

China Internet Cafe Holdings Group, Inc.  
Form S-1/A  
July 17, 2012

**As filed with the Securities and Exchange Commission on July 17, 2012**

**Registration No. 333-173407**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM S-1/A**

**Amendment No. 4**

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

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

(Exact name of registrant as specified in its charter)

**Nevada**

(State or other jurisdiction of incorporation or organization)

**5960**

(Primary Standard Industrial Classification Code Number)

**98-0500738**

(I.R.S. Employer Identification Number)

**#1707, Block A, Genzon Times Square**  
**Longcheng Blvd, Centre City, Longgang District**  
**Shenzhen, Guangdong Province**  
**People's Republic of China 518172**  
**86 -755- 89896008**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Mr. Dishan Guo**  
**Chief Executive Officer**  
**#1707, Block A, Genzon Times Square**  
**Longcheng Blvd, Centre City, Longgang District**  
**Shenzhen, Guangdong Province**  
**People's Republic of China 518172**  
**86 -755- 89896008**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

*Copy to:*

**Gregory Sichenzia, Esq.**  
**Benjamin Tan, Esq.**  
**Sichenzia Ross Friedman Ference LLP**  
**61 Broadway, 32nd Floor**  
**New York, NY 10006**  
**Tel: (212) 930 9700**

**Fax: (212) 930 9725**

Approximate date of commencement of proposed sale to the public: From time to time after the Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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 12b2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

**CALCULATION OF REGISTRATION FEE**

Title of Class of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Aggregate Offering Price	<b>Proposed Maximum Offering Price per</b>	Amount of Registration Fee (2)
---	-----------------------------	---	--	--------------------------------

			<b>Unit</b>		
Common Stock, par value \$0.00001	6,649,538	\$ 1,728,879.88	\$ 19.07	\$ 198.13	(3)

(1) All shares registered pursuant to this registration statement are to be offered by the selling stockholders.

Estimated solely for purposes of calculating the registration fee. The registration fee is calculated pursuant to Rule (2) 457(c). Our Common Stock is quoted under the symbol "CICC" on the Over-the-Counter Bulletin Board ("OTCBB") administered by FINRA. As of July 16, 2012, the last reported sale price was for \$0.26 per share.

(3) An aggregate registration fee of \$1,051.87 has been previously paid in connection with the initially filed registration statement on Form S-1 (File No. 333-173407).

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. The selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer and sale is not permitted.

PRELIMINARY PROSPECTUS SUBJECT TO COMPLETION, DATED \_\_\_\_\_, 2012

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

**6,649,538 SHARES OF COMMON STOCK**

The selling stockholders identified in this prospectus are offering for sale from time to time up to 6,649,538 shares of our common stock, par value \$0.00001, (the “Common Stock”) including (i) 474,967 shares of Common Stock, (ii) 4,274,703 shares of Common Stock issuable upon conversion of preferred shares, (iii) and 1,899,868 shares of Common Stock that they may acquire from time to time upon exercise of certain warrants.

The Common Stock and warrants have already been issued to the selling stockholders in a private placement transaction on February 22, 2011, which was exempt from the registration and prospectus delivery requirements of the Securities Act of 1933, as amended (the “Offering”).

In the Offering, Investors were issued warrants to purchase 949,934 shares of Common Stock at a purchase price of \$2.00 (the “Series A Warrants”) and another 949,934 shares of Common Stock at a purchase price of \$3.00 (the “Series B Warrants”). Additionally, the placement agents were issued warrants to purchase 427,470 shares of Common Stock at a purchase price of \$1.35 per share (the “Placement Agent Warrants”), Series A Warrants to purchase 85,494 shares of Common Stock at a purchase price of \$2.00 per share, and Series B Warrants to purchase 85,494 shares of Common Stock at a purchase price of \$3.00 per share. The Series A Warrants, Series B Warrants, and Placement Agent Warrants all have a term of three years from the date of issue (equivalent to February 21, 2014).

The resale of the shares of Common Stock is not being underwritten. The selling stockholders may sell or distribute the shares, from time to time, depending on market conditions and other factors, through underwriters, dealers, brokers or other agents, or directly to one or more purchasers. Each selling stockholder will determine the prices at which it sells its shares. Although we will incur expenses in connection with the registration of the Common Stock (estimated to be approximately \$68,262), we will not receive any proceeds from the sale of the shares of Common Stock by the selling stockholders. To the extent the warrants are exercised for cash, if at all, we will receive the exercise price for those warrants. We cannot assure you that the warrants will be exercised for cash or at all.

To the extent the warrants are exercised to purchase shares of our Common Stock, if at all, we will receive the exercise price for those warrants. To the extent that the warrants are exercised using a cashless exercise, we will not receive the exercise price for those warrants.

Our Common Stock is quoted on the Over-the-Counter Bulletin Board (the "OTCBB") overseen by the Financial Industry Regulatory Authority ("FINRA") under the symbol "CICC" but there is a limited and/or sporadic trading market for our Common Stock. On July 16, 2012, the last reported sale price of our Common Stock quoted on the OTCBB was \$0.26 per share.

**Investing in our Common Stock involves a high degree of risk. You may lose your entire investment. See "Risk Factors" beginning on page 10 for a discussion of certain risk factors that you should consider.**

**You should read the entire prospectus before making an investment decision.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

The date of this prospectus is \_\_\_\_\_, 2012

**TABLE OF CONTENTS**

	Page
<b>PART I – INFORMATION REQUIRED IN PROSPECTUS</b>	
Prospectus Summary	4
Cautionary Note Regarding Forward-Looking Statements and Other Information Contained in this Prospectus	9
Risk Factors	10
Use of Proceeds	24
Dilution	24
Selling Shareholders	25
Plan of Distribution	29
Description of Securities to be Registered	30
Interests of Named Experts and Counsel	31
Business	31
Properties	43
Legal Proceedings	44
Market for Common Equity and Related Stockholder Matters	44
Management’s Discussion and Analysis of Financial Condition and Results of Operation	44
Changes In and Disagreements with Accountants	57
Directors, Executive Officers, Promoters and Control Persons	57
Executive Compensation	61
Security Ownership of Certain Beneficial Owners and Management	63
Certain Relationships and Related Transactions	64
Legal Matters	65
Experts	65
Available Information	65
Financial Statements	65
<b>PART II – INFORMATION NOT REQUIRED IN PROSPECTUS</b>	
Other Expenses of Issuance and Distribution	66
Indemnification of Directors and Officers	66
Recent Sales of Unregistered Securities	67
Exhibits	68
Undertakings	71
Signatures	73

## **ABOUT THIS PROSPECTUS**

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. The selling stockholders are offering to sell and seeking offers to buy shares of our Common Stock, including shares they acquire upon exercise of their warrants, only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our Common Stock. The prospectus will be updated and updated prospectuses made available for delivery to the extent required by the federal securities laws.

No person is authorized in connection with this prospectus to give any information or to make any representations about us, the selling stockholders, the securities or any matter discussed in this prospectus, other than the information and representations contained in this prospectus. If any other information or representation is given or made, such information or representation may not be relied upon as having been authorized by us or any selling stockholder. This prospectus does not constitute an offer to sell, or a solicitation of an offer to buy the securities in any circumstances under which the offer or solicitation is unlawful. Neither the delivery of this prospectus nor any distribution of securities in accordance with this prospectus shall, under any circumstances, imply that there has been no change in our affairs since the date of this prospectus. The prospectus will be updated and updated prospectuses made available for delivery to the extent required by the federal securities laws.

## **PROSPECTUS SUMMARY**

*This summary highlights information contained elsewhere in this prospectus. This summary does not contain all of the information you should consider before investing in our Common Stock. You should read the entire prospectus, including “Risk Factors” and the consolidated financial statements and the related notes before making an investment decision. Contents from our website, [www.chinainternetcave.com](http://www.chinainternetcave.com), are not part of this prospectus. Except as otherwise specifically stated or unless the context otherwise requires, the “Company,” “we,” “our” and “us” refers collectively to China Internet Cafe Holdings Group, Inc.*

## **THE COMPANY**

### **Business Overview**



We operate a chain of 59 internet cafés in Shenzhen, Guangdong, PRC that are generally open 24 hours a day, seven days a week. We provide internet café facilities to our customers and we believe we are the largest internet café chain in Shenzhen. We provide internet access at prices that we believe are affordable to both students and migrant workers. Although we sell snacks, drinks, and game access cards, over 95% of our revenue comes from selling access time to our computers. We sell internet café memberships to our customers. Members purchase prepaid IC cards (a pocket-sized card with embedded integrated circuits that can be used for identification, authentication, data storage and application processing), which include stored value that will be deducted based on time usage of a computer at the internet café. The cards are only sold at our cafés. We deduct the amount that reflects the access time used by a customer when the customer's IC card is inserted into the IC card slot 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 People’s Republic of China (“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 license to operate internet cafés in 2005. 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. These contracts 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 the VIE in exchange for service fees up to 100% of the VIE's Aggregate Net Profits (as defined in the agreement). In consideration for its right to receive the VIE's aggregate net profits, Zhonghefangda will reimburse to the VIE the full amount of Net Losses (as defined in the Agreement) incurred by the VIE. During the term of the agreement, the VIE 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, the shareholders of the VIE, Mr. Dishan Guo, Mr. Jinzhou Zeng and Ms. Xiaofen Wang (the "VIE Shareholders"), who collectively own 100% of the equity interest in the VIE, granted Zhonghefangda an exclusive, irrevocable option to purchase all or part of their equity interests in the VIE, 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 VIE Shareholders have pledged their entire equity interest in the VIE to Zhonghefangda pursuant to the Equity Pledge Agreement. The equity interests are pledged as collateral to secure the obligations of the VIE under the Management and Consulting Services Agreement and the VIE Shareholders' obligations under the Option Agreement and the Proxy Agreement.

**Voting Rights Proxy Agreement.** Pursuant to the Voting Rights Proxy Agreement, each of the VIE Shareholders has irrevocably granted and entrusted Zhonghefangda with all of the voting rights as a shareholder of the VIE for the maximum period of time permitted by law. Each VIE Shareholder has also covenanted not to transfer his or her equity interest in the VIE 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 China Internet Cafe Holdings Group, Inc. 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 of Directors") 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. Junlong was incorporated in the PRC in December 2003. It obtained its first licenses from the Ministry of Culture to operate an internet café chain in 2005 and opened its first internet café in April 2006.

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

On July 2, 2010, our Board of Directors 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, the Company filed with the Nevada Secretary of State a Certificate of Amendment to Articles of Incorporation to give effect to a name change from “China Unitech Group, Inc.” to “China Internet Cafe Holdings Group, Inc.” The Certificate of Amendment was approved by our Board of Directors on July 30, 2010 and was approved by a stockholder holding 59.45% of our outstanding Common Stock by written consent on July 30, 2010. In connection with the name change, on January 25, 2011, the Company filed an Issuer Company-Related Action Notification Form with FINRA requesting a name change from “China Unitech Group, Inc.” to “China Internet Cafe Holdings Group, Inc.” as well as an OTC voluntary symbol change from “CUIG” to “CICC.” These changes became effective on February 1, 2011. Our Common Stock began trading under the Company’s new name on the Over-the Counter Bulletin Boards on Tuesday, February 1, 2011 under our new trading symbol “CICC.”

On February 22, 2011, in connection with a security purchase agreement between the Company and certain investors (collectively, the “Investors”), we closed a private placement of approximately \$6.4 million from offering a total of 474,967 units (the “Units”) at a purchase price of \$13.50 per Unit, each consisting of:(i) nine shares of the Company’s 5% Series A Convertible Preferred Stock, par value \$0.00001 per share (the “Preferred Shares ”), 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, 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, each exercisable for the purchase of one share of Common Stock, to purchase one share of Common Stock, at an exercise price of \$3.00 per share.

## **Our Corporation Information**

We maintain our corporate offices at #1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City, Longgang District, Shenzhen, Guangdong Province, People’s Republic of China. Our telephone number is 86-755-89896008 and our facsimile number is 86-755-89896018. We also have a website at <http://www.chinainternetcfe.com/>

## **THE OFFERING**

### **The Offering**

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

This prospectus relates to (i) 474,967 shares of Common Stock, (ii) 1,899,868 shares of Common Stock underlying certain convertible warrants, and (iii) 4,274,703 shares of Common Stock underlying Preferred Shares.

