered Public Accounting Firm	3
Unaudited Condensed Consolidated Financial Statements	
Balance Sheets	4
Statements of Operations	5
Statements of Cash Flows	6
Notes to Unaudited Condensed Consolidated Financial Statements	8

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
CTX Virtual Technologies, Inc.
Boca Raton, Florida

We have reviewed the accompanying condensed consolidated balance sheet of CTXV Virtual Technologies, Inc. and subsidiaries (the "Corporation") as of September 30, 2013, and the related condensed consolidated statements of cash flows for the nine-months ended September 30, 2013 and 2012 and consolidated statements of operations for the nine-months and three-months ended September 30, 2013 and 2012. These interim financial statements are the responsibility of the Corporation's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of CTXV Virtual Technologies, Inc. and subsidiaries as of December 31, 2012, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated June 11, 2013 and August 26, 2013 (as restated), we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2012 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Simon & Edward, LLP

City of Industry, California
December 18, 2013

CTX Virtual Technologies, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	<i>(Unaudited)</i> September 30, 2013	<i>(As restated)</i> December 31, 2012
ASSETS		
Current Assets:		
Cash	\$ 3,007,598	\$ 2,808,702
Accounts receivable, net of allowance for bad debt of \$0 and \$757,740, respectively	14,377,190	14,130,945
Inventories, net	8,390,183	3,678,653
Prepaid expenses and other current assets	12,728,068	5,142,209
Amounts due from related parties	8,797,561	5,899,458
Total current assets	47,300,600	31,659,967
Property and equipment, net	4,093,118	3,860,921
Intangible assets, net	13,112,221	15,344,902
Goodwill	479,544	519,580
Other assets	1,070,710	139,490
Total assets	\$ 66,056,193	\$ 51,524,860
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	\$ 11,817,188	\$ 15,072,959
Accrued liabilities and other current liabilities	19,718,872	13,849,631
Unearned revenue	8,541,379	1,457,062
Income taxes payable	7,066,140	4,075,443
Short-term bank loan	2,118,506	1,105,112
Amounts due to related parties	7,298,761	5,451,470
Derivative liability	10,031,503	1,669,470
Convertible debt, net of unamortized issuance costs of \$4,767,919 and \$1,560,702, respectively	4,343,113	1,830,823
Total current liabilities	70,935,462	44,511,970
Warrant liabilities	21,608,556	12,084,368
Total liabilities	92,544,018	56,596,338
Commitments and contingencies		
Stockholders' equity (deficit)		
Common stock - par value of \$0.001; 110,000,000 shares authorized, 23,930,948 and 22,227,698 shares issued and outstanding, respectively	23,931	22,227
Class AA preferred stock - par value of \$0.001; 50,000 shares authorized, 27,250 shares issued and outstanding	27	27
Class A preferred stock - par value of \$0.001; 5,000,000 shares authorized, no shares issued and outstanding	-	-
Class B preferred stock - par value of \$0.001; 10,000,000 shares authorized, 10,000,000 shares issued and outstanding	10,000	10,000
Class C preferred stock - par value of \$0.001; 67,841 shares authorized, no shares issued and outstanding	-	-
Additional paid-in capital	17,124,310	17,047,810
Accumulated deficit	(43,676,313)	(22,554,364)
Accumulated other comprehensive income	30,220	402,822
Total stockholders' equity (deficit)	(26,487,825)	(5,071,478)
Total liabilities and stockholders' equity (deficit)	\$ 66,056,193	\$ 51,524,860

See accompanying notes to unaudited condensed consolidated financial statements.

CTX Virtual Technologies, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Operations

	<i>Nine Months Ended</i>		<i>Three Months Ended</i>	
	<i>September 30,</i>		<i>September 30,</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
Net sales	\$ 132,256,219	\$ 67,937,891	\$ 40,934,785	\$ 41,207,111
Cost of sales	119,232,877	57,053,660	37,852,436	34,319,900
Gross profit	13,023,342	10,884,231	3,082,349	6,887,211
Operating expenses:				
General and administrative expenses	5,977,019	3,392,841	1,867,317	1,874,162
Selling expenses	142,323	99,105	58,088	47,554
Total operating expenses	6,119,342	3,491,946	1,925,405	1,921,716
Income from operations	6,904,000	7,392,285	1,156,944	4,965,495
Other expense (income)				
Gain on bargain purchase price	-	(18,818,110)	-	-
Interest expense – convertible debt and term loan	422,597	58,350	78,899	53,417
Interest expense – amortization of debt discount	6,136,911	-	4,082,644	-
Interest expense – issuances of warrant and derivative liability in excess of debt discount	11,447,455	-	3,274,726	-
Interest income	-	-	380	2
Changes in fair value of warrant liabilities	2,972,422	3,099,940	3,523,381	(216,484)
Changes in derivative liability	(2,172,861)	-	(3,693,008)	-
Other expense, net	224,582	770,332	190,834	277,549
Total other expense (income), net	19,031,106	(14,889,488)	7,457,856	114,484
Income (loss) before income tax provision	(12,127,106)	22,281,773	(6,300,912)	4,851,011
Income tax provision	2,904,610	2,451,957	705,082	1,579,021
Net income (loss) before deconsolidation of subsidiary	(15,031,716)	19,829,816	(7,005,994)	3,271,990
Loss from deconsolidation of subsidiary	-	5,053,923	-	-
Net income (loss)	\$ (15,031,716)	\$ 14,775,893	\$ (7,005,994)	\$ 3,271,990
Earnings (Loss) per share:				
Basic	\$ (0.63)	\$ 0.68	\$ (0.29)	\$ 0.15
Diluted	\$ (0.63)	\$ 0.42	\$ (0.29)	\$ 0.09
Weighted average number of common shares outstanding:				
Basic	23,757,188	21,781,312	23,922,789	21,814,920
Diluted	23,757,188	35,305,106	23,922,789	35,338,714

See accompanying notes to unaudited condensed consolidated financial statements.

CTX Virtual Technologies, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

<i>Nine Months Ended September 30,</i>	<i>2013</i>	<i>2012</i>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss) before deconsolidation	\$ (15,031,716)	\$ 19,829,816
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization – property and equipment	353,921	206,078
Amortization of intangible assets	2,682,745	1,449,376
Stock-based compensation – stock options and restricted stocks	76,500	76,100
Changes in fair value of warrant liability	2,972,422	3,099,940
Changes in fair value of derivative liability	(2,172,861)	-
Interest expense – amortization of debt issuance costs	6,136,911	-
Interest expense – warrant and derivative liability in excess of debt discount	11,447,455	-
Changes in operating assets and liabilities:		
Accounts receivable	167,630	3,285,880
Inventories	(4,616,798)	(2,070,788)
Prepaid expenses and other current assets	(7,483,604)	(7,293,881)
Other assets	(930,987)	-
Accounts payable	(7,854,678)	15,512,217
Accrued liabilities and other current liabilities	5,466,341	2,912,588
Deferred revenue	7,043,485	7,755,954
Income taxes payable	2,872,099	755,486
Net cash provided by operating activities	1,128,865	45,518,766
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(473,182)	(2,896,405)
Net payments received (due) from related parties	(2,995,057)	(22,616,457)
Increase in loan from unrelated parties	-	1,900,000
Net cash used in investing activities	(3,468,239)	(23,612,862)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of convertible debt	7,348,302	-
Principal repayments on convertible debt	(1,628,795)	-
Proceeds from bank loan	981,287	1,188,872
Distribution to shareholder	(6,194,171)	(18,761,230)
Net borrowings (payments) for amounts due to related parties	2,024,180	(3,635,751)
Net cash provided by investing activities	2,530,803	(21,208,109)
Effect of foreign currency exchange translation	7,467	(490)
Net increase in cash	198,896	697,305
Cash at beginning of year	2,808,702	81,944
Cash at end of year	\$ 3,007,598	\$ 779,249

See accompanying notes to unaudited condensed consolidated financial statements.

CTX Virtual Technologies, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows

<i>Nine months Ended September 30,</i>	<i>2013</i>	<i>2012</i>
Supplemental disclosures of cash flow information:		
Interest paid	\$ 139,977	\$ 54,931
Income taxes paid	\$ 93,525	\$ 73,112

Supplemental disclosures of significant non-cash finance transactions:		
Issuance of common stock in connection with exercise of convertible debts	-	\$ -
Share-based compensation	-	\$ 103,200
Stock subscription payable	-	\$ -

Supplemental disclosures of significant non-cash investing activities:

The Company acquired subsidiaries (see Note 4). The following table summarizes the purchase transaction on the date of acquisition:

Issuance of common stock	\$ -	\$ 3,600,000
Working capital payout liability and earn-out	-	3,727,236
Cash paid	-	-
Total purchase price	-	<u>7,327,236</u>
Less: fair value of		
Assets acquired (including cash acquired of \$2,120,935)	-	(40,970,374)
Liabilities assumed	-	14,856,119
Currency translation adjustment	-	<u>(31,091)</u>
Goodwill (excess purchase price over fair value of net assets acquired) or bargain purchase (excess of net assets acquired over purchase price)	\$ -	\$ (18,818,110)

See accompanying notes to unaudited condensed consolidated financial statements.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. PRESENTATION AND NATURE OF OPERATIONS

Prior Business

CTX Virtual Technologies, Inc. (“CTXV” or the “Company”), we, or us, was originally incorporated as a Colorado corporation in January 1988 under the name Cap Rock Corporation, later changed its name to Striker Capital Corp. (“Striker Capital”) in April 2004 and reincorporated by merger as a Nevada corporation in May 2006. On or about September 30, 2006, Striker Capital acquired all of the outstanding shares of Pioneer Realty Group, Inc., a Delaware corporation (“Pioneer”), in exchange for the issuance of a controlling equity interest in Striker Capital to the former shareholders of Pioneer. As a result of the transaction, Mr. David Cohen, a member of our Board of Directors at the time, acquired control of Striker Capital and designated management and Board of Directors. In July 2006, Striker Capital changed its name to Petro Plus USA, Inc. and in August 2006 to Petroleum Consolidators of America, Inc. (“Petroleum Consolidators”). In August 2008, Petroleum Consolidators acquired all of the outstanding shares of Gas Retailers, Inc. in exchange for the issuance of shares of Petroleum Consolidators common stock to the former shareholders of that company. From 2006 to February 2010, Petroleum Consolidators was engaged in the acquisition and operation of gasoline stations (“Prior Business”).

On or about February 17, 2010, the Petroleum Consolidators acquired all of the capital stock of CTX Virtual Technologies, Inc., a Delaware corporation (“CTXV”), in exchange for shares of preferred stock of Petroleum Consolidators (the “Acquisition”) and certain shareholders of CTXV and others contemporaneously therewith acquired certain shares of preferred stock of Petroleum Consolidators from a stockholder of Petroleum Consolidators. At the closing, CTXV designated a majority of the members of the board of directors and appointed certain officers of Petroleum Consolidators. The Acquisition resulted in a change in control of Petroleum Consolidators. On March 10, 2010, Mr. Clifford Rhee was appointed President and CEO of the Petroleum Consolidators. Effective with the open of business on March 25, 2010, Petroleum Consolidators effectuated a 1 for 125 reverse stock split of its shares of common stock, \$0.001 par value per share. In April 2010, Petroleum Consolidators completed a reincorporation merger pursuant to which Petroleum Consolidators changed domicile to Delaware and adopted CTX Virtual Technologies, Inc. name. At the closing of these transactions, Mr. Clifford Rhee held 9,000,000 Series B Preference Shares of CTXV, representing in the aggregate of 54% of CTXV outstanding common stock on a fully diluted basis and maintained 84% of the voting power attributable to CTXV outstanding securities. The original shareholders of Petroleum Consolidators held 10,000 Series AA Preference Shares of CTXV and 1,702,135 common shares.

The acquisition of CTXV has been accounted for as a “reverse merger” and recapitalization since the shareholder of CTXV became controlling owner of Petroleum Consolidators after the acquisition. Accordingly, the assets and liabilities and the historical operations that were reflected in the financial statements are those of CTXV and were recorded at the historical cost basis.

Acquisitions

Prior to acquisitions or formation of its wholly owned subsidiaries, CTXV was a shell company with no operations. The followings are the acquisitions by CTXV:

- ***Kaibida Acquisition*** – On April 26, 2010, CTXV acquired 100% equity interest of Kaibida International Limited, a Hong Kong company (“Kaibida”) incorporated on January 21, 2010. Prior to the acquisition, Mr. Lee Poo Ying and Mr. Clifford Rhee, each owned 50% ownership interest of Kaibida and signed acting in cert agreement to control Kaibida as a group.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. PRESENTATION AND NATURE OF OPERATIONS (continued)

Acquisitions (continued)

The acquisition was accomplished by means of a share exchange in which CTXV issued 17,250 shares of Series AA Preferred Stock to the former Kaibida, Comstar and Yongyang shareholders, Mr. Lee Poo Ying, General Manager and Vice President of Manufacturing of Kaibida, received 4,150 shares. The shares issued in the exchange represented in the aggregate of 8.2% of CTXV outstanding common stock on a fully diluted basis and 1.8% of the voting power attributable to our outstanding securities. The remaining 12,100 shares of Series AA Preferred Stock were issued to the other shareholders of Comstar, Yongyang and other personnel, which represented in the aggregate of 25.9% of CTXV outstanding common stock on a fully diluted basis and 5.7% of voting rights of CTXV.

Mr. Clifford Rhee held 9,000,000 Series B preference shares before and after the acquisition, representing in the aggregate of 54% and 35.5% of CTXV outstanding common stock on a fully diluted basis before and after the acquisition, respectively, and maintained 78% of the voting power attributable to CTXV outstanding securities. Mr. Rhee had the ability to appoint all the board of directors as well as other powers as the controlling shareholder to control CTXV before and after the acquisition.

As the acquisition involved companies under common control, the acquisition was accounted for in accordance with ASC 805-50, Business Combinations – Related Issues, and the assets and liabilities and historical operations that are reflected in the financial statements are those of CTXV and Kaibida and are recorded at the historical cost basis.

In accordance with the acquisition agreement, the Company is able to exercise equity owner's rights over Kaibida, which give control over Kaibida in substance. As a result, Kaibida is treated as a subsidiary of the Company. As of September 30, 2013, the equity transfer procedure has been completed.

- **Acquisition of Yong Yang and Comstar** – On April 15, 2010, per the acquisition agreement entered into between all parties, Kaibida acquired all of equity interest of Fuzhou Comstar Computer Network Engineering Limited (“Comstar”) and Beijing Shouxin Yongyang Technology Limited (“Yongyang”). The two operating subsidiaries have been in business since 2007 or earlier. Mr. Lee Poo Ying and Mr. Clifford Rhee each owned 50% of the outstanding equity of Kaibida while Mr. Lee Poo Ying owned 61% of the outstanding equity of Comstar and Yong Yang prior to the acquisition. According to an acting in concert agreement, Mr. Lee Poo Ying and Mr. Clifford Rhee are considered as a control group, thus having the controlling interest of Kaibida, Comstar, and Yong Yang before and after Kaibida's acquisition of both companies.

As the acquisition involved companies under common control, the acquisition was accounted for in accordance with ASC 805-50, Business Combinations – Related Issues, and the assets and liabilities and the historical operations that are reflected in the financial statements are those of CTXV, Yong Yang, and Comstar and are recorded at their historical cost basis.

In accordance with the acquisition agreement, the Company is able to exercise equity owner's rights over Yong Yang and Comstar, which give the Company control over Yong Yang and Comstar in substance. As a result, Yong Yang and Comstar are treated as subsidiaries of the Company. As of September 30, 2013, the equity transfer procedure has been completed.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. PRESENTATION AND NATURE OF OPERATIONS (continued)

Acquisitions (continued)

- **Guoqian Division A Acquisition**—On February 18, 2009, Comstar and Shenzhen Guoqian Technology Limited (or “Guoqian”) entered into a business combination agreement which would allow Comstar to control division A of Guoqian(or “Guoqian Division A”). Under this business combination agreement, Guoqian would receive 250,000 shares of common stocks Kaibida International Limited or CTX Virtual Technologies Inc.