Common Stock outstanding prior to offering	21,361,534
Common Stock offered by Company	0
Total shares of Common Stock offered by selling shareholders	6,649,538 (comprising 1,899,868 shares of Common Stock underlying certain warrants, 4,274,703 shares of Common Stock underlying certain convertible preferred stock, and 474,967 shares of Common Stock)
Common Stock to be outstanding after the offering (assuming all the warrants have been either exercised or converted and all Preferred Shares have been converted)	28,134,563

Use of proceeds of sale

We will not receive any of the proceeds of sale of the shares of Common Stock by the selling stockholders. However, we will receive proceeds from any exercise or conversion of the warrants into and up to 1,899,868 shares of our Common Stock, which are presently offered under this prospectus unless the warrants are exercised on a cashless basis, in which case we will not receive any proceeds from the exercise of the warrants. We intend to use any proceeds received from the exercise or conversion, as the case may be, for working capital and other general corporate purposes. We, however, cannot assure you that any of the warrants will be exercised or converted.

Risk Factors

See “Risk Factors” beginning on page 10 and other information included in this prospectus for a discussion of factors you should consider before deciding to invest in shares of our Common Stock.

## **Background**

On February 22, 2011 (the "Closing Date"), in connection with a security purchase agreement between the Company and the Investors, we closed a private placement (the "Offering") of approximately \$6.4 million from offering a total of 474,967 units (the "Units") at a purchase price of \$13.50 per Unit, each consisting of: (i) nine shares of the Company's Preferred Shares, 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, 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, each exercisable for the purchase of one share of Common Stock, to purchase one share of Common Stock, at an exercise price of \$3.00 per share.

As a condition to the Offering, we agreed to grant certain registration rights to the Investors pursuant to a Registration Rights Agreement dated February 22, 2011. We agreed to register for resale with the Securities and Exchange Commission (i) the shares of Common Stock issuable upon conversion of the Preferred Shares (4,274,703); (ii) the Common Shares (474,967); (iii) the shares of Common Stock issuable upon exercise of the Warrants (1,899,868); and (iv) any securities issued or issuable upon any stock split, dividend or other distribution, recapitalization or similar event with respect to the foregoing.

For more information on the Offering, please refer to our Current Report on Form 8-K filed with the Securities and Exchange Commission on February 23, 2011 and in the "Recent Sales of Unregistered Securities" section below.

## **Plan of Distribution**

This offering is not being underwritten. The selling stockholders directly, through agents designated by them from time to time or through brokers or dealers also to be designated, may sell their shares from time to time, in or through privately negotiated transactions, or in one or more transactions, including block transactions, on the OTC Bulletin Board or on any stock exchange on which the shares may be listed in the future pursuant to and in accordance with the applicable rules of such exchange or otherwise. The selling price of the shares may be at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices. To the extent required, the specific shares to be sold, the names of the selling stockholders, the respective purchase prices and public offering prices, the names of any such agent, broker or dealer and any applicable commission or discounts with respect to a particular offer will be described in an accompanying prospectus. In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 may be sold under Rule 144 rather than pursuant to this prospectus. We will keep this prospectus current until the expiration dates of the convertible warrants, even if the convertible warrants which underlie certain shares of our Common Stock subject to this prospectus are out of the money.

The selling security holders and any other persons participating in the sale or distribution of the shares offered under this prospectus will be subject to applicable provisions of the Exchange Act, and the rules and regulations under that act, including Regulation M. These provisions may restrict activities of, and limit the timing of purchases and sales of any of the shares by, the selling security holders or any other person. Furthermore, under Regulation M, persons engaged in a distribution of securities are prohibited from simultaneously engaging in market making and other activities with respect to those securities for a specified period of time prior to the commencement of such distributions, subject to specified exceptions or exemptions. All of these limitations may affect the marketability of the shares.

We will not receive any proceeds from sales of shares by the selling stockholders. However, if any of the selling stockholders decide to exercise their warrants, we will receive the net proceeds of the exercise of such security held by the selling stockholders. We intend to use any proceeds we receive from the exercise or conversion of warrants for working capital and other general corporate purposes. We cannot assure you that any of the warrants will ever be exercised or converted. To the extent that the warrants are exercised on a cashless basis, we will not receive any proceeds from the exercise of the warrants.

We will pay all expenses of registration incurred in connection with this offering (estimated to be \$68,262), but the selling stockholders will pay all of the selling commissions, brokerage fees and related expenses.

The selling stockholders and any broker-dealers or agents that participate with the selling stockholders in the distribution of any of the shares may be deemed to be “underwriters” within the meaning of the Securities Act, and any commissions received by them and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act.



**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION CONTAINED IN THIS PROSPECTUS**

This prospectus contains some forward-looking statements. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Forward-looking statements involve risks and uncertainties. Forward-looking statements include statements regarding, among other things, (a) our projected sales, profitability, and cash flows, (b) our growth strategies, (c) anticipated trends in our industries, (d) our future financing plans and (e) our anticipated needs for working capital. They are generally identifiable by use of the words “may,” “will,” “should,” “anticipate,” “estimate,” “plans,” “potential,” “projects,” “continuing,” “ongoing,” “expects,” “management believes,” “we believe,” “we intend” or the negative words or other variations on these words or comparable terminology. These statements may be found under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business,” as well as in this prospectus generally. In particular, these include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, the outcome of contingencies such as legal proceedings, and financial results.

Any or all of our forward-looking statements in this report may turn out to be inaccurate. They can be affected by inaccurate assumptions we might make or by known or unknown risks or uncertainties. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially as a result of various factors, including, without limitation, the risks outlined under “Risk Factors” and matters described in this prospectus generally. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur. You should not place undue reliance on these forward-looking statements.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to publicly update any forward-looking statements, whether as the result of new information, future events, or otherwise.

**Currency, exchange rate, and “China” and other references**

Unless otherwise noted, all currency figures in this filing are in U.S. dollars. References to “Yuan” or “RMB” are to the Chinese Yuan, which is also known as the *Renminbi*. According to the currency exchange website [www.xe.com](http://www.xe.com), on July 16, 2012, \$1.00 was equivalent to 6.38 Yuan.

References to “PRC” or “China” are to the People’s Republic of China.

Unless otherwise specified or required by context, references to “we,” “the Company”, “our” and “us” refer to China Internet Cafe Holdings Group, Inc.

References to the “Bulletin Board,” the “OTC Bulletin Board” is to the Over-the-Counter Bulletin Board, a securities quotation service, which is accessible at the website [www.otcbb.com](http://www.otcbb.com).

## **RISK FACTORS**

*An investment in our Common Stock involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information included in this report, before making an investment decision. If any of the following risks actually occurs, our business, financial condition or results of operations could suffer. In that case, the trading price of our Common Stock could decline, and you may lose all or part of your investment.*

### **RISKS RELATED TO OUR BUSINESS**

*Our limited operating history makes evaluating our business and prospects difficult.*

Our VIE, Junlong, was established in December 2003 and obtained the license to operate internet cafés in Shenzhen in 2005. Our limited operating history may not provide a meaningful basis for you to evaluate our business and prospects. Our business strategy has not been proven over time and we cannot be certain that we will be able to successfully expand our business.

Fluctuations in operating results or the failure of operating results to meet the expectations of public market analysts and investors may negatively impact the market price of our securities. Operating results may fluctuate in the future due to a variety of factors that could affect revenues or expenses in any particular quarter. Fluctuations in operating results could cause the value of our securities to decline. Investors should not rely on comparisons of results of operations as an indication of future performance. As a result of the factors listed below, it is possible that in future periods results of operations may be below the expectations of public market analysts and investors. This could cause the market price of our securities to decline. Factors that may affect our quarterly results include:

- vulnerability of our business to a general economic downturn in the PRC;
- changes in the laws of the PRC that affect our operations;
- competition from other similar service providers; and
- our ability to obtain necessary government certifications and/or licenses to conduct our business.

***We are dependent on our management team and the loss of any key member of that team could have a material adverse effect on our operations and financial condition.***

We attribute our success to the leadership and contributions of our managing team comprising executive directors and key executives, in particular, to our Chief Executive Officer and Chief Financial Officer, Dishan Guo and our Chief Technology Officer Zhenfan Li.

Our continued success is therefore dependent to a large extent on our ability to retain the services of these key management personnel. The loss of their services without timely and qualified replacement, will adversely affect our operations and hence, our revenue and profits.

***We have limited internal controls due to our lack of sufficient personnel with an appropriate level of technical accounting knowledge, experience, and training in the application of GAAP.***

During the year ended December 31, 2011, we lacked 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. Due to this lack of qualified personnel, there is a reasonable possibility that material misstatements of the financial statements including disclosures will not be prevented or detected on a timely basis.

***We have not obtained social insurance benefits for all of our employees and could incur administrative fines and penalties that could materially affect our financial condition and reputation.***

We have obtained social benefits coverage for employees who work at the headquarters of Junlong. For other employees, because of the high mobility of their work, they usually work on a probationary basis and will not enter into a long employment relationship with us. We are subject to administrative fines and penalties as a result of our failure to obtain social insurance for these employees. The amount of these fines and penalties, in the aggregate, may adversely affect our financial condition and our public image.

***Tightened regulations on internet cafés may adversely affect our operations and revenues.***

The PRC government has been tough on internet café regulations. In 2003, 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 \$7.32 million) for national café chains. On September 29, 2002, the State Council 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. The number of internet cafés in China was reduced after these regulations went effective.

If the PRC government decided to impose more stringent regulations on internet cafés and their operations, our business may be adversely affected and our revenues may decrease as a result.

***There may be reduced use of internet cafés with the increase in computer ownership and internet connections at home and any such reduction would negatively affect our financial performance.***

With the rapid economic development and growing disposable income, computer ownership and internet connections at home will gradually increase as the price for computer hardware, software and internet access decreases. The increase in computer ownership and internet connections at home may result in decreased demand for our services. Such decrease in demand may adversely affect our business and our revenues may decrease as a result.

***Negative media coverage of internet cafés may reduce the number of customers that visit our internet cafés and result in lower revenues.***

In the last few years there have been several negative stories in the media about internet cafés. A fatal fire in Beijing's Lanjisu Internet café in June 2002 raised nationwide concern about the country's burgeoning internet café business. In 2006, a report from the China National Children's Center, a government think-tank, said that 13 percent of the PRC's 18 million internet users under 18 were internet addicts. Responding to the problems associated with internet cafés, the PRC imposed more stringent laws and regulations on internet cafés. In 2007, fearful of soaring internet addiction and juvenile crime, the PRC banned the opening of new internet cafés for a year. Such negative media coverage may result in stricter government regulations and reduced number of customers.

***Interruption or failure of our own information technology and communications systems or those of third-party service providers we rely upon could impair our ability to effectively provide our services, which could damage our reputation and harm our operating results.***

Our ability to provide our services depends on the continuing operation of our information technology and communications systems. Any damage to or failure of our systems could interrupt our service. Service interruptions could reduce our revenues and profits, and damage our brand if our system is perceived to be unreliable. Our systems are vulnerable to damage or interruption as a result of terrorist attacks, wars, earthquakes, floods, fires, power loss, telecommunications failures, undetected errors or “bugs” in our software, and computer viruses.

Our servers are vulnerable to break-ins, sabotage and vandalism. The occurrence of a natural disaster or a closure of an Internet data center by a third-party provider without adequate notice could result in lengthy service interruptions.

The steps we take to increase the reliability and redundancy of our systems are expensive, reduce our operating margin and may not be successful in reducing the frequency or duration of service interruptions.

***Our business may be adversely affected by third-party software applications or practices that interfere with our receipt of information from, or provision of information to, our customers, which may impair our customers' experience.***

Our business may be adversely affected by third-party malicious or unintentional software applications that make changes to our computers and interfere with our services. These software applications may be difficult or impossible to remove or disable, may reinstall themselves and may circumvent other applications' efforts to block or remove them. The ability to provide a superior user experience is critical to our success. If we are unable to successfully combat third-party software applications that interfere with our products and services, our reputation may be harmed.

***The successful operation of our business depends upon the performance and reliability of the Internet infrastructure and fixed telecommunications networks in China.***

Our business depends on the performance and reliability of the Internet infrastructure in China. Almost all access to the Internet is maintained through state-owned telecommunication operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology (or its predecessor, the Ministry of Information Industry, before its formal establishment in 2008), or the MIIT. In addition, the national networks in China are connected to the Internet through international gateways controlled by the PRC government. These international gateways are the only channels through which a domestic user can connect to the Internet. We cannot assure you that a more sophisticated Internet infrastructure will be developed in China. We may not have access to alternative networks in the event of disruptions, failures or other problems with China's Internet infrastructure. In addition, the Internet infrastructure in China may not support the demands associated with continued growth in Internet usage.