The Company accounted this acquisition under ASC 810, Consolidation, as variable interest entity subject to consolidation due to the following characteristics under the contractual agreements:

- The equity investment at risk is not sufficient for the Guoqian Division A to finance its activities without additional subordinated financial support;
- As a group, the holders of equity investment at risk do not possess:
 - The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity’s economic performance.
 - The obligation to absorb expected losses or the right to receive the expected residual returns of the entity; and
 - Symmetry between voting rights and economic interests and where substantially all of the entity’s activities either involve or are conducted on behalf of an investor with disproportionately fewer voting rights.
- The Company has obligation to absorb losses from or right to receive benefits.

The Company accounted for the acquisition under the purchase method of accounting in accordance with the provisions of ASC 805, “Business Combinations.” Under this accounting method, the Company recorded at fair value the acquired assets of Guoqian Division A less the liabilities assumed, with the excess of the purchase price over the estimated fair value of such net assets reflected as goodwill. Based on purchase accounting performed, no goodwill was required to be recorded. The consolidated statement of operations includes the operations of Guoqian Division A from the date of acquisition.

In January 2012, this subsidiary was deconsolidated due to lack of control and in accordance with ASC 810-10, *Consolidation*. As a result, the Company recognized a loss from deconsolidation in the amount of \$5,102,514 for the year ended December 31, 2012.

- **Celluon Technologies Holdings Acquisition** – In April 2010, CTXV incorporated and formed CTX Technologies, Inc. (“CTX”), a 100% owned subsidiary, for purpose of acquiring Celluon Technologies Holdings (“Celluon”), a Canadian company. In April 2010 after the formation of CTX, CTX acquired 100% equity interest of Celluon. Since Mr. Clifford Rhee, the majority shareholder of Celluon has the controlling interest of CTXV before and after the acquisition, there was no change in control. The acquisition involved companies under common control, the acquisition was accounted for in accordance with ASC 805-50, Business Combinations – Related Issues, and the assets and liabilities and the historical operations that were reflected in the financial statements are those of CTXV and Celluon and were recorded at their historical cost basis. The activities of Celluon were not material for 2011 and 2010.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. PRESENTATION AND NATURE OF OPERATIONS (continued)

- **Xinyuanhao Acquisition**– On October 1, 2011, Kaibida acquired all of equity interest of Shenzhen Xinyuanhao Electronics Co., Ltd. (“Xinyuanhao”), which is principally engaged in manufacturing and sale of SMT. Under the agreement, Kaibida shareholders will designate and issue 3,750 Series AA preferred shares of CTX Virtual Technologies, Inc. which they owned to the sole owner of Xinyuanhao in exchange to all of the equity interest of Xinyuanhao. In 2012, these 3,750 Series AA preferred shares were converted into common shares of CTX Virtual Technologies, Inc.

The Company accounted for the acquisition under the purchase method of accounting in accordance with the provisions of ASC 805, “Business Combinations.” Under this accounting method, the Company recorded at fair value the acquired assets of Xinyuanhao less the liabilities assumed, with the excess of the purchase price over the estimated fair value of such net assets reflected as goodwill. The consolidated statement of operations includes the operations of Xinyuanhao from the date of acquisition.

- **Business Amalgamation** – On May 1, 2012, Kaibida International Limited entered into an amalgamation agreement with Norian Digital, Shenzhen Lebailing Communication Equipment Company Ltd., and Shenzhen Kuanda Technology Company Ltd., (Collectively “Shenzhen Co”). Under the amalgamation agreement, the shareholders of Shenzhen Co received equity consideration in CTX Virtual Technologies Inc. (“Company”) by way of 2 million shares stock transfer by the Company’s select shareholders. Under the acquisition, the shareholders of Shenzhen co is entitled to certain earn-out provisions based on future earnings of the amalgamated businesses as well as deferred working capital payments over three years.

The acquisition of the three entities enables the Company to expand its growing customer base in the smartphone manufacturing market and addition of new channels in the touch screen and tablet markets for the launch of its proprietary embedded virtual keyboard applications.

The Company accounted for the acquisition under the purchase method of accounting in accordance with the provisions of ASC 805, “Business Combinations.” Under this accounting method, the Company recorded at fair value the acquired assets less the liabilities assumed, with the excess of the purchase price over the estimated fair value of such net assets reflected as goodwill. Based on purchase accounting performed, goodwill was recorded at year-end. The consolidated statement of operations includes the operations of Shenzhen Co from the date of acquisition.

Current Business

CTX Virtual Technologies, Inc. manufactures and sells mobile communication and electronic devices and provides technology consulting services. Through its wholly-owned subsidiary, Kaibida International Limited, a Hong Kong company (“Kaibida”), the Company designs and manufactures cellular telephones including converged mobile devices, often referred to as “Smartphones” or “PDAs”, for network operators and original equipment manufacturers. Kaibida also designs and manufactures printed circuit boards and other Surface Mounted Technology components used in cellular telephones and Smartphones.

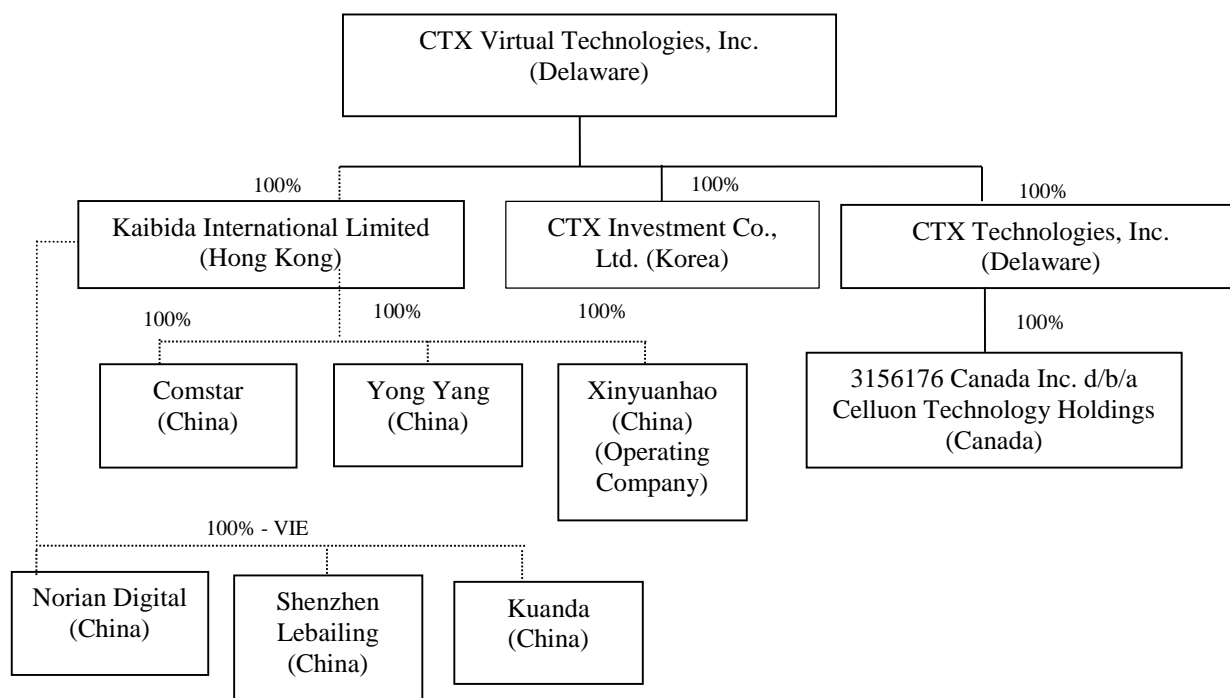
Celluon Technology Holdings, Inc. is engaged in providing IT consulting and sales to various medical and healthcare industry. The company is currently engaged in sale of certain software and finished products to the hospitals and other healthcare related companies. In 2009, Celluon technology acquired the license to develop EMR (Electronic Medical Record) initiative which was adopted as part of the Canadian Government’s healthcare reform act. As of December 31, 2011, Celluon Technology was negotiating with an international health care provider on a major IT joint project which is waiting client review and confirmation. During the nine months ended September 30, 2013 and 2012, Celluon Technology did not record and business activity or sales.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. PRESENTATION AND NATURE OF OPERATIONS (continued)

Below is a diagram showing the corporate structure of the Company as of December 31, 2011:



2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial information and with the instructions to Securities and Exchange Commission, or SEC, Form 10-Q and Article 10 of SEC Regulation S-X. They do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2012 issued on June 11, 2013.

The interim condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly our results of operations and financial position for the interim periods. The results of operations for the three and nine months ended September 30, 2013 and 2012 are not necessarily indicative of the results to be expected for future quarters or the full year.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Principles of Consolidation, Deconsolidation and Presentation

The consolidated financial statements include the accounts of the CTXV, its wholly-owned subsidiaries and variable interest entities (collectively the “Company”). In the preparation of consolidated financial statements of the Company, all intercompany balances and transactions have been eliminated.

In January 2012, this subsidiary was deconsolidated due to lack of control and no longer met the conditions to be VIE’s primary beneficiary in accordance with ASC 810-10, Consolidation. As a result, the Company recognized a loss from deconsolidation in the amount of \$5,053,923 and \$0 for the nine and three months ended September 30, 2012, respectively.

Variable Interest Entities

On May 1, 2012, Kaibida International Limited entered into an amalgamation agreement with Norian Digital, Shenzhen Lebailing Communication Equipment Company Ltd., and Shenzhen Kuanda Technology Company Ltd., (collectively the “Shenzhen Co”). Under the amalgamation agreement, the shareholders of Shenzhen Co received equity consideration in CTX Virtual Technologies Inc. (“Company”) by way of 2 million shares stock transfer by the Company’s select shareholders. Under the acquisition, the shareholders of Shenzhen Co is entitled to certain earn-out provisions based on future earnings of the amalgamated businesses as well as deferred working capital payments over three years.

The Company accounted transactions under ASC 810-10, Consolidation, “Variable Interest Entities” subsections. Under the amalgamation agreement, the board of directors of Kaibida who has the majority voting rights are comprised of directors of CTXV. The agreement also provides for Kaibida to direct and authorize any distribution of earnings of the Shenzhen Co, direct daily operations, and financially control by controlling various financial aspects of the operations.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management reviews its estimates based on currently available information. Actual results could materially differ from those estimates and such differences could be material to the financial position and results of operations.

Revenue Recognition

The Company recognizes in accordance with ASC 605, Revenue Recognition, when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured, and delivery of products has occurred or services have been rendered. Accordingly, the Company recognizes revenues at the time when the economic benefits and risk associated with the transaction are transferred to the customers. Allowance for doubtful accounts is estimated based on estimates of losses related to customer receivable balances.

Shipping and Handling Costs

All shipping and handling are expensed as incurred. Shipping and handling expenses included in selling expenses was \$48,573 and \$24,413 for the nine months ended September 30, 2013 and 2012, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Advertising and Promotion Costs

Costs associated with advertising and promotions are expensed as incurred. Advertising and promotion costs were \$40,659 and \$30,602 for the nine months ended September 30, 2013 and 2012, respectively.

Research and Development

Research and development cost include payroll, employee benefits, and other headcount-related expenses associated with product development and are expensed as incurred. The Company incurred \$3,563 and \$33,965 of research and development expenses for the nine months ended September 30, 2013 and 2012, respectively.

Segment Information

ASC 280 requires companies to report information about operating segment in interim and annual financial statements. It also requires disclosures about products and services geographic and major customers. The Company has determined that it does not have any separately reportable operating segments.

Foreign Currency Translation

The Company translates the assets and liabilities of its non-U.S. functional currency subsidiaries into dollars at the current rates of exchange in effect at the end of the reporting period. Revenues and expenses are translated at average current rates during the reporting period. Translation adjustments are included in accumulated other comprehensive income as a separate component of stockholders' equity.

Fair Value of Financial Instruments

The fair values of the Company's trade accounts receivable, income taxes receivable/payable, accounts payable, accrued expenses and other current liabilities approximate their carrying values due to the relatively short maturities of these instruments. The carrying value of the Company's short and long term debt approximates fair value based on management's best estimate of the interest rates that would be available for similar debt obligations having similar terms at the balance sheet date.

Inventories

Inventories consist of electronic components and finished goods and are valued at the lower of cost, determined on a moving average basis which approximates cost, and estimated net realizable value. The Company assesses the inventory carrying value and reduces it, if necessary, to its net realizable value based on customer orders on hand and internal demand forecasts using management's best estimates given information currently available. The Company's customer demand is highly unpredictable and can fluctuate significantly caused by factors beyond its control. The Company may maintain an allowance for inventories for potentially excess and obsolete inventories and inventories that are carried at costs that are higher than their estimated net realizable values.

Intangible Assets

Intangible assets are comprised of work force and customer relationships is recorded at fair value at the date of purchase accounting. The intangible assets are amortized over 5 years.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and Equipment

Property and equipment is recorded at cost. Major improvements are capitalized, while maintenance and repairs are charged to expense as incurred. Gains and losses from disposition of property and equipment are included in income and expense when realized. Depreciation and amortization are provided using the straight-line method or declining method over the following estimated useful lives:

	<u>Useful Lives</u>
Machinery and equipment	3-10 Years
Office equipment	2-5 Years
Logistical equipment	3 Years
Leasehold improvement	Lesser of the lease term or useful life

Income Taxes

The Company follows ASC 740, "Income Taxes", which requires the recognition of deferred tax assets and liabilities or the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates, applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. Based on the assessment, management believes that the Company is more likely than not to fully realize its deferred tax assets in U.S. As such, no valuation allowance has been established related to the Company's US operations.

The Company adopted ASC 740-10-25 on January 1, 2007, which provides criteria for the recognition, measurement, presentation and disclosure of uncertain tax position. The Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The Company did not recognize any additional liabilities for uncertain tax positions as a result of the implementation of ASC 740-10-25. As of September 30, 2013 and December 31, 2012, the Company had no material unrecognized tax benefits.

Impairment of Long-lived Assets

In accordance with ASC 360, "Property, Plant, and Equipment," the Company reviews for impairment of long-lived assets and certain identifiable intangibles whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. The Company considers the carrying value of assets may not be recoverable based upon its review of the following events or changes in circumstances: the asset's ability to continue to generate income from operations and positive cash flow in future periods; loss of legal ownership or title to the assets; significant changes in the Company's strategic business objectives and utilization of the asset; or significant negative industry or economic trends. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset is less than its carrying amount.

The Company tested the long-lived assets for impairment as of September 30, 2013 and December 31, 2012 by comparing the discounted cash flows of the assets to their carrying values and concluded that, as of this date, no impairment existed. The Company is not aware of any events or changes in circumstances following this date that would indicate that the long-lived assets are impaired.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill

Goodwill represents the excess of the purchase price over the fair value assigned to net tangible and identifiable intangible assets of business acquired and accounted for under the acquisition method. In accordance with ASC 350, Goodwill, the impairment evaluation of goodwill is conducted annually, or more frequently, if events or changes in circumstances indicate that an asset might be impaired. The evaluation is performed by using a two-step process. In the first step, the fair value of each reporting unit is compared with the carrying amount of the reporting unit, including goodwill. The estimated fair value of the reporting unit is generally determined on the basis of discounted future cash flows. If the estimated fair value of the reporting unit is less than the carrying amount of the reporting unit, then a second step must be completed in order to determine the amount of the goodwill impairment that should be recorded. In the second step, the implied fair value of the reporting unit's goodwill is determined by allocating the reporting unit's fair value to all of its assets and liabilities other than goodwill (including any unrecognized intangible assets) in a manner similar to a purchase price allocation. The resulting implied fair value of the goodwill that results from the application of the second step is then compared to the carrying amount of the goodwill and an impairment charge is recorded for the difference.