Any unscheduled service interruption could damage our reputation and result in a decrease in our revenues. Furthermore, if the prices that we pay for telecommunications and Internet services rise significantly, our gross margins could be adversely affected.

***Concerns about the security of electronic commerce transactions and confidentiality of information on the Internet may reduce use of our internet cafes and impede our growth.***

A significant barrier to electronic commerce and communications over the Internet in general has been a public concern over security and privacy, including the transmission of confidential information. If these concerns are not adequately addressed, they may inhibit the growth of the Internet and other online services generally, especially as a means of conducting commercial transactions. If a well-publicized Internet breach of security were to occur, general Internet usage could decline, which could cause our operations to be adversely affected.

***Regulation and censorship of information disseminated over the Internet in China may adversely affect our business.***

The PRC government has adopted regulations governing Internet access and the distribution of news and other information over the Internet. Under these regulations, Internet content providers and Internet publishers are prohibited from posting or displaying over the Internet content that, among other things, violates PRC laws and regulations, impairs the national dignity of China, or is reactionary, obscene, superstitious, fraudulent or defamatory. Failure to comply with these requirements may result in the revocation of licenses to provide Internet content and other licenses and the closure of the concerned websites.



The Ministry of Public Security has the authority to order any local Internet service provider to block any Internet website at its sole discretion. From time to time, the Ministry of Public Security has stopped the dissemination over the Internet of information which it believes to be socially destabilizing. The State Secrecy Bureau is also authorized to block any website it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of State secrets in the dissemination of online information.

Such regulation and censorship could lead to a decrease in our customers' interest in utilizing our internet cafes which would cause our operations to be adversely affected.

***Intensified government regulation of Internet cafes could cause our operations to be adversely affected.***

The PRC government has tightened its regulation of Internet cafes in recent years. In particular, a large number of unlicensed Internet cafes have been closed. In addition, the PRC government has imposed higher capital and facility requirements for the establishment of Internet cafes. Furthermore, the PRC 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. In June 2002, the Ministry of Culture, together with other government authorities, issued a joint notice, and in February 2004, the State Administration for Industry and Commerce issued another notice, suspending the issuance of new Internet cafe licenses. In May 2007, the State Administration for Industry and Commerce reiterated its position not to register any new Internet cafes in 2007. In 2008 and 2009, the Ministry of Culture, the State Administration for Industry and Commerce and other relevant government authorities, individually or jointly, issued several notices that provide various ways to strengthen the regulation of Internet cafes, including investigating and punishing Internet cafes that accept minors, cracking down on Internet cafes without sufficient and valid licenses, limiting the total number of Internet cafes and approving Internet cafes within the planning made by relevant authorities, screening unlawful and adverse games and websites, and improving the coordination of regulation over Internet cafes and online games. Such intensified government regulation of Internet cafes and any additional government regulation that may arise in the future could adversely affect our operations by limiting the services currently provided by our cafes, which in turn could decrease our customer base or have similar negative effect on our operations.

***If we fail to successfully update our computer hardware, software, and systems to customer requirements or emerging industry standards, our business, prospects and financial results may be materially and adversely affected.***

To remain competitive, we must continue to update the computer hardware, software and systems in our internet cafes. The computer industry is characterized by rapid technological evolution, changes in user requirements and preferences, frequent introductions of new products and services embodying new technologies and the emergence of new industry standards and practices that could render our existing proprietary technologies and systems obsolete. If we are unable to adapt in a cost-effective and timely manner in response to changing market conditions or customer

requirements, whether for technical, legal, financial or other reasons, our business, prospects, financial condition and results of operations would be materially adversely affected.

***We may be unable to adequately safeguard our intellectual property or we may face claims that may be costly to resolve or that limit our ability to use such intellectual property in the future.***

Our business is reliant on our intellectual property. Our software SAFLASH is the result of our research and development efforts, which we believe to be proprietary and unique. However, we are unable to assure you that third parties will not assert infringement claims against us in respect of our intellectual property or that such claims will not be successful. It may be difficult for us to establish or protect our intellectual property against such third parties and we could incur substantial costs and diversion of management resources in defending any claims relating to proprietary rights. If any party succeeds in asserting a claim against us relating to the disputed intellectual property, we may need to obtain licenses to continue to use the same. We cannot assure you that we will be able to obtain these licenses on commercially reasonable terms, if at all. The failure to obtain the necessary licenses or other rights could cause our business results to suffer.

Further, we rely upon a combination of trade secrets, non-disclosure and other contractual agreements with our employees as well as limitation of access to and distribution of our intellectual property in our efforts to protect intellectual property. However, our efforts in this regard may be inadequate to deter misappropriation of our proprietary information or we may be unable to detect unauthorized use and take appropriate steps to enforce our rights. Policing unauthorized use of our intellectual property is difficult and there can be no assurance that the steps taken by us will prevent misappropriation of our intellectual property.

Where litigation is necessary to safeguard our intellectual property, or to determine the validity and scope of the proprietary rights of others, this could result in substantial costs and diversion of our resources and could have a material adverse effect on our business, financial condition, operating results or future prospects.

***We may not have sufficient insurance coverage and an interruption of our business or loss of a significant amount of property could have a material adverse effect on our financial condition and operations.***

We currently do not maintain any insurance policies against loss of key personnel and business interruption as well as product liability claims. If such events were to occur, our business, financial performance and financial position may be materially and adversely affected.

***Inability to maintain our competitiveness would adversely affect our financial performance.***

We operate in a competitive environment and face competition from existing competitors and new market entrants. Some of these existing competitors, especially the national chains of internet cafés have more resources than us and may provide better services to customers.

There is no assurance that we will be able to compete successfully in the future. Any failure by us to remain competitive would adversely affect our financial performance.

***We may be adversely affected by a significant or prolonged economic downturn in the level of consumer spending in the industries and markets served by our customers.***

We rely on the spending of our customers in our cafés for our revenues, which may in turn depend on the customers' level of disposable income, perceived future earning capabilities and willingness to spend. Any significant or

prolonged decline of the PRC economy or economy of such markets served by our customers will affect consumers' disposable income and consumer spending in these markets, and lead to a decrease in demand for consumer products.

To the extent that such decrease in demand for consumer products translates into a decline in the demand for internet café services, our performance will be adversely affected.

***Revocation of the license for operating internet café chain will adversely affect our business.***

We hold a license for operating a regional internet café chain in Shenzhen and each of our internet cafés obtains a license for the internet access services. These licenses are currently valid, and will continue to be valid within the term of the corresponding business licenses. These licenses do not need to be renewed unless there is change of information thereon. But the competent authorities are entitled to examine and reevaluate our internet cafés any time upon their initiatives or following orders of the higher-level authorities, and we must comply with the then prevailing standards and regulations which may change from time to time. Failure to comply with these changing standards and regulations could result in our licenses being revoked or suspended, which could have a material adverse effect on our operations. Furthermore, if escalating compliance costs associated with governmental standards and regulations restrict or prohibit any part of our operations, it may adversely affect our operations and profitability.

***We may be unable to effectively manage our expansion.***

We have identified several growth plans. These expansion plans may strain our financial resources. In addition, any significant growth into new markets may require an expansion of our employee base for managerial, operational, financial, and other purposes. During any growth, we may face problems related to our operational and financial systems and controls. We would also need to continue to expand, train and manage our employee base. Continued future growth will impose significant added responsibilities upon the members of management to identify, recruit, maintain, integrate, and motivate new employees.

If we are unable to successfully manage our expansion, we may encounter operational and financial difficulties which would in turn adversely affect our business and financial results.

***We may require additional funding for our growth plans, and such funding may result in a dilution of your investment.***

We attempted to estimate our funding requirements in order to implement our growth plans.

If the costs of implementing such plans should exceed these estimates significantly or if we come across opportunities to grow through expansion plans which cannot be predicted at this time, and our funds generated from our operations prove insufficient for such purposes, we may need to raise additional funds to meet these funding requirements.

These additional funds may be raised by issuing equity or debt securities or by borrowing from banks or other resources. We cannot assure you that we will be able to obtain any additional financing on terms that are acceptable to us, or at all. If we fail to obtain additional financing on terms that are acceptable to us, we will not be able to implement such plans fully. Such financing even if obtained, may be accompanied by conditions that limit our ability to pay dividends or require us to seek lenders' consent for payment of dividends, or restrict our freedom to operate our business by requiring lender's consent for certain corporate actions.

Further, if we raise additional funds by way of a rights offering or through the issuance of new shares, any shareholders who are unable or unwilling to participate in such an additional round of fund raising may suffer dilution in their investment.

***Our strategy to acquire companies may result in unsuitable acquisitions or failure to successfully integrate acquired companies, which could lead to reduced profitability.***

We intend to expand our business through acquisitions of companies or operations similar to our own. We may be unsuccessful in identifying suitable acquisition candidates, or may be unable to consummate a desired acquisition. To the extent any future acquisitions are completed, we may be unsuccessful in integrating acquired companies or their operations, or if integration is more difficult than anticipated, we may experience disruptions that could have a material adverse impact on future profitability. Some of the risks that may affect our ability to integrate, or realize any anticipated benefits from, acquisitions include:

- unexpected losses of key employees or customer of the acquired company;
- difficulties integrating the acquired company's standards, processes, procedures and controls;
- difficulties hiring additional management and other critical personnel;
- difficulties increasing the scope, geographic diversity and complexity of our operations;
- difficulties consolidating facilities, transferring processes and know-how;
- difficulties reducing costs of the acquired company's business; and
- diversion of management's attention from our management.

*We may be exposed to potential risks relating to our internal controls 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.

***Our holding company structure may limit the payment of dividends.***

We have no direct business operations, other than our ownership of our subsidiaries and contractual relationship with Junlong. Should we decide in the future to pay dividends, as a holding company, our ability to pay dividends and meet other obligations depends upon the receipt of dividends or other payments from our operating subsidiaries and other holdings and investments. In addition, our operating subsidiaries, from time to time, may be subject to restrictions on their ability to make distributions to us, including as a result of restrictive covenants in loan agreements, restrictions on the conversion of local currency into U.S. dollars or other hard currency and other regulatory restrictions as discussed below. If future dividends are paid in RMB, fluctuations in the exchange rate for the conversion of RMB into U.S. dollars may reduce the amount received by U.S. stockholders upon conversion of the dividend payment into U.S. dollars. Further, dividends paid to non-PRC stockholders may be subject to a 10% withholding, as further discussed in a later section. Under the EIT Law, we may be classified as a ‘resident enterprise’ of the PRC. Such classification will likely result in unfavorable tax consequences to us and our non-PRC shareholders.”

Relevant PRC statutory laws and regulation permit payments of dividends by the Company’s subsidiaries in the PRC only out of their accumulated profits, if any, as determined in accordance with the PRC accounting standards and regulations.

Our subsidiary in the PRC is also required to set aside a portion of its after tax profits according to PRC accounting standards and regulations to fund certain reserve funds. Currently, our subsidiary in the PRC is the only sources of revenues or investment holdings for the payment of dividends. If it does not accumulate sufficient profits under PRC accounting standards and regulations to first fund certain reserve funds as required by PRC accounting standards, we will be unable to pay any dividends.

As of December 31, 2011 and 2010, \$718,744 was appropriated from retained earnings and set aside for the statutory reserve by the Company’s subsidiaries in the PRC. As a result of these PRC laws and regulations, the Company’s subsidiaries in the PRC are restricted in their ability to transfer a portion of their net assets to either in the form of dividends, loans or advances, which consisted of paid-up capital and statutory reserves, amounting to \$2,214,999 as of December 31, 2011 and 2010.

**RISKS RELATING TO OUR COMMERCIAL RELATIONSHIP WITH JUNLONG**

***All of our revenues are generated through our VIE, and we rely on payments made by our VIE to Zhonghefangda, our subsidiary, pursuant to contractual arrangements to transfer any such revenues to Zhonghefangda. Any restriction on such payments and any increase in the amount of PRC taxes applicable to such payments may materially and adversely affect our business and our ability to pay dividends to our shareholders.***

We conduct substantially all of our operations through Junlong, our VIE, which generates all of our revenues. As Junlong is not owned by our subsidiary, it is not able to make dividend payments to our subsidiary. Instead, Zhonghefangda, our subsidiary in China, entered into a number of contracts with Junlong, including a Management and Consulting Services Agreement, an Equity Pledge Agreement, an Option Agreement and a Voting Rights Proxy Agreement, pursuant to which Junlong pays Zhonghefangda for certain services that Zhonghefangda provides to Junlong. However, depending on the nature of services provided, certain of these payments are subject to PRC taxes at different rates, including business taxes and VATs, which effectively reduce the amount that Zhonghefangda receives from Junlong. We cannot assure you that the PRC government will not impose restrictions on such payments or change the tax rates applicable to such payments. Any such restrictions on such payment or increases in the applicable tax rates may materially and adversely affect our ability to receive payments from Junlong or the amount of such payments, and may in turn materially and adversely affect our business, our net income and our ability to pay dividends to our shareholders.



***Dishan Guo, Jinzhou Zeng, and Xiaofen Wang's association with Junlong could pose a conflict of interest which may result in Junlong decisions that are adverse to our business.***

Dishan Guo, Jinzhou Zeng and Xiaofen Wang, who hold controlling interest in Classic Bond are also controlling shareholders of our VIE. Conflicts of interests between their dual roles as owners of both Junlong and our company may arise. We cannot assure you that when conflicts of interest arise, any or all of these individuals will act in the best interests of our company or that any conflict of interest will be resolved in our favor. In addition, these individuals may breach or cause Junlong to breach or refuse to renew the existing contractual arrangements, which will have a material adverse effect on our ability to effectively control Junlong and receive economic benefits from it. If we cannot resolve any conflicts of interest or disputes between us and the beneficial owners of Junlong, we would have to rely on legal proceedings, the outcome of which is uncertain and which could be disruptive to our business.

Messrs Guo, Zeng and Wang do not have a formalized dispute resolution agreement. However, it is anticipated that parties will resolve any conflict through mutual consultation and negotiations as is typical in China. Should such conflict endure, the parties will subject their dispute to be adjudicated before a court of competent jurisdiction in China. The Company does not have a policy pursuant to which its directors, such as Messrs. Guo, Zeng and Wang must resolve any conflict of interest that arise as a result of their ownership interests in or management of other companies, such as Classic Bond.

***If Junlong or the VIE Shareholders violate our contractual arrangements with it, our business could be disrupted and we may have to resort to litigation to enforce our rights which may be time consuming and expensive.***

Our operations are currently dependent upon our commercial relationship with Junlong. If Junlong or their shareholders are unwilling or unable to perform their obligations under our commercial arrangements with them, including payment of revenues under the Management and Consulting Service Agreement, we will not be able to conduct our operations in the manner currently planned.

***If the PRC government determines that the agreements establishing the structure for operating our China business do not comply with applicable PRC laws, rules and regulations, we could be subject to severe penalties including being prohibited from continuing our operations in the PRC.***

On August 8, 2006, six PRC regulatory agencies, including Ministry of Commerce (the “MOFCOM”), the China Securities Regulatory Commission (the “CSRC”), the State Asset Supervision and Administration Commission (the “SASAC”), the State Administration of Taxation (the “SAT”), the State Administration for Industry and Commerce (the “SAIC”) and the State Administration of Foreign Exchange (the “SAFE”), jointly adopted the *Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the M&A Rule* (the “M&A Rule”), which became

effective on September 8, 2006. This new regulation, among other things, governs the approval process by which a PRC company may participate in an acquisition of assets or equity interests. In the opinion of our PRC counsel, China Commercial Law Firm, this approval process was not required in our case because we have not acquired either the equity or assets of a company located in the PRC, and that the VIE agreements do not constitute such an acquisition. If the PRC government were to take a contrary view, we might be subject to fines or other enforcement action, and might be forced to amend or terminate our contractual arrangements with Junlong, which could have an adverse effect on our business.

***Uncertainties in the PRC legal system may impede our ability to enforce the commercial agreements that we have entered into with Junlong or any arbitral award thereunder and any inability to enforce these agreements could materially and adversely affect our business and operation.***

While disputes under the Consulting Agreement with Junlong are subject to binding arbitration before the China International Economic and Trade Arbitration Commission, or CIETAC, in accordance with CIETAC Arbitration Rules, the agreements are governed by PRC law and an arbitration award may be challenged in accordance with PRC law. For example, a claim that the enforcement of an award in our favor will be detrimental to the public interest, or that an issue does not fall within the scope of the arbitration would require us to engage in administrative and judicial proceedings to defend an award. PRC legal system is a civil law system based on written statutes and unlike common law systems, it is a system in which decided legal cases have little value as precedent. As a result, PRC administrative and judicial authorities have significant discretion in interpreting and implementing statutory and contractual terms, and it may be more difficult to evaluate the outcome of administrative and judicial proceedings and the level of legal protection available than in more developed legal systems. These uncertainties may impede our ability to enforce the terms of the Consulting Agreement and the other contracts that we may enter into with Junlong. Any inability to enforce the Consulting Agreement or an award thereunder could materially and adversely affect our business and operation.

***Our arrangements with Junlong and the VIE Shareholders may be subject to a transfer pricing adjustment by the PRC tax authorities which could have an adverse effect on our income and expenses.***

We could face material and adverse tax consequences if the PRC tax authorities determine that our contracts with Junlong and the VIE Shareholders were not entered into based on arm's length negotiations. If the PRC tax authorities determine that these contracts were not entered into on an arm's length basis, they may adjust our income and expenses for PRC tax purposes in the form of a transfer pricing adjustment. Such an adjustment may require that we pay additional PRC taxes plus applicable penalties and interest, if any.

## **RISKS RELATED TO DOING BUSINESS IN THE PRC**

***New labor law in the PRC may adversely affect our results of operations.***

On June 29, 2007, the National People's Congress promulgated the Labor Contract Law of PRC, or the Labor Law, which became effective as of January 1, 2008. On September 18, 2008, the PRC State Council issued the PRC Labor Contract Law Implementation Rules, which became effective as of the date of issuance. The Labor Law and its implementation rules are intended to give employees long-term job security by, among other things, requiring employers to enter into written contracts with their employees and restricting the use of temporary workers. The Labor Law and its implementation rules impose greater liabilities on employers, require certain terminations to be based upon seniority rather than merit and significantly affect the cost of an employer's decision to reduce its workforce. Employment contracts lawfully entered into prior to the implementation of the Labor Law and continuing after the date of its implementation remain legally binding and the parties to such contracts are required to continue to perform their respective obligations thereunder. However, employment relationships established prior to the implementation of the Labor Law without a written employment agreement were required to be memorialized by a written employment agreement that satisfies the requirements of the Labor Law within one month after it became effective on January 1, 2008. In the event we decide to significantly change or decrease our workforce, the New Labor Contract Law could adversely affect our ability to enact such changes in a manner that is most advantageous to our business or in a timely and cost effective manner, thus materially and adversely affecting our financial condition and results of operations.

***We may be exposed to liabilities under the Foreign Corrupt Practices Act and Chinese anti-corruption law, and any determination that we violated such laws could hurt our business.***

We are subject to the Foreign Corrupt Practice Act, or FCPA, and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by U.S. persons and issuers as defined by the statute for the purpose of obtaining or retaining business. We are also subject to Chinese anti-corruption laws, which strictly prohibit bribery. We have operations, agreements with third parties and make sales

in the PRC, which may experience corruption. Our activities in the PRC create the risk of unauthorized payments or offers of payments by one of the employees, consultants, sales agents or distributors of our Company, even though these parties are not always subject to our control. It is our policy to implement safeguards to discourage these practices by our employees. However, our existing safeguards and any future improvements may prove to be less than effective, and our employees, consultants, sales agents or distributors may engage in conduct for which we might be held responsible. Violations of the FCPA or Chinese anti-corruption law may result in severe criminal or civil sanctions, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition. In addition, the United States government may seek to hold us liable for successor liability FCPA violations committed by companies in which we invest or that we acquire.

***Changes in PRC political or economic situation could harm us and our operating results.***

Some of the changes in PRC political or economic situation that could harm us and our operating results are the:

- level of government involvement in the economy;
  - control of foreign exchange;
  - methods of allocating resources;
  - balance of payments position;
  
- international trade restrictions; and
  - international conflict.

The PRC economy differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development, or OECD, in many ways. For example, state-owned enterprises still constitute a large portion of the PRC economy and weak corporate governance and a lack of flexible currency exchange policy still prevail in the PRC. As a result of these differences, we may not develop in the same way or at the same rate as might be expected if the PRC economy was similar to those of the OECD member countries.

***Our business is largely subject to the uncertain legal environment in China and your legal protection could be limited.***

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which precedents set in earlier legal cases are not generally used. The overall effect of legislation enacted over the past 20 years has been to enhance the legal protections afforded to foreign invested enterprises in the PRC. However, these laws, regulations and legal requirements are relatively recent and are evolving rapidly, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to foreign investors, such as the right of foreign invested enterprises to hold licenses and permits such as requisite business licenses. In addition, all of our executive officers and our directors are residents of the PRC and not of the U.S., and substantially all the assets of these persons are located outside the U.S. As a result, it could be difficult for investors to effect service of process in the U.S., or to enforce a judgment obtained in the U.S. against our PRC operations and our controlled VIE.

***The PRC government exerts substantial influence over the manner in which we must conduct our business activities.***

The PRC only recently has permitted provincial and local economic autonomy and private economic activities. The PRC government has exercised and continues to exercise substantial control over virtually every sector of the PRC economy through regulation and state ownership. Our ability to operate in the PRC may be harmed by changes in its laws and regulations, including those relating to taxation, import and export tariffs, environmental regulations, land use rights, property and other matters. We believe that our operations in the PRC are in material compliance with all applicable legal and regulatory requirements. However, the central or local governments of the jurisdictions in which we operate may impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures and efforts on our part to ensure our compliance with such regulations or interpretations.

Accordingly, government actions in the future, including any decision not to continue to support recent economic reforms and to return to a more centrally planned economy or regional or local variations in the implementation of economic policies, could have a significant effect on economic conditions in the PRC or particular regions thereof, and could require us to divest ourselves of any interest we then hold in PRC properties or joint ventures.

***Future inflation in the PRC may inhibit our ability to conduct business in the PRC.***

In recent years, the PRC economy has experienced periods of rapid expansion and highly fluctuating rates of inflation. During the past ten years, the rate of inflation in the PRC has been as high as 20.7% and as low as -2.2%. These factors have led to the adoption by the PRC government, from time to time, of various corrective measures designed to restrict the availability of credit or regulate growth and contain inflation. High inflation may in the future cause the PRC government to impose controls on credit and/or prices, or to take other action, which could inhibit economic activity in the PRC, and thereby harm the market for our products and our company.

***Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.***

The majority of our revenues will be settled in Renminbi and any future restrictions on currency exchanges may limit our ability to use revenue generated in Renminbi to fund any future business activities outside the PRC or to make dividend or other payments in U.S. dollars. Current significant currency exchange restrictions include the restriction that foreign-invested enterprises may only buy, sell or remit foreign currencies after providing valid commercial documents, at those banks in the PRC authorized to conduct foreign exchange business. In addition, conversion of Renminbi for capital account items, including direct investment and loans, is subject to governmental approval in the PRC, and companies are required to open and maintain separate foreign exchange accounts for capital account items. We cannot be certain that the PRC regulatory authorities will not impose more stringent restrictions on the convertibility of the Renminbi.