Comprehensive Income

Comprehensive income includes accumulated foreign currency translation gains and losses. The Company has reported the components of comprehensive income on its statements of stockholders' equity.

Concentrations of Credit Risk and Risk Factors

Accounts Receivable – Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers dispersed across diverse markets and generally short payment terms. Credit is extended based on an evaluation of the customer's financial condition and collateral generally is not required. The Company evaluates the collectability of accounts receivable based on a combination of factors. In cases where the Company is aware of circumstances that may impair a specific customer's ability to meet its financial obligations subsequent to the original sale, the Company will record a specific allowance against amounts due, and thereby reduce the net recognized receivable to the amount the Company reasonably believes will be collected.

Net Revenues – Substantially all of the Company's revenues are derived from sales of the group in PRC. Any significant decline in market acceptance of the Company's products or in the financial condition of our existing customers could impair our ability to operate effectively.

Recent Accounting Pronouncements

The Company does not expect that any recently issued accounting updates will have a material impact on its Interim Financial Statements.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

3. FAIR VALUE MEASUREMENTS

ASC 820 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability. ASC 820 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SC 820 establishes three levels of inputs that may be used to measure fair value:

- Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company holds. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Valuation based on quoted prices in markets that are not active for which all significant inputs are observable, either directly or indirectly.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The Company adopted ASC 820, Fair Value Measurements and Disclosures, on January 1, 2008 for all financial assets and liabilities and nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Combined financial statements on a recurring basis (at least annually). ASC 820 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements.

Financial instruments include cash, accounts receivable, prepayments and other receivables, accounts payable and accrued expenses and other payables. The carrying amounts of cash, accounts receivable, prepayments and other receivables, short-term loans, accounts payable and accrued expenses approximate their fair value due to the short term maturities of these instruments.

The Company has Level 2 financial instrument, warrants that are recorded at fair value on a periodic basis. Warrants are evaluated under the hierarchy of ASC Subtopic 480-10, ASC Paragraph 815-25-1 and ASC Subparagraph 815-10-15-74 addressing embedded derivatives. The fair value of such warrants are estimated using the Black-Scholes option pricing model. The foregoing warrants have certain anti-dilution and exercise price reset provisions which qualify the warrants to be classified as a liability under ASC 815.

The Company has Level 3 financial instrument, an embedded derivative that is recorded at fair value on periodic basis. The embedded derivative is evaluated under the hierarchy of ASC 480-10, ASC Paragraph 815-25-1 and ASC Subparagraph 815-10-15-74 addressing embedded derivatives. The fair value of such warrants are estimated using the Black-Scholes option pricing model. The foregoing warrants have certain anti-dilution and exercise price reset provisions which qualify the warrants to be classified as a liability under ASC 815.

As of December 31, 2012, the following table represents the Company's fair value hierarchy for items that are required to be measured at fair value on a recurring basis:

Description	Level 1	Level 2	Level 3
Embedded conversion feature liability	\$ -	\$ -	\$ 1,669,470
Warrant liabilities	\$ -	\$ 12,084,368	\$ -

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

3. FAIR VALUE MEASUREMENTS (continued)

As of September 30, 2013, the following table represents the Company's fair value hierarchy for items that are required to be measured at fair value on a recurring basis:

Description	Level 1	Level 2	Level 3
Embedded conversion feature liability	\$ -	\$ -	\$ 10,031,503
Warrant liabilities	\$ -	\$ 21,608,556	\$ -

4. INVENTORIES

Inventories comprised the following:

<i>Description</i>	September 30, 2013	December 31, 2012
Raw material	\$ 7,268,294	\$ 823,787
Work-in-progress	-	999,203
Finished goods	1,121,889	1,855,663
Inventories, net	\$ 8,390,183	\$ 3,678,653

5. LOAN RECEIVABLE

In July 2010, the Company provided a loan to an unrelated company located in South Korea with interest rate per annum equal to London Inter-bank borrowing rate plus two percent. The loan and accrued interest became due on July 29, 2012. The Company subsequently received the outstanding balance plus accrued interest in July 2012.

6. AMOUNTS DUE FROM RELATED PARTIES

Amounts due from related parties comprised the following:

<i>Description</i>	September 30, 2013	December 31, 2012
Due from shareholder – non-interest bearing note receivable due upon demand	\$ 6,945,841	\$ 5,505,786
Due from executive employee – non-interest bearing note receivable due upon demand	1,811,720	393,672
Due from executive employee – interest bearing note receivable due upon demand, 5% annum	40,000	-
Total	\$ 8,797,561	\$ 5,899,458

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

7. PROPERTY AND EQUIPMENT, NET

Property and equipment, net comprised the following:

<i>Description</i>	September 30, 2013	December 31, 2012
Machinery and equipment	\$ 3,352,499	\$ 2,836,734
Office equipment	254,664	237,059
Logistical equipment	197,154	181,736
Leasehold improvements	1,163,531	1,140,235
Total property and equipment	4,967,848	4,395,764
Accumulated depreciation	(874,730)	(534,843)
Property and equipment, net	\$ 4,093,118	\$ 3,860,921

Depreciation expense on property and equipment was \$353,921 and \$206,078 for the nine months ended September 30, 2013 and 2012, respectively. Depreciation expense on property and equipment was \$188,116 and \$68,187 for the three months ended September 30, 2013 and 2012, respectively.

8. INTANGIBLE ASSETS, NET

Intangible assets, net comprised the following:

<i>Description</i>	September 30, 2013	December 31, 2012
Customer relationship	\$ 17,371,587	\$ 17,371,587
Total	17,371,587	17,371,587
Accumulated amortization	(4,259,366)	(2,026,685)
Intangible assets, net	\$ 13,112,221	\$ 15,344,902

Amortization expense on intangible assets was \$2,626,130 and \$1,449,376 for the nine months ended September 30, 2013 and 2012, respectively, and are included in general and administrative expenses. Amortization expense on intangible assets was \$553,972 and \$290,142 for the three months ended September 30, 2013 and 2012, respectively.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

9. ACCRUED LIABILITIES AND OTHER CURRENT LIABILITIES

Accrued liabilities and other current liabilities consisted of the following:

	September 30, 2013	December 31, 2012
Accrued salaries and welfare	\$ 557,301	\$ 538,652
Accrued value added taxes and other taxes	14,641,318	3,554,254
Working capital payable	3,405,385	3,308,498
Other accrued liabilities	1,114,868	6,448,227
Total	\$ 19,718,872	\$ 13,849,631

10. AMOUNTS DUE TO RELATED PARTIES

Amounts due to related parties comprised the following:

<i>Description</i>	September 30, 2013	<i>December 31, 2012</i>
Due from shareholder – non-interest bearing note receivable due upon demand	\$ 4,099,612	\$ 3,153,996
Due from executive employee – non-interest bearing note receivable due upon demand	3,199,149	2,297,474
Total	\$ 7,298,761	\$ 5,451,470

11. CONVERTIBLE DEBT

The Company had the following convertible debt outstanding:

	September 30, 2013	December 31, 2012
July 2013 to September 2013 Convertible Debt – Various	\$ 2,861,714	\$ -
January 2013 to June 2013 Convertible Debt – Various	4,486,588	-
December 2012 Convertible Debt	1,572,375	1,572,375
November 2012 Convertible Debt	190,355	1,819,150
Total	9,111,032	3,391,525
Convertible debt discount, net of additions and amortization	(4,767,919)	(1,560,702)
Total convertible debt, net of debt discount and accretion	\$ 4,343,113	\$ 1,830,823

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

11. CONVERTIBLE DEBT (continued)

Convertible Debt Issued in July 2013 to September 2013 - Various

As part of December 1, 2012 convertible debt, CTX Virtual Technologies, Inc. (the “Company”) the Company received net proceeds of \$2,861,714 throughout the three months ended September 30, 2013 from this transaction. The terms of the convertible debt are the same as the December 1, 2012 convertible debt.