***Failure to comply with PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident stockholders to personal liability, limit our ability to acquire PRC companies or to inject capital into our PRC controlled VIEs, limit our PRC controlled VIEs' ability to distribute profits to us or otherwise materially adversely affect us.***

On October 21, 2005, the State Administration for Foreign Exchange of the PRC (“SAFE”) issued a *Circular on Relevant Issues Concerning Foreign Exchange Administration on the Financing and Return Investment by Chinese Domestic Residents through Overseas Special Purpose Companies* (“**Circular 75**”), which became effective on November 1, 2005. Circular 75 and its relevant implementing rules issued thereafter regulate the foreign exchange matters in relation to the use of a “special purpose vehicle” by PRC residents to seek offshore equity financing and conduct “round trip investment” in China. Under Circular 75, a ‘special purpose vehicle’ or ‘SPV’ refers to an offshore entity established or controlled, directly or indirectly, by PRC residents or PRC entities for the purpose of seeking offshore equity financing using assets or interests owned by such PRC residents or PRC entities in onshore companies, while “round trip investment” refers to the direct investment in China by PRC residents through the “SPV”, including without limitation establishing foreign invested enterprises and using such foreign invested enterprises to purchase or control (by way of contractual arrangements) onshore assets. Pursuant to Circular 75, (i) a PRC resident shall register with a local branch of the SAFE before he or she establishes or controls an overseas SPV, for the purpose of overseas equity financing (including convertible debt financing); (ii) when a PRC resident contributes the assets of or his or her equity interests in a domestic enterprise to an SPV, or engages in overseas financing after contributing assets or equity interests to an SPV, such PRC resident must register his or her interest in the SPV and any subsequent changes in such interest with a local branch of the SAFE; and (iii) when the SPV undergoes a material change outside of China, such as a change in share capital or merger or acquisition, the PRC resident shall, within 30 days from the occurrence of the event that triggers the change, register such change with a local branch of the SAFE. In addition, the PRC subsidiary of the offshore SPV are prohibited from distributing their profits and proceeds from any reduction in capital, share transfer or liquidation to their offshore special purpose vehicle parent companies if the SPV shareholders who are PRC residents have not completed foreign exchange registration pursuant to Circular 75. If any PRC resident stockholder of a SPV fails to make the required SAFE registration and amended registration, the onshore PRC subsidiaries of that offshore company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to the offshore entity. Failure to comply with the SAFE registration and amendment requirements described above could result in liability under PRC laws for evasion of

applicable foreign exchange restrictions.

Our current shareholders, who are PRC residents as defined in Circular 75, (the “**PRC** Shareholders”) have not completed the necessary registrations as required under Circular 75. We have already asked our PRC Shareholders to make up the necessary applications and registrations as required under Circular 75 and related regulations, and our PRC Shareholders have agreed to do so immediately. However, we cannot assure you that our PRC Shareholders will be able to make up the necessary approval and registration procedures required by the Circular 75 and related regulations. Failure by the PRC Shareholders to register as required with the relevant local branch of SAFE could subject them to fines and legal sanctions and may also limit our ability to contribute additional capital into or provide loans to (including using the proceeds from this offering) our PRC subsidiary, limit our PRC subsidiary’s ability to pay dividends or otherwise distribute profits to us, or otherwise adversely affect us.



*The approval of the China Securities Regulatory Commission, or the CSRC, may be required in connection with this offering under PRC regulations. The regulation also establishes more complex procedures for acquisitions conducted by foreign investors that could make it more difficult for us to grow through acquisitions.*

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the *Regulation on Mergers and Acquisitions of Domestic Companies by Foreign Investors*, which became effective on September 8, 2006 (the “**M&A Rules**”). The M&A Rules requires offshore special purpose vehicles that are controlled by PRC companies or residents and that have been formed for the purpose of seeking a public listing on an overseas stock exchange through acquisitions of PRC domestic companies or assets to obtain CSRC approval prior to publicly listing their securities on an overseas stock exchange. On September 21, 2006, the CSRC published a notice on its website specifying the documents and materials that special purpose vehicles are required to submit when seeking CSRC approval for their listings outside of China. The interpretation and application of the M&A Rules remain unclear, and this offering may ultimately require approval from the CSRC, and if it does, it is uncertain how long it will take us to obtain the approval. If CSRC approval is required for this offering, our failure to obtain or delay in obtaining the CSRC approval for this offering would subject us to sanctions imposed by the CSRC and other PRC regulatory agencies, which could include fines and penalties on our operations in China, restrictions or limitations on our ability to pay dividends outside of China, and other forms of sanctions that may materially and adversely affect our business, results of operations and financial condition. The CSRC or other PRC regulatory agencies may also take actions requiring us, or making it advisable for us, to halt this offering before settlement and delivery of the offering.

Our PRC counsel, China Commercial Law Firm, has advised us that, based on their understanding of the current PRC laws, regulations and rules and the procedures announced on September 21, 2006, because (i) we established our PRC subsidiary by means of direct investment other than by merger or acquisition of the equity or assets of Junlong, and (ii) our VIE between our PRC subsidiary and Junlong does not constitute the acquisition of our PRC subsidiary, we are not required to apply with the CSRC for the approval of the listing and offering on the OTCBB market.

The M&A Rules also established additional procedures and requirements that are expected to make merger and acquisition activities in China by foreign investors more time-consuming and complex, including requirements in some instances that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise, or that the approval from the MOFCOM be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire affiliated domestic companies. We may grow our business in part by acquiring other companies operating in our industry. Complying with the requirements of the M&A Rules to complete such transactions could be time-consuming, and any required approval processes, including approval from Ministry of Commerce, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

The M&A Rules, along with foreign exchange regulations discussed in the above subsection, will be interpreted or implemented by the relevant government authorities in connection with our future offshore financings or acquisitions, and we cannot predict how they will affect our business development strategy.

***Under the EIT Law, we may be classified as a “resident enterprise” of China. Such classification will likely result in unfavorable tax consequences to us and our non-PRC shareholders.***

Under the new PRC Enterprise Income Tax Law, or the EIT Law, and its implementing rules, both of which became effective on January 1, 2008, an enterprise established outside of the PRC with “de facto management bodies” within the PRC is considered a “resident enterprise,” meaning that it can be treated in a manner similar to a PRC enterprise for enterprise income tax purposes. The implementing rules of the EIT Law define de facto management as “substantial and overall management and control over the production and operations, personnel, accounting, and properties” of the enterprise.

On April 22, 2009, the State Administration of Taxation issued the Notice Concerning Relevant Issues Regarding Cognizance of Chinese Investment Controlled Enterprises Incorporated Offshore as Resident Enterprises pursuant to Criteria of de facto Management Bodies, or the Notice, further interpreting the application of the EIT Law and its implementation non-PRC enterprise or group controlled offshore entities. Pursuant to the Notice, an enterprise incorporated in an offshore jurisdiction and controlled by a PRC enterprise or group will be classified as a “non-domestically incorporated resident enterprise” if (i) its senior management in charge of daily operation reside or perform their duties mainly in the PRC; (ii) its financial or personnel decisions are made or approved by bodies or persons in the PRC; (iii) its substantial properties, accounting books, corporate chops, board and shareholder minutes are kept in the PRC; and (iv) half of the directors with voting rights or senior management often resident in the PRC. Such resident enterprise would be subject to an enterprise income tax rate of 25% on its worldwide income and must pay a withholding tax at a rate of 10% when paying dividends to its non-PRC shareholders. However, it remains unclear as to whether the Notice is applicable to an offshore enterprise incorporated by a PRC natural person. Nor are detailed measures on imposition of tax from non-domestically incorporated resident enterprises available. Therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

However, as our case substantially meets the foregoing criteria, there is a likelihood that we are deemed to be a resident enterprise by PRC tax authorities. If the PRC tax authorities determine that we are a “resident enterprise” for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to the enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that income such as interest on financing proceeds and non-PRC source income would be subject to PRC enterprise income tax at a rate of 25%. Second, although under the EIT Law and its implementing rules dividends paid to us from our PRC subsidiaries would qualify as “tax-exempt income,” we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as resident enterprises for PRC enterprise income tax purposes. Finally, it is possible that future guidance issued with respect to the new “resident enterprise” classification could result in a situation in which a 10% withholding tax is imposed on dividends we pay to our non-PRC shareholders and with respect to gains derived by our non-PRC shareholders from transferring our shares. We are actively monitoring the possibility of “resident enterprise” treatment for the 2010 tax year and are evaluating appropriate organizational changes to avoid this treatment, to the extent possible.

If we were treated as a “resident enterprise” by PRC tax authorities, we would be subject to taxation in both the U.S. and the PRC, and our PRC tax may not be creditable against our U.S. tax.

***The value of our securities will be affected by the currency exchange rate between U.S. dollars and RMB.***

The value of our Common Stock will be affected by the foreign exchange rate between U.S. dollars and RMB, and between those currencies and other currencies in which our sales may be denominated. For example, if we need to convert U.S. dollars into RMB for our operational needs and the RMB appreciates against the U.S. dollar at that time, our financial position, our business, and the price of our Common Stock may be harmed. Conversely, if we decide to

convert our RMB into U.S. dollars for the purpose of declaring dividends on our Common Stock or for other business purposes and the U.S. dollar appreciates against the RMB, the U.S. dollar equivalent of our earnings from our subsidiaries in the PRC would be reduced.

## **RISKS RELATED TO THE MARKET FOR OUR STOCK**

*Our Common Stock is quoted on the OTC Bulletin Board which may have an unfavorable impact on our stock price and liquidity.*

Our Common Stock is quoted on the OTC Bulletin Board. The OTC Bulletin Board is a significantly more limited market than the New York Stock Exchange or NASDAQ stock markets. The quotation of our shares on the OTC Bulletin Board means there is a less liquid market available for existing and potential stockholders to trade shares of our Common Stock. The limited liquidity could depress the trading price of our Common Stock and could have a long-term adverse impact on our ability to raise capital in the future.

***You may have difficulty trading and obtaining quotations for our Common Stock.***

Our Common Stock does not trade, and the bid and asked prices for our Common Stock on the OTC Bulletin Board may fluctuate widely in the future. As a result, investors may find it difficult to dispose of, or to obtain accurate quotations of the price of, our securities. This severely limits the liquidity of the Common Stock, and would likely reduce the market price of our Common Stock and hamper our ability to raise additional capital.

***The market price of our Common Stock is likely to be highly volatile and subject to wide fluctuations.***

Dramatic fluctuations in the price of our Common Stock may make it difficult to sell our Common Stock. The market price of our Common Stock is likely to be highly volatile and could be subject to wide fluctuations in response to a number of factors that are beyond our control, including:

- dilution caused by our issuance of additional shares of Common Stock and other forms of equity securities, which we expect to make in the Offering and in connection with future capital financings to fund our operations and growth, to attract and retain valuable personnel and in connection with future strategic partnerships with other companies;
- variations in our quarterly operating results;
- announcements that our revenue or income are below or that costs or losses are greater than analysts' expectations;
- the general economic slowdown;
- sales of large blocks of our Common Stock;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments; and
- fluctuations in stock market prices and volumes;

These and other factors are largely beyond our control, and the impact of these risks, singly or in the aggregate, may result in material adverse changes to the market price of our Common Stock and/or our results of operations and financial condition.

***We do not expect to pay cash dividends on our Common Stock in the future.***

We have paid no cash dividends on our Common Stock in the past and do not intend to pay any cash dividends on our Common Stock in the foreseeable future. We anticipate that we will reinvest profits from our operations, if any, into our business. We cannot assure you that we will ever pay cash dividends to holders of our Common Stock. Therefore, investors will not receive any funds unless they sell their Common Stock, and stockholders may be unable to sell their shares on favorable terms or at all. Investors cannot be assured of a positive return on investment or that they will not

lose the entire amount of their investment in the Common Stock.

***You may be diluted if we issue additional equity securities.***

We anticipate issuing additional equity securities in the future. There can be no assurance that the pricing of any such additional securities will not be lower than the price at which you purchased your securities in this Offering. If and when we issue additional securities, it is possible that your percentage interest in us will be diluted further.

***We are subject to penny stock regulations and restrictions.***

The SEC has adopted regulations which generally define so-called “penny stocks” to be an equity security that has a market price less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exemptions. If our Common Stock becomes a “penny stock,” we may become subject to Rule 15g-9 under the Exchange Act, or the Penny Stock Rule. This rule imposes additional sales practice requirements on broker-dealers that sell such securities to persons other than established customers and “accredited investors” (generally, individuals with a net worth in excess of \$1,000,000 or annual incomes exceeding \$200,000, or \$300,000 together with their spouses). For transactions covered by Rule 15g-9, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to sale. As a result, this rule may affect the ability of broker-dealers to sell our securities and may affect the ability of purchasers to sell any of our securities in the secondary market.

For any transaction involving a penny stock, unless exempt, the rules require delivery, prior to any transaction in a penny stock, of a disclosure schedule prepared by the SEC relating to the penny stock market. Disclosure is also required to be made about sales commissions payable to both the broker-dealer and the registered representative and current quotations for the securities. Finally, monthly statements are required to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stock.

There can be no assurance that our Common Stock will qualify for exemption from the Penny Stock Rule. In any event, even if our Common Stock were exempt from the Penny Stock Rule, we would remain subject to Section 15(b)(6) of the Exchange Act, which gives the SEC the authority to restrict any person from participating in a distribution of penny stock, if the SEC finds that such a restriction would be in the public interest.