The Company adopted the provisions of FASB ASC Topic 815, “Derivatives and Hedging” (“ASC 815”) (previously EITF 07-5, “Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity’s Own Stock”), as the convertible debts agreement contained that item that the number of shares to be received upon conversion will increase if an IPO does not occur within a certain time frame, the convertible debt failed to pass the “fixed for fixed” criteria of ASC815, the conversion feature of the convertible debt should have to be bifurcated and recorded separately until the conversion date.

Based on ASC 815, the Company determined that the convertible debt contained embedded derivatives and full-ratchet provision which the Company used an independent third party valuation firm to value the convertible debt and embedded derivatives using the Black-Scholes and Monte-Carlo Simulation method. The Company used an independent third party valuation firm and the result was as follows:

<i>Description</i>	Fair Value at Date of Issuance	Changes in Fair Value Nine months Ended September 30, 2013	Fair Value at September 30, 2013
Derivative liability	\$ 3,090,067	\$ (79,084)	\$ 3,010,983
Warrant liability	\$ 2,452,809	30,307	2,483,116

As a result of initial recording of derivative liability of \$3,090,067 and warrant liability of \$2,452,809 with net proceeds of \$2,861,714, the Company recorded debt discount of \$2,861,714 (which is net proceeds as the debt discount cannot exceed the proceeds and is a contra convertible debt account) and interest expense of \$2,681,161 at the date of issuance of convertible debt for the nine months ended September 30, 2013.

Convertible Debt Issued in January to June 2013 - Various

As part of December 1, 2012 convertible debt, CTX Virtual Technologies, Inc. (the “Company”) the Company received net proceeds of \$4,408,625 throughout the nine months ended September 30, 2013 from this transaction. The terms of the convertible debt are the same as the December 1, 2012 convertible debt.

The Company adopted the provisions of FASB ASC Topic 815, “Derivatives and Hedging” (“ASC 815”) (previously EITF 07-5, “Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity’s Own Stock”), as the convertible debts agreement contained that item that the number of shares to be received upon conversion will increase if an IPO does not occur within a certain time frame, the convertible debt failed to pass the “fixed for fixed” criteria of ASC815, the conversion feature of the convertible debt should have to be bifurcated and recorded separately until the conversion date.

Based on ASC 815, the Company determined that the convertible debt contained embedded derivatives and full-ratchet provision which the Company used an independent third party valuation firm to value the convertible debt and embedded derivatives using the Black-Scholes and Monte-Carlo Simulation method. The Company used an independent third party valuation firm and the result was as follows:

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

11. CONVERTIBLE DEBT (continued)

Convertible Debt Issued in January to June 2013 – Various (continued)

<i>Description</i>	Fair Value at Date of Issuance	Changes in Fair Value Nine months Ended September 30, 2013	Fair Value at September 30, 2013
Derivative liability	\$ 5,775,356	\$ (608,588)	\$ 5,166,768
Warrant liability	\$ 4,098,957	222,469	4,321,426

As a result of initial recording of derivative liability of \$5,775,356 and warrant liability of \$4,098,957 with net proceeds of \$4,408,625, the Company recorded debt discount of \$4,408,625 (which is net proceeds as the debt discount cannot exceed the proceeds and is a contra convertible debt account) and interest expense of \$6,114,200 at the date of issuance of convertible debt for the nine months ended September 30, 2013.

The Company accretes debt discount of \$4,408,625 over the life of the convertible debt which is approximately 18 months. The Company recorded accretion of \$1,323,968 for the nine months ended September 30, 2013 which is recorded as interest expense.

Convertible Debt Issued in December 2012

On December 1, 2012, CTX Virtual Technologies, Inc. (the “Company”) issued 6,857.14 units (each, a “Unit” and collectively, the “Units”) at a purchase price of \$875.00 per Unit, or an aggregate purchase price of \$6,000,000 (the “Offering Amount”). The minimum subscription by an investor is 50 Units (\$43,750.00); however, the Company reserves the right to accept subscriptions for a lesser amount in the Company’s sole discretion. The Company received net proceeds of \$1,572,375 on December 1, 2012 from this transaction.

Each Unit is comprised of:

- a) one senior convertible promissory note, \$1,000.00 par value, convertible into shares of our common stock, \$0.001 par value per share (the “Common Stock”), at a conversion price of \$0.85 per share, subject to anti-dilution adjustment (each, a “Senior Convertible Note,” “Convertible Note” or a “Note” and collectively, the “Senior Convertible Notes,” “Convertible Notes” or the “Notes”), and
- b) a warrant to purchase 588 shares of our Common Stock at a price of \$0.85 per share (the “Common Stock”), subject to anti-dilution adjustment (each, a “Warrant” and collectively, the “Warrants”).

Each Senior Convertible Note shall accrue interest at a rate of 10% per annum, payable quarterly in cash, and be due and payable, at par, on the 18 month anniversary of its issuance. The Warrants are exercisable at any time from the date of issuance until the fifth anniversary of the issuance of such Warrants. There is no minimum number of Units being offered in the Offering.

The Company adopted the provisions of FASB ASC Topic 815, “Derivatives and Hedging” (“ASC 815”) (previously EITF 07-5, “Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity’s Own Stock”), as the convertible debts agreement contained that item that the number of shares to be received upon conversion will increase if an IPO does not occur within a certain time frame, the convertible debt failed to pass the “fixed for fixed” criteria of ASC815, the conversion feature of the convertible debt should have to be bifurcated and recorded separately until the conversion date.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

11. CONVERTIBLE DEBT (continued)

Convertible Debt Issued in December 2012 (continued)

Based on ASC 815, the Company determined that the convertible debt contained embedded derivatives and full-ratchet provision which the Company used an independent third party valuation firm to value the convertible debt and embedded derivatives using the Black-Scholes and Monte-Carlo Simulation method. The Company used an independent third party valuation firm and the result was as follows:

<i>Description</i>	Fair Value at Date of Issuance	Changes in Fair Value 2012	Fair Value at December 31, 2012	Changes in Fair Value Nine months Ended September 30, 2013	Fair Value at September 30, 2013
Derivative liability	\$ 1,614,714	\$ -	\$ 1,614,714	\$ 200,655	\$ 1,815,369
Warrant liability	\$ 1,357,989	\$ -	\$ 1,357,989	181,318	1,539,307

As a result of initial recording of derivative liability of \$1,614,714 and warrant liability of \$1,357,989 with net proceeds of \$1,572,375, the Company recorded debt discount of \$1,572,375 (which is net proceeds as the debt discount cannot exceed the proceeds and is a contra convertible debt account) and interest expense of \$1,400,328 at the date of issuance of convertible debt in 2012.

The Company accretes debt discount of \$1,572,375 over the life of the convertible debt which is 18 months. The Company recorded accretion of \$786,188 for the nine months ended September 30, 2013 which is recorded as interest expense.

Convertible Debt Issued in November 2012 - \$1,819,150 with 10% Interest

On November 29, 2013, CTX Virtual Technologies, Inc., (the "Company") entered into 10% Convertible Note due November 29, 2013 in the amount of \$1,819,150 with interest from the date of issuance at the rate of ten (10%) percent per annum due to an private investor, an individual ("Holder"). The Company has the right to accrue the interest on the outstanding principal amount.

The Company and Holder agree use of proceeds shall be to fund the necessary tooling, fixtures, and other expenses associated with production of items necessary to fulfill Company's contracts. Cliff Rhee, the Company CEO, shall personally provide any shortfall of funds necessary to complete the specified contract.

The Holder, at any time before the maturity date, shall have the right to convert the outstanding and unpaid principal amount of this Note, in whole but not in part, into units ("Conversion Units") at a conversion price of \$2.00 per Conversion Unit.