***Compliance with changing regulation of corporate governance and public disclosure will result in additional expenses.***

Changing laws, regulations and standards relating to corporate governance and public disclosure, including SOX and related SEC regulations, have created uncertainty for public companies and significantly increased the costs and risks associated with accessing the public markets and public reporting. Our management team will need to invest significant management time and financial resources to comply with both existing and evolving standards for public companies, which will lead to increased general and administrative expenses and a diversion of management time and attention from revenue generating activities to compliance activities.

***Certain provisions of our Articles of Incorporation may make it more difficult for a third party to effect a change-in-control.***

Our Articles of Incorporation authorizes the Board of Directors to issue up to 50 million shares of preferred stock. The preferred stock may be issued in one or more series, the terms of which may be determined at the time of issuance by the Board of Directors without further action by the stockholders. These terms may include voting rights including the right to vote as a series on particular matters, preferences as to dividends and liquidation, conversion rights and redemption rights provisions. The issuance of any preferred stock could diminish the rights of holders of our Common Stock, and therefore could reduce the value of such Common Stock. In addition, specific rights granted to future holders of preferred stock could be used to restrict our ability to merge with, or sell assets to, a third party. The ability of the Board of Directors to issue preferred stock could make it more difficult, delay, discourage, prevent or make it more costly to acquire or effect a change-in-control, which in turn could prevent the stockholders from recognizing a gain in the event that a favorable offer is extended and could materially and negatively affect the market price of our Common Stock.

## **USE OF PROCEEDS**

We will not receive any of the proceeds from any sales of the shares offered for sale and sold under this prospectus by the selling stockholders. To the extent the warrants are exercised for cash, we will receive the exercise price for those warrants. We intend to use the proceeds from the exercise of the warrants for working capital and other general corporate purposes. We cannot assure you that any of the warrants will ever be exercised or exercised for cash, if at all. To the extent that the warrants are exercised on a cashless basis, we will not receive any proceeds from the exercise of the warrants.

## **DILUTION**

Not applicable. We are not offering any shares in this registration statement. All shares are being registered on behalf of our selling shareholders.



## SELLING SHAREHOLDERS

The securities being offered hereunder are being offered by the selling shareholders listed below or their respective transferees, pledgees, donees or successors. Each selling shareholder may from time to time offer and sell any or all of such selling shareholder's shares that are registered under this prospectus. For purposes of the selling shareholder table below, we are assuming the sale of all of the shares being registered. The dollar value of the shares being registered as of July 16, 2012 was \$ 1,728,879.88, which is approximately 27% of the \$6,412,054 raised in the Offering.

All expenses incurred with respect to the registration of the Common Stock covered by this prospectus will be borne by us, but we will not be obligated to pay any underwriting fees, discounts, commissions or other expenses incurred by any selling shareholder in connection with the sale of shares.

None of the selling shareholders has been an officer or director of the Company or any of its predecessors or affiliates within the last three years, nor has any selling shareholder had a material relationship with the Company.

None of the selling shareholders is a broker dealer or an affiliate of a broker dealer. None of the selling shareholders have any agreement or understanding to distribute any of the shares being registered.

Besides the securities held by the account of Stephen S. Taylor Roth IRA c/o First Clearing, LLC and the Taylor International Fund, Ltd., over which Steven Taylor exercises the voting and dispositive power, there are no relationships among the selling shareholders other than the relationships identified below.

The following table sets forth, with respect to the selling shareholders (i) the number of shares of Common Stock beneficially owned as of July 16, 2012 and prior to the offering contemplated hereby, (ii) the maximum number of shares of Common Stock which may be sold by the selling shareholders under this prospectus, and (iii) the number of shares of Common Stock which will be owned after the offering by the selling shareholders. All shareholders listed below are eligible to sell their shares. The percentage ownerships set forth below are based on 21,361,534 shares of Common Stock outstanding as of the date of this prospectus.

Name of Shareholder	Total Number of Shares of Currently Outstanding Common Stock Held Prior to Offering	Number of Shares of Common Stock Beneficially Owned and Offered Pursuant to this Prospectus	Number of Shares of Common Stock Underlying the Preferred Shares and Warrants Held and Offered Pursuant to the Prospectus	Shares Beneficially Owned Before Offering (Percentage) (1)(2)	Shares Beneficially Owned After the Offering (Number) (1)	Shares Beneficially Owned After the Offering (Percentage) (1)(2)	Acquisition Price per Share
BBS Capital Fund, LP (3)	29,961	280,000	260,000	1.34 %	29,961	0.13 %	\$ 1.35
Dennis Jason Wong, Sole Trustee of the Dennis and Shannon Wong Family Trust (4)	25,467	238,000	221,000	1.14 %	25,467	0.11 %	\$ 1.35
DSEA Wong Foundation (5)	14,980	140,000	130,000	0.67 %	14,980	0.06 %	\$ 1.35
SPI Hawaii Investments, LP (6)	34,456	322,000	299,000	1.54 %	34,456	0.15 %	\$ 1.35
Greg Freihofner	7,490	70,000	65,000	0.34 %	7,490	0.03 %	\$ 1.35
Steven Cooley Smith	5,617	52,500	48,750	0.25 %	5,617	0.02 %	\$ 1.35
Gary Reed Hawkins	18,397	171,920	159,640	0.83 %	18,397	0.08 %	\$ 1.35
Daybreak Special Situations Master Fund (7)	4,494	42,000	39,000	0.20 %	4,494	0.02 %	\$ 1.35
Robert Lee Moody, Jr.	14,980	140,000	130,000	0.67 %	14,980	0.06 %	\$ 1.35
Haus Capital Fund, LLP (8)	7,490	70,000	65,000	0.34 %	7,490	0.03 %	\$ 1.35
Silver Rock II, Ltd (9)	22,471	210,000	195,000	1.01 %	22,471	0.10 %	\$ 1.35
MKM Opportunity Master Fund, Ltd (10)	11,984	112,000	104,000	0.54 %	11,984	0.05 %	\$ 1.35
Lennox Capital Partners, LP (11)	55,430	518,000	481,000	2.46 %	55,430	0.24 %	\$ 1.35
Squires Family LP (12)	20,974	196,000	182,000	0.94 %	20,974	0.09 %	\$ 1.35
	11,236	105,000	97,500	0.51 %	11,236	0.05 %	\$ 1.35

## Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Rushlade Investments Ltd (13)									
Cranshire Capital, LP (14)	11,085	103,600	96,200	0.50	%	11,085	0.05	%	\$ 1.35
John Charles Kleinert	1,497	14,000	13,000	0.07	%	1,497	0.01	%	\$ 1.35
Venturetek, L.P. (15)	19,476	182,000	169,000	0.88	%	19,476	0.08	%	\$ 1.35
Stephen S. Taylor Roth IRA c/o First Clearing, LLC (16)	55,430	518,000	481,000	2.46	%	55,430	0.24	%	\$ 1.35
Taylor International Fund, Ltd (17)	167,786	1,568,000	1,456,000	7.12	%	167,786	0.73	%	\$ 1.35
Blue Earth Fund, LP (18)	2,996	28,000	26,000	0.14	%	2,996	0.01	%	\$ 1.35
Paul Hickey	1,497	14,000	13,000	0.07	%	1,497	0.01	%	\$ 1.35
Joseph J Amiel Money Purchase Plan (19)	2,772	25,900	24,050	0.13	%	2,772	0.01	%	\$ 1.35
Dynacap Global Capital Fund II LP (20)	5,993	56,000	52,000	0.27	%	5,993	0.03	%	\$ 1.35
John David Bell	4,494	42,000	39,000	0.20	%	4,494	0.02	%	\$ 1.35
Kari Ekholm	2,996	28,000	26,000	0.14	%	2,996	0.01	%	\$ 1.35
Tommy Dilling	1,686	15,750	14,625	0.08	%	1,686	0.01	%	\$ 1.35
Peter Ekberg	1,686	15,750	14,625	0.08	%	1,686	0.01	%	\$ 1.35
Kristian Stensjo and Pernilla Stensjo Enebybergs	2,247	21,000	19,500	0.10	%	2,247	0.01	%	\$ 1.35
Revisionsbyra AB (21)	8,389	78,400	72,800	0.38	%	8,389	0.04	%	\$ 1.35
Minti Global Investment 2KB (22)	22,192	207,396	192,582	1.00	%	22,192	0.10	%	\$ 1.35
P.J. Levay Lawrence	10,787	100,800	93,600	0.49	%	10,787	0.05	%	\$ 1.35
P.K. Solutions AB (23)	11,123	103,950	96,525	0.50	%	11,123	0.05	%	\$ 1.35
Heinrich H Foerster	2,396	22,400	20,800	0.11	%	2,396	0.01	%	\$ 1.35
Jesper Kronborg	2,247	21,000	19,500	0.10	%	2,247	0.01	%	\$ 1.35
Garolf AB (24)	16,666	155,750	144,625	0.75	%	16,666	0.07	%	\$ 1.35
Peter Gustafsson	5,550	51,870	48,165	0.25	%	5,550	0.02	%	\$ 1.35
Ferghal O'Regan	16,778	156,800	145,600	0.75	%	16,778	0.07	%	\$ 1.35
David Sandgren	7,768	72,590	67,405	0.35	%	7,768	0.03	%	\$ 1.35
Niklas Flisberg	11,085	103,600	96,200	0.50	%	11,085	0.05	%	\$ 1.35
Robin Whaite	9,737	91,000	84,500	0.44	%	9,737	0.04	%	\$ 1.35

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Herbert Verse	3,221	30,100	27,950	0.15	%	3,221	0.01	%	\$ 1.35
Olive or Twist Limited (25)	4,993	46,662	43,329	0.23	%	4,993	0.02	%	\$ 1.35
ULF Sorvik	5,543	51,800	48,100	0.25	%	5,543	0.02	%	\$ 1.35
Hans Waren	4,494	42,000	39,000	0.20	%	4,494	0.02	%	\$ 1.35
Paul Maas	1,497	14,000	13,000	0.07	%	1,497	0.01	%	\$ 1.35
Total	711,534	6,649,538	6,773,029	31.51	%	711,534	3.08	%	

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. Each listed selling stockholder has the sole investment and voting power with respect to all shares of Common Stock shown as beneficially owned by such selling stockholder, except as otherwise indicated in the footnotes to the table.

(2) As of July 16, 2012, there were 21,361,534 shares of our Common Stock issued and outstanding. In determining the percent of Common Stock beneficially owned by a selling shareholder as of July 16, 2012, (a) the numerator is the number of shares of Common Stock beneficially owned by such selling shareholder (including the shares that he has the right to acquire within 60 days of July 16, 2012, and (b) the denominator is the sum of (i) the 21,361,534 shares of Common Stock outstanding on July 16, 2012 and (ii) the number of shares of Common Stock which such selling shareholder has the right to acquire within 60 days of July 16, 2012 .

(3) Berke Bakay has the voting and dispositive power over the securities held for the account of this selling stockholder.

(4) Dennis Jason Wong has the voting and dispositive power over the securities held for the account of this selling stockholder.

(5) Dennis Jason Wong has the voting and dispositive power over the securities held for the account of this selling stockholder.

(6) Dennis Jason Wong has the voting and dispositive power over the securities held for the account of this selling stockholder.

(7) Larry Butz and John Prinz have voting and dispositive power over the securities held for the account of this selling stockholder.

(8) William Haus has the voting and dispositive power over the securities held for the account of this selling stockholder.

(9) Ezzat Jallad has the voting and dispositive power over the securities held for the account of this selling stockholder.

(10) David Skriloff has the voting and dispositive power over the securities held for the account of this selling stockholder.

- (11) Richard Squires has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (12) Richard Squires has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (13) Anthony Heller has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (14) Keith Goodman has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (15) David Selengut and Dov Perlisky have the voting and dispositive power over the securities held for the account of this selling stockholder.

(16) Steven S. Taylor has the voting and dispositive power over the securities held for the account of this selling stockholder. Steven S. Taylor also has the voting and dispositive power over the securities held for the account of the Stephen S. Taylor Roth IRA c/o First Clearing, LLC.

(17) Steven S. Taylor has the voting and dispositive power over the securities held for the account of this selling stockholder. Steven S. Taylor also has the voting and dispositive power over the securities held for the account of the Taylor International Fund, Ltd.

- (18) Brett Conrad has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (19) Joseph Amiel has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (20) Charles Smith has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (21) Lars Svantemark has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (22) Ulf Ivarsson has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (23) Peter Gustafsson has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (24) Tommy Maartensson has the voting and dispositive power over the securities held for the account of this selling stockholder.
- (25) Joel Wahlstrom has the voting and dispositive power over the securities held for the account of this selling stockholder.

We are not aware of any selling shareholder maintaining a short position on our Common Stock.

Other than as shareholders of the Company and as parties to the various agreement set out in the “**Recent Sales of Unregistered Securities**” section below, we do not have any other relationships and arrangements with the selling shareholders.

## **PLAN OF DISTRIBUTION**

The selling shareholders may sell the Common Stock offered by this prospectus directly or through brokers or dealers who may act solely as agents or may acquire Common Stock as principals. Such sales may be made at prevailing market prices, at prices related to such prevailing market prices, or at variable prices negotiated between the sellers and purchasers. The selling shareholders may distribute the Common Stock in one or more of the following methods:

• ordinary brokers transactions, which may include long or short sales through the facilities of the OTC Bulletin Board (if a market maker successfully applies for inclusion of our Common Stock in such market) or other market;

• privately negotiated transactions;

• transactions involving cross or block trades or otherwise on the open market;

• sales “at the market” to or through market makers or into an existing market for the Common Stock;

• sales in other ways not involving market makers or established trading markets, including direct sales to purchasers or sales made through agents;

• through transactions in puts, calls, options, swaps or other derivatives (whether exchange listed or otherwise); or

• any combination of the above, or by any other legally available means.

In addition, the selling shareholders may enter into hedging transactions with broker-dealers who may engage in short sales of Common Stock, or options or other transactions that require delivery by broker-dealers of the Common Stock.

The selling shareholders and/or the purchasers of Common Stock may compensate brokers, dealers, underwriters or agents with discounts, concessions or commissions (compensation may be in excess of customary commissions). The selling shareholders and any broker dealers acting in connection with the sale of the shares being registered may be



deemed to be underwriters within the meaning of Section 2(11) of the Securities Act, as amended, and any profit realized by them on the resale of shares as principals may be deemed underwriting compensation under the Securities Act. We do not know of any arrangements between the selling shareholders and any broker, dealer, or agent relating to the sale or distribution of the shares being registered.

We and the selling shareholders and any other persons participating in a distribution of our Common Stock will be subject to applicable provisions of the Exchange Act and the rules and regulations thereunder, including, without limitation, Regulation M, which may restrict certain activities of, and limit the timing of purchases and sales of securities by, these parties and other persons participating in a distribution of securities. Furthermore, under Regulation M, persons engaged in a distribution of securities are prohibited from simultaneously engaging in market making and certain other activities with respect to such securities for a specified period of time prior to the commencement of such distributions subject to specified exceptions or exemptions.

The selling shareholders may sell any securities that this prospectus covers under Rule 144 of the Securities Act rather than under this prospectus if they qualify.

We cannot assure you that the selling shareholders will sell any of their shares of Common Stock.

In order to comply with the securities laws of certain states, if applicable, the selling shareholders will sell the Common Stock in jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states, the selling shareholders may not sell or offer the Common Stock unless the holder registers the sale of the shares of Common Stock in the applicable state or the applicable state qualifies the Common Stock for sale in that state, or the applicable state exempts the Common Stock from the registration or qualification requirement.

We have agreed to pay all fees and expenses incident to the registration of the shares being offered under this prospectus (estimated to be \$68,262). However each selling shareholder is responsible for paying any discounts, commissions and similar selling expenses they incur.

We have agreed to indemnify the selling shareholders whose shares we are registering from all liability and losses resulting from any misrepresentations we make in connection with the registration statement.

## **DESCRIPTION OF SECURITIES TO BE REGISTERED**

The following is a summary of our capital stock and certain provisions of our Articles of Incorporation and By-laws, as amended and by the provisions of Nevada law.

### **General**

We are authorized to issue (i) 100,000,000 shares of Common Stock and 100,000,000 shares of Preferred Stock with a par value of \$0.00001 per share.

### **Common Stock**

As of July 16, 2012, there were 21,361,534 shares of Common Stock issued and outstanding.

Each outstanding share of Common Stock is entitled to one vote, either in person or by proxy, on all matters that may be voted upon by the owners thereof at meetings of the shareholders. Holders of our Common Stock:

- (i) have equal ratable rights to dividends from funds legally available therefore, if declared by our Board of Directors,
- (ii) are entitled to share ratably in all our assets available for distribution to holders of Common Stock upon our liquidation, dissolution or winding up;
- (iii) do not have preemptive, subscription or conversion rights or redemption or sinking fund provisions; and
- (iv) are entitled to one non-cumulative vote per share on all matters on which shareholders may vote at all meetings of our shareholders.

### **Non-Cumulative Voting**

The holders of shares of our Common Stock do not have cumulative voting rights, which means that the holders of more than fifty percent (50%) of outstanding shares voting for the election of directors can elect all of our directors if they so choose and, in such event, the holders of the remaining shares will not be able to elect any of our directors.

## **Cash Dividends**

Junlong declared a dividend distribution to Dishan Guo, Jinzhou Zeng, Xiaojiang Yang and Xiaofen Wang on December 31, 2008, totaling RMB 20 million (approximately US\$2.9 million). Our Board of Directors will make any future decisions regarding 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.

## **Series A Preferred Shares**

Preferred Shares may be divided into series and issued by the Board of Directors on such terms as it may determine prior to their issuance. On February 16, 2011, the Company filed with the Secretary of State of Nevada a Certificate of Designation, Preferences and Rights for 5% Series A Convertible Preferred Stock (the "Certificate of Designation") as an amendment to its Articles of Incorporation.

For each outstanding share of Series A Preferred Stock, dividends shall be payable quarterly, at the rate of 5% per annum. Dividends on the Series A Preferred Stock shall accrue and be cumulative from and after the date of the initial issuance of the Series A Preferred Stock.

Until conversion, the Preferred Stock shall have no voting rights other than with respect to matters that may adversely affect the rights of the holders of the Series A Preferred Stock.

Upon liquidation of the Company, holders of Series A Preferred Stock are entitled to be paid, prior to any distribution to any holders of Common Stock, or any other class or series of stock issued hereafter or junior to the Series A Preferred Stock, an amount equal to \$1.35 per share plus the amount of any accrued but unpaid dividends thereon, as of the date of liquidation (the "Series A Liquidation Preference Amount").

Each share of Series A Preferred Stock at the option of the holder may be convertible into a number of fully paid and nonassessable shares of Common Stock equal to the quotient of (i) the Series A Liquidation Preference Amount divided by (ii) the Conversion Price in effect as of the date of the Conversion Notice

## **Warrants**

We issued warrants to purchase, in the aggregate, 2,498,326 shares of Common Stock to the selling stockholders and the placement agents in the Offering. Each warrant has a term of three years from the date of issuance and an exercise price of \$2.00 for Series A Warrants, \$3.00 for Series B Warrants, and \$1.35 for Placement Agent Warrants. For more information regarding the material terms of the warrants, please refer to the “**Recent Sales of Unregistered Securities**” section below.

## **INTERESTS OF NAMED EXPERTS AND COUNSEL**

No "expert" or "counsel" as defined by Item 509 of Regulation S-K promulgated under the Securities Act, whose services were used in the preparation of this Form S-1, was hired on a contingent basis or will receive a direct or indirect interest in us or our parents or subsidiaries, nor was any of them a promoter, underwriter, voting trustee, director, officer or employee of the Company.

## **BUSINESS**

### **Our Corporate History**

We were incorporated under the name China Unitech Group, Inc. in the State of Nevada on March 14, 2006. From our office in China, we planned to operate in the online travel business using the website [www.chinabizhotel.com](http://www.chinabizhotel.com). The website was planned to offer viewers the ability to book hotel rooms in China and earn us booking fees from the respective hotels. However, we did not engage in any operations and were dormant from our inception until our reverse acquisition of Classic Bond on July 2, 2010. As a result of the reverse acquisition, we ceased to be a shell company on July 2, 2010.

### *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 China Unitech Group, Inc. 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 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. Junlong was incorporated in the PRC in December 2003. It obtained its first licenses from the Ministry of Culture to operate an internet café chain in 2005 and opened its first internet café in April 2006.

On July 2, 2010, our Board of Directors 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 filed with the Nevada Secretary of State a Certificate of Amendment to Articles of Incorporation to give effect to a name change from "China Unitech Group, Inc." to "China Internet Cafe Holdings Group, Inc." The Certificate of Amendment was approved by our Board of Directors on July 30, 2010 and was approved by a stockholder holding 59.45% of our outstanding Common Stock by written consent on July 30, 2010. In connection with the name change, on January 25, 2011, the Company filed an Issuer Company-Related Action Notification Form with the Financial Industry Regulatory Authority ("FINRA") requesting a name change from "China Unitech Group, Inc."

to “China Internet Cafe Holdings Group, Inc.” as well as an OTC voluntary symbol change from “CUIG” to “CICC.” These changes became effective on February 1, 2011. Our Common Stock began trading under the Company’s new name on the Over-the Counter Bulletin Boards on Tuesday, February 1, 2011 under our new trading symbol “CICC.”

On February 16, 2011, we filed with the Secretary of State of Nevada a Certificate of Designation, Preferences and Rights for the 5% Series A Convertible Preferred Stock (the “**Certificate of Designation**”) as an amendment to its Articles of Incorporation. Capitalized terms not defined herein shall have the meaning ascribed to them in the Certificate of Designation.

For each outstanding share of Series A Preferred Stock, dividends shall be payable quarterly, at the rate of 5% per annum, on or before each date that is thirty days following the last day of each June, September, December and March of each year. Dividends on the Series A Preferred Stock shall accrue and be cumulative from and after the date of the initial issuance of the Series A Preferred Stock.

Upon liquidation of the Company, holders of Series A Preferred Stock are entitled to be paid, prior to any distribution to any holders of Common Stock, or any other class or series of stock issued hereafter or junior to the Series A Preferred Stock, an amount equal to \$1.35 per share plus the amount of any accrued but unpaid dividends thereon, as of the date of liquidation (the “**Series A Liquidation Preference Amount**”).

Each share of Series A Preferred Stock at the option of the holder may be convertible into a number of fully paid and nonassessable shares of Common Stock equal to the quotient of (i) the Series A Liquidation Preference Amount divided by (ii) the Conversion Price in effect as of the date of the Conversion Notice.

Until conversion, the Preferred Stock shall have no voting rights other than with respect to matters that may adversely affect the rights of the holders of the Series A Preferred Stock.

The description of the Series A Preferred Stock above is qualified in its entirety by reference to a copy of the Certificate of Designation attached to this Registration Statement on Form S-1.

On February 22, 2011, in connection with a security purchase agreement between the Company and certain investors (collectively, the “Investors”), we closed a private placement of approximately \$6.4 million from offering a total of 474,967 units (the “Units”) at a purchase price of \$13.50 per Unit, each consisting of: (i) nine shares of the Company’s 5% Series A Convertible Preferred Stock, par value \$0.00001 per share (the “Preferred Shares”), convertible on a one to one basis into nine shares of the Company’s Common Stock, par value \$0.00001 per share (the “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, to purchase one share of Common Stock, at an exercise price of \$3.00 per share.

## **Business Overview**

We operate a chain of 59 internet cafés in Shenzhen, Guangdong, PRC that are generally open 24 hours a day, seven days a week. We provide modern internet café facilities and we believe we are the largest internet café chain in Shenzhen. We provide internet access at prices that we believe, based on our experience in the industry, are affordable to both students and migrant workers. Although we sell snacks, drinks, and game access cards, over 95% of our revenue comes from selling access time to our computers. We sell internet café memberships to our customers. Members purchase prepaid IC cards (a pocket-sized card with embedded integrated circuits that can be used for identification, authentication, data storage and application processing), which include stored value that will be deducted based on time usage of a computer at the internet café. The cards are only sold at our cafés. We deduct the amount that reflects the access time used by a customer when the customer’s IC card is inserted into the IC card slot on the computer.

The 59 Internet cafes that we operate are categorized into small, medium, and large cafes. The parameters and number of each type of store are provided in the table below:



Store Size	<b>Number of Stores</b>	Description of Cafe
Large	13	Large cafes contain 300 or more computers and focus on high end games, movies and entertainment.
Medium	36	Medium cafes contain 150-300 computers and focus on high-end games. They also provide several movie suites for customers.
Small	10	Small cafes contain 100-150 computers.