The Company adopted the provisions of FASB ASC Topic 815, "Derivatives and Hedging" ("ASC 815") (previously EITF 07-5, "Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity's Own Stock"), as the convertible debts agreement contained that item that the number of shares to be received upon conversion will increase if an IPO does not occur within a certain time frame, the convertible debt failed to pass the "fixed for fixed" criteria of ASC815, the conversion feature of the convertible debt should have to be bifurcated and recorded separately until the conversion date.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

11. CONVERTIBLE DEBT (continued)

Convertible Debt Issued in November 2012 - \$1,819,150 with 10% Interest (continued)

Based on ASC 815, the Company determined that the convertible debt contained embedded derivatives and full-ratchet provision which the Company used an independent third party valuation firm to value the convertible debt and embedded derivatives using the Black-Scholes and Monte-Carlo Simulation method. The result was as follows:

<i>Description</i>	Fair Value at Date of Issuance	Changes in Fair Value 2012	Fair Value at December 31, 2012	Changes in Fair Value Nine months Ended September 30, 2013	Fair Value at September 30, 2013
Derivative liability	\$ 69,492	\$ (14,736)	\$ 54,756	\$ (16,372)	\$ 38,384

As a result of initial recording of derivative liability of \$169,492 and warrant liability of \$1,792,954 with net proceeds of \$1,819,150, the Company recorded debt discount of \$205,564.

The Company accretes debt discount of \$205,564 over the life of the convertible debt which is 18 months. The Company recorded accretion of \$68,521 for the nine months ended September 30, 2013 which is recorded as interest expense.

12. WARRANT ISSUANCE

The Company issued warrants throughout various periods and these warrants meet the criteria under ASC 470-20, Debt with Conversion Options and Other Options and ASC 815-10, Derivatives and Hedging, and was accounted as a derivative instrument. Under ASC 815-15, an entity should recognize derivative instruments (which in this case would be the Warrants), including certain derivative instruments embedded in other contracts, as assets or liabilities in the statement of financial position and measure them at fair value.

The Company used an independent third party valuation firm to perform valuation of the warrants at issuance and for each reporting periods thereafter. The Company records gain or loss from changes in fair value of warrant liability in accordance with ASC 815-15.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

12. WARRANT ISSUANCE (continued)

The Company's warrant liability roll-forward schedule is as follows for the nine months ended September 30, 2013:

<i>Description</i>	Fair Value at Date of Issuance	Fair Value at December 31, 2012	Changes in Fair Value Nine months Ended September 30, 2013	Fair Value at September 30, 2013
July to September 2013 – Warrants issued under various convertible debt	\$ 2,452,809	\$ N/A	\$ 30,307	\$ 2,483,116
January to June 2013 – Warrants issued under various convertible debt	4,098,957	N/A	222,469	4,321,426
December 2012 – Warrants issued under convertible debt	1,357,989	1,357,989	181,318	1,539,307
March 2011 – Warrants Issued upon exercise of convertible debt	4,206,305	7,258,305	1,661,186	8,919,491
May 2010 – Warrants issued with private placement offering	3,130,977	3,468,074	877,142	4,345,216
Total	N/A	\$ 12,084,368	\$ 2,972,422	\$ 21,608,556

The Company's warrant liability roll-forward schedule is as follows for the nine months ended September 30, 2012:

<i>Description</i>	Fair Value at Date of Issuance	Fair Value at December 31, 2011	Changes in Fair Value Nine months Ended September 30, 2012	Fair Value at September 30, 2012
March 2011 – Warrants Issued upon exercise of convertible debt	\$ 4,206,305	\$ 3,098,813	\$ 2,049,492	\$ 5,148,305
May 2010 – Warrants issued with private placement offering	3,130,977	1,480,638	1,050,448	2,531,086
Total	N/A	\$ 4,579,451	\$ 3,099,940	\$ 7,679,391

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

12. WARRANT ISSUANCE (continued)

Warrants Issued Under Convertible Debt (Issued in December 2012) – On December 1, 2012, CTX Virtual Technologies, Inc. (the “Company”) issued 6,857.14 units (each, a “Unit” and collectively, the “Units”) at a purchase price of \$875.00 per Unit, or an aggregate purchase price of \$6,000,000 (the “Offering Amount”). The minimum subscription by an investor is 50 Units (\$43,750.00); however, the Company reserves the right to accept subscriptions for a lesser amount in the Company’s sole discretion. Each Unit is comprised of:

- a) one senior convertible promissory note, \$1,000.00 par value, convertible into shares of our common stock, \$0.001 par value per share (the “Common Stock”), at a conversion price of \$0.85 per share, subject to anti-dilution adjustment (each, a “Senior Convertible Note,” “Convertible Note” or a “Note” and collectively, the “Senior Convertible Notes,” “Convertible Notes” or the “Notes”), and
- b) a warrant to purchase 588 shares of our Common Stock at a price of \$0.85 per share (the “Common Stock”), subject to anti-dilution adjustment (each, a “Warrant” and collectively, the “Warrants”).

Each Senior Convertible Note shall accrue interest at a rate of 10% per annum, payable quarterly in cash, and be due and payable, at par, on the 18 month anniversary of its issuance. The Warrants are exercisable at any time from the date of issuance until the fifth anniversary of the issuance of such Warrants.

Warrants Issued Upon Exercise of Convertible Debt – In March 2011 upon exercise of convertible debt (refer to Note 12), the Company issued additional warrants to the Convertible Note Holder and for the Placement agents in the amount of 8,474,576. The warrants are exercisable for five years at a price of \$1.00 per share.

The warrant meets the criteria under ASC 470-20, Debt with Conversion Options and Other Options and ASC 815-10, Derivatives and Hedging, and was accounted as a derivative instrument. Under ASC 815-15, an entity should recognize derivative instruments (which in this case would be the Warrants), including certain derivative instruments embedded in other contracts, as assets or liabilities in the statement of financial position and measure them at fair value.

Private Placement Offering – In May 2010, the Company entered into stock subscription agreement whereby the Company issued approximately 4,049,218 units (“Units”) for the proceeds of \$2,389,038 to accredited investors at a price of \$.59 per unit, each unit consisting of one share of common stock and one warrant to purchase one share of common stock.

The warrants are exercisable for five years at a price of \$1.00 per share. The warrants are subject to redemption by the Company at \$0.05 per warrant if the common stock achieves a volume weighted average price of at least 150% of the exercise price for 10 consecutive days and certain other conditions are satisfied. By the end of December 31, 2011, the condition of the redemption of the warrants had not been reached, no warrant was redeemed.

The warrant meets the criteria under ASC 470-20, Debt with Conversion Options and Other Options and ASC 815-10, Derivatives and Hedging, and was accounted as a derivative instrument. Under ASC 815-15, an entity should recognize derivative instruments (which in this case would be the Warrants), including certain derivative instruments embedded in other contracts, as assets or liabilities in the statement of financial position and measure them at fair value.

13. PRC STATUTORY RESERVES

In accordance with PRC Company Law, the Company is required to appropriate at least 10% of the profit arrived at for each year to the statutory surplus reserve. Appropriation to the statutory surplus reserve by the Company is based on profit arrived at under PRC accounting standards for business enterprises for each year.

The profit arrived at must be set off against any accumulated losses sustained by the Company in prior years, before allocation is made to the statutory surplus reserve. Appropriation to the statutory surplus reserve must be made before distribution of dividends to owners. The appropriation is required until the statutory surplus reserve reaches 50% of the registered capital. This statutory surplus reserve is not distributable in the form of cash dividends but only on liquidation. It can be used to make good of previous losses, if any, and may be utilized for business expansion or converted into capital by increasing registered capital to existing equity owners in proportion to their equity holding, provided that remaining reserve balance after such conversion is not less than 25% of the registered capital. As of March 31, 2013 and December 31, 2012, the accumulated balance of our statutory surplus reserve amounted to \$0.