33

## **Our Industry**

### ***Background on Internet Cafés in the PRC***

According to the Survey of China Internet Café Industry by the Ministry of Culture in 2005, the PRC had 110,000 internet cafés, with more than 1,000,000 employees and contributing RMB 18,500,000,000 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) on January 19, 2011, the amount of internet users in China in 2009 was 385 million, 135 million of which (35.1%) surf the internet via internet cafes. By the end of 2010, the amount of internet users in China reached 457 million, 35.7% of which 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) and Call to Arms, played either with their friends in the café or with users across the globe.

Due to tightened regulations on the operations of internet cafés, there are currently around 81,000 internet cafés in the PRC (Source: “Internet café ban call draws Chinese hacker wrath”. AFP 3 Mar 2010. <http://www.google.com/hostednews/afp/article/ALeqM5gJus4tWVAaeWI8IoS-n238PYpFjw>). 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-ChinaComm Communications Co., Ltd, and Read China Investment.

### ***Computer Gaming Industry in China***

According to a report by Hudson Square Research dated October 2009 prepared by Scott Tilghman and Daniel Ernst, which cited Pearl Research, a business intelligence and consulting firm, the PRC online game market rose 63% in

2008 to \$2.8 billion (source: <http://www.zhongman.com/games/gamehot/20090429/15485138631.htm>), rose 36% in 2009 to \$3.97 billion (source <http://tech.qq.com/a/20100111/000389.htm>), and rose 26% in 2010 to \$4.8 billion (source: <http://games.sina.com.cn/y/n/2011-05-05/1111495419.shtml>). 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](http://blog.sina.com.cn/s/blog_4aff94ef01007zei.html)). The chart below, provided by Pearl Research, a business intelligence and consulting firm, shows the revenue growth of online game companies from 2003 to 2010.

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 have been making great efforts to support internet cafés to expand their customer base (*see*: [http://blog.sina.com.cn/s/blog\\_4aff94ef01007zei.html](http://blog.sina.com.cn/s/blog_4aff94ef01007zei.html)) in the last few years. Many online game companies promote new products by allowing internet café customers to sample the new products in Internet cafes. In this way, online game operators are 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.

The Company has been involved in several such promotions with the following operators:

Giant Network who promote their product “Titan.” As consideration for promoting their product in our Internet (i)cafes, we receive a commission based on the time spent by customers playing the game and the level reached by customers in the game. The commissions are capped at 20,000 RMB per month.

Sanda Network who promote their product “Rainbow Island.” As consideration for promoting their product in our (ii)Internet cafes, we receive a commission based on the time spent by customers playing the game and the level reached by customers in the game.

Tencent, who promote their product “Cross Fire.” As consideration for promoting their product in our Internet (iii)cafes, we receive a commission based on the time spent by customers playing the game and the level reached by customers in the game.

These promotions benefit the Company by increasing the number of customers who visit our Internet cafes. Currently, we have 59 direct outlets in Shenzhen City, and we believe that the Company name has strong brand recognition in Shenzhen. As a result, these promotions in our Internet cafés are likely to increase the customer base for new online gaming products.

As the Company continues to grow, we believes that we will have the leverage to seek more lucrative terms when partnering with game operators who want to promote their products in our cafes.

***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.

**Table 1 Major Internet Company Revenues**

Company	2011 Revenue		YOY	Net Profit	% Net	Market Cap
	Million US\$					
Tencent Q4	\$ 4,523	45 %	\$1,619.30	26.7 %	\$ 53,031	

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Shanda	\$ 835.03	17.7 %	\$199.97	23.95 %	\$ 1,005
Netease	\$ 1150	28.5 %	\$511.31	44.36 %	\$ 7,640
ChangYou	\$ 484.58	37.7 %	\$245.46	50.65 %	\$ 1,430
Giant	\$ 282.99	34.4 %	\$138.95	49.1 %	\$ 1,180
Perfect World	\$ 471.6	30.9 %	\$155.57	32.98 %	\$ 738
NetDragon	\$ 14	58.1 %	\$2.78	19.86 %	\$ 331
Total	\$ 7,761		\$2,873		\$ 65,355

(Source: finance.yahoo.com, last accessed March 15, 2012. )

## 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 59 cafés. The scale of operations allows us to control cost and standardize store management. It is our belief that our scale of operations will not be affected as we expand into additional provinces and obtain a national internet chain license as described in more detail below. The target companies that we intend to acquire in the future in provinces outside of Guangdong Province will be 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.

**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 CEO and CFO, 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. Mr. Guo attends annual conferences held by the Ministry of Culture in Beijing each year. 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 44 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 plan to expand in Guizhou, Sichuan, and Yunnan Provinces as well as the Chongqing Municipality principally through the acquisition of local small chains, in order to meet the requirements of applying for a national chain license. The national chain license requires 30 internet cafés in three provinces. In the future, we plan to acquire internet cafés in Guizhou and Sichuan Provinces to help us satisfy the requirements of obtaining a national chain license. We also 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 a yearly fee. Junlong, on the other hand, is deeply involved in the operational management of its company-owned cafés. After we obtain a national chain license, we will focus on developing high-end internet cafés in the more developed cities to create new concepts of internet café operation such as operating cafes that provide food and beverage service as well as overnight accommodation. The high-end internet cafes that we plan to open in the future will house the most up to date computers and have private rooms for movie viewing and game play with surround sound capability. These high-end cafes will cater to individuals with disposable income exceeding that of our general customers, young low-income males and migrant workers. We expect to spread to the less developed cities in three years in order to gain competitive market shares. We plan to put 20% of our resources to the less developed cities for market integration after we are granted a national license, which will effectively lay the foundation for us in those cities.

***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. Our mission is to set up internet cafés all over the PRC to become a real national chain and the industry leader, and we will start to implement these plans in the second half of 2012.

***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 market research in Sichuan, Guizhou, and Yunan provinces and Chongqing municipalities in March 2011. 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.

### **Use of Prepaid IC Cards**

Internet café members purchase prepaid IC cards which include stored value that is deducted based on time usage of a computer at the internet café. The cards are only sold at our cafés. We deduct from the stored value amount to reflect customer usage when the customers' IC cards are inserted into the IC card slot on the computer. Revenues derived from the prepaid IC cards at the internet café are recognized when services are provided. Below is our IC card sample.

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

The basic membership comes with the IC card and costs RMB 10 (approximately \$1.52) on top of the initial credits deposited. Members receive a discount (e.g. RMB 50 (approximately \$7.60) deposit gets RMB 60 (approximately \$9.12) credit in the IC card). There is no expiration date for IC cards, but money deposited into the IC cards is not refundable.

### **Software on the Computers**

We have on average 232 computers in each location and a total of over 13,600 computers serving all 59 internet cafés. We install more than 100 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 50% of computer time is spent on gaming, 30% for other entertainment (e.g. online chatting, online movies, or online music); and 20% for other purposes (e.g. work).

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](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.

In the year 2012 we plan to open internet cafés around university areas in the south-western provinces and cities including 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**

There are approximately 146,000 Internet cafés in the PRC in 2011. (<http://www.ccm.gov.cn/show.php?aid=70449&cid=70> “The meeting of National chain Internet cafes-by the China

Ministry of Culture,” accessed March 2012)) The market is extremely fragmented. One of the largest national chains which has around 1,000 locations has national market share of less than 2%. The following describes some of our local, regional and national competitors.

### *Local Competitors in Shenzhen*

Shenzhen Weiwo Internet Café Chain Company. Weiwo was founded in 1997. Currently, Weiwo has 16 cafés. The company mainly operates a franchise model, with only 3 company owned cafés. The cafés are mainly located in Futian district, Shenzhen City. The company concentrates on mid-range market. Each café is relatively small with 100 to 150 computers (for a total of around 1,600 computers). Its franchised stores are charged a franchising fee per month of approximately RMB 5,000 (approximately \$774.67). Weiwo is the smallest internet café chain company 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 three 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 Baoan 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.

### *Competitors in Potential Markets*

As we plan to expand our operations in other major cities, we identify the following competitors in the potential new markets where we expect to operate in the future:

Kunming – Yunnan Jin-Zhao Yuan Culture Communication Network Co., Ltd. The company was founded on May 1, 2003 by the Yunnan Provincial Department of Culture. It obtained its business license and registration to operate a chain of Internet cafés from the Industrial and Commercial Bureau of Yunnan Province on April 31, 2004. It has a registered capital of RMB 10 million. The company has opened approximately 19 cafés with an average of 200 computers in each café and a total of nearly 4,000 computers.

-

Chengdu – Chengdu Shang Dynasty Networks Co., Ltd. The company was founded in 2002 with a registered capital of RMB 12 million. It would be most accurately described as a multifunctional entertainment facility with coffee bars and multi-function rooms. Its facilities have full range of digital entertainment including hardware and software products, and professional e-sport training. The company has four wholly owned cafés, and has more than 20,000 registered members.

## **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.chinainternetcafe.com](http://www.chinainternetcafe.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 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 controlled 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. 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/zwx/ggtz/200909/t20090917\\_73276.html](http://www.ccnt.gov.cn/xxfb/zwx/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 July 16, 2012, we had 634 employees. The following table sets forth the number of employees by function:

Function	Number of Employees
Senior Management	66
Accounting	8
Staff employees	560
Total	634

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.

## **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 from an individual Changsheng Hao the office space for its headquarters located at Room 1010, Unit D, Block 1, Yuanjing Garden, Longxiang Road, Zhongxin Cheng, Longgang District, Shenzhen. The term of the lease was originally December 1, 2009 to December 31, 2010, but the lease has been extended for until December 31, 2012. The lease has been filed with the House Leasing Management Office of Longgang District, Shenzhen.

Junlong also leases spaces from different entities or individuals for its 59 internet cafés.

## 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 affect on our business, financial condition or operating results.

## MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

### *Market Information*

Since March 10, 2011, our common stock has been eligible for quotation on the OTC Bulletin Board under the symbol CICC.OB. Prior to March 10, 2011, there was no active market for our common stock. The following table sets forth the high and low bid prices for our common stock for the periods indicated, as reported by the OTC Bulletin Board. The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

	High	Low
Year ended December 31, 2012		
1 <sup>st</sup> Quarter	\$0.55	\$0.36
Year ended December 31, 2011		
1 <sup>st</sup> Quarter	\$2.00	\$1.50
2 <sup>nd</sup> Quarter	\$1.50	\$0.80
3 <sup>rd</sup> Quarter	\$1.01	\$0.40
4 <sup>th</sup> Quarter	\$0.50	\$0.15

The last reported sales price of our common stock on the OTC Bulletin Board on December 30, 2011 was \$0.44, and on July 16, 2012, the last reported sales price was \$0.26.

There are, 6,773,029 shares of the Company's Common Stock subject to outstanding warrants (2,498,326 shares of Common Stock) and securities convertible into the Company's Common Stock (4,274,703 shares of Common Stock).

***Approximate Number of Holders of Our Common Stock***

As of July 16, 2012, there were approximately 179 stockholders of record of our Common Stock, as reported by our transfer agent. In computing the number of holders of record, each broker-dealer and clearing corporation holding shares on behalf of its customers is counted as a single stockholder.

***Dividends***

Junlong declared a dividend distribution to Dishan Guo, Jinzhou Zeng, Xiaojiang Yang and Xiaofen Wang on December 31, 2008, totaling RMB 20 million (approximately US\$2.9 million). Our Board of Directors will make any future decisions regarding 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***

We do not have in effect any compensation plans under which our equity securities are authorized for issuance and we do not have any outstanding stock options.

**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, operating through our variable interest entity, Junlong Culture Communication Co. Ltd. ("Junlong"), we operate in our belief the largest Internet Café chain in Shenzhen, Guangdong, China consisting of 59 locations in high traffic areas. Our focus is on providing modern internet café facilities that offer a one-stop entertainment and media venue for customers, typically mature students and migrant workers, at prices affordable to those demographics. Although our locations do sell snacks, drinks, and game access cards, more than 95% of our revenue comes directly from selling internet access time to our computers. We have been recognized by the China Internet Café Online, the only Chinese internet café industry website dedicated to the field of internet business and industry practitioners to provide professional internet café marketing and information services as, and it is also our belief that we are the largest Internet café chain operator in Shenzhen. In making this decision, China Internet Café Online conducted a study of Internet cafes in the Shenzhen area. Their research represents the belief of a third party and that of the Company. The Company was not affiliated with China Internet Café Online's research nor