14. EQUITY

Common and Treasury Stock

On March 10, 2011, the Company's Chief Executive Officer was issued 600,000 shares of common stock in accordance with the employment agreement. On March 10, 2011, the Company exercised its option to convert \$5,000,000 convertible note into 8,474,576 shares of common stock. On March 10, 2011, the company issued 1,012,304 shares of common stock to various investors who participated in the first Private Placement offering dated May 25, 2010. On September 30, 2011, the company issued 2,118,644 shares of common stock to the holder of the \$5.0 million convertible note as additional shares as outlined in the conversion agreement.

During the years ended December 31, 2011, the company issued 130,000 shares of common stock to its board of directors and investor relations consultant as per the non-employee stock compensation plan.

Preferred Stock

The Company has designated 50,000 of the 11,000,000 authorized shares of preferred stock as convertible Series AA Preferred Stock ("Series AA Preferred Stock"). The Series AA Preferred Stock is 1-1 voting, has a liquidation preference equal to its stated value, and does not pay dividends. The holders can call the conversion of the Series AA Preferred Stock at any time. On December 31, 2011, 27,250 Series AA Preferred Stock shares were outstanding.

The Company has designated 10,000,000 of the 11,000,000 authorized shares of preferred stock as Series B Convertible Preferred Stock ("Series B Preferred Stock"). The Series B Preferred Stock is 10-1 voting, has a liquidation preference equal to its purchase price, and does not pay dividends. As of December 31, 2011, 10,000,000 Series B Preferred Stock was outstanding.

The Company has designated 68,741 of the 11,000,000 authorized shares of preferred stock as Series C Convertible Preferred Stock ("Series B Preferred Stock"). The Series B Preferred Stock is 1-1 voting, has a liquidation preference equal to \$3.0 per share, and does not pay dividends. As of December 31, 2012 and March 31, 2013, no Series C Preferred Stock was outstanding.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

16. EARNINGS PER SHARE

The Company calculates earnings per share in accordance with ASC 260, Earnings Per Share, which requires a dual presentation of basic and diluted earnings per share. Basic earnings per share are computed using the weighted average number of shares outstanding during the fiscal year. Potentially dilutive common shares consist of exercisable warrants, restricted stocks, and stock options outstanding (using the treasury method).

The following table set forth the computation of basic and diluted net income per common share:

	<i>Nine months Ended September</i>		<i>Three Months Ended September</i>	
	<i>30,</i>		<i>30,</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
Net income (loss) before deconsolidation	\$ (15,031,716)	\$ 19,829,816	\$ (7,005,994)	\$ 3,271,990
Weighted-average shares of common stock outstanding				
Basic	23,757,188	21,781,312	23,922,789	21,814,920
Dilutive effect of stock warrants	-	12,523,794	-	12,523,794
Dilutive effect of restricted stocks and stock options	-	1,000,000	-	1,000,000
Diluted	23,757,188	35,305,106	23,922,789	35,338,714
Earnings per share:				
Basic	\$ (0.63)	\$ 0.68	\$ (0.29)	\$ 0.15
Diluted	\$ (0.63)	\$ 0.42	\$ (0.29)	\$ 0.09

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

17. INCOME TAXES

The Company and its subsidiary, CTX Technologies, Inc., are incorporated in the United States and are subject to statutory income tax rate of 34% under the relevant jurisdiction. Celluon Technology Holdings Ltd. is incorporated in Canada, and is subject to statutory income tax rate of 24%. Kaibida International Limited is incorporated in Hong Kong, and is subject to statutory income tax rate of 16.5%. The Company's PRC subsidiaries are the standard statutory tax rate of PRC Enterprise Income tax of 25%.

The following table represented the Company's effective tax rate reconciliation for the periods presented:

<i>Nine months Ended September 30,</i>	2013	2012
Statutory tax rate	34%	34%
Income tax rate deduction	(9%)	(9%)
Income not taxable	-	(21%)
Effective tax rate	25%	4%

The provision for income taxes consists of taxes on income from operations plus changes in deferred taxes for the periods presented:

<i>Nine months Ended September 30,</i>	2013	2012
Current tax expenses	\$ 2,904,610	\$ 2,451,957
Deferred tax expenses (benefits)	-	-
Total income tax expenses	\$ 2,904,610	\$ 2,451,957

Deferred tax assets and liabilities reflected the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

	September 30, 2013	December 31, 2012
Product development expenses	\$ 11,366	\$ 1,527,882
Net operating loss carry forwards	4,764,347	1,359,484
Less – deferred tax assets valuation allowance	(4,775,713)	(2,887,366)
Total net deferred tax assets	\$ -	\$ -

As of September 30, 2013 and December 31, 2012, the Company had deferred income tax of \$4,775,713 and \$2,887,366, respectively, which more likely than not that the potential economic benefits of the net operating loss of these subsidiaries will not be realized in the near future. As a result, the full amount of the valuation allowance was provided against the potential tax benefits.

CTX Virtual Technologies, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

18. COMPREHENSIVE INCOME

Total comprehensive income includes, in addition to net income, changes in equity that are excluded from the consolidated statements of income and are recorded directly into a separate section of shareholders' equity on the consolidated balance sheets. Comprehensive income and its components consisted of the following:

<i>Three Months Ended September 30,</i>	2013	2012
Net income (loss) before deconsolidation	\$ (7,005,994)	\$ 3,271,990
Foreign currency translation adjustment – gain (loss)	3,636	(59,694)
Comprehensive income (loss)	\$ (7,009,630)	\$ 3,212,296
<i>Nine months Ended September 30,</i>	2013	2012
Net income (loss) before deconsolidation	\$ (15,031,716)	\$ 19,829,816
Foreign currency translation adjustment – gain (loss)	(372,602)	(411,807)
Comprehensive income (loss)	\$ (15,404,318)	\$ 19,418,009

19. COMMITMENTS AND CONTINGENCIES

The Company is subject to various legal proceedings from time to time as part of its business. As of December 31, 2012, the Company was party to legal proceedings or threatened legal proceedings, however the adverse outcome of which, individually or in the aggregate, it believes would not have a material adverse effect on its business, financial condition and results of operations.

The Company leases its administrative facilities under several non-cancelable operating leases. Rental expenses under operating leases included in the consolidated statement of operations were \$254,618 and \$209,226 for the nine months ended September 30, 2013 and 2012, respectively.

As at September 30, 2013, the Group's commitments for minimum lease payments under these leases for the next year are as follows:

<i>Years Ending December 31,</i>	<i>Amount(\$)</i>
2013	70,670
2014	197,047
2015	133,676
2016	51,560
Total	452,953

20. RESTATEMENT – ACCOUNTING FOR DEBT INSURANCE COST

In July 2010, the Company issued a \$5,000,000 convertible debt to EFT Biotech Holdings, Inc., a company based in California with various business interests in distribution of diverse products in China through sales membership network. The convertible debt carries 8% annual interest and any time after January 26, 2011, CTXV may elect to convert into common stock at \$0.59 per common share for a total of 8,474,576 new shares. The convertible debt also contains certain anti-dilution provision and allows of issuance additional warrant of 8,474,576 upon exercise of convertible debt. The Company incurred convertible debt issuance costs primarily consisting of brokerage, legal, and professional fees related to this debt, which is amortized over the convertible period (January 26, 2011). On March 10, 2011, the Company exercised the option to convert the debts into equity by issuance of 8,474,576 shares of common stocks to the holders.

The Company initially recorded the debt issuance costs in the amount of \$2,504,782 for fiscal years ended December 31, 2012 and 2011 and did not amortize the debt when the convertible debt was converted in 2011. The Company incorrectly recorded the debt issuance costs for fiscal years ended December 31, 2012 and 2011 due to the Company fully converted the debt in March 2011, and the amount of debt issuance costs should have been expensed for fiscal year ended December 31, 2011. As a result, the Company restated its financial statements for as of and for the year ended December 31, 2012 and 2011. The restatement did not have impact its cash flows for the years ended December 31, 2012 and 2011.

21. SUBSEQUENT EVENTS

The Company evaluated all events or transactions that occurred after September 30, 2013 up through the date the financial statements were available to be issued. During these periods, the Company did not have any material recognizable subsequent events required to be disclosed as of and for the nine months ended September 30, 2013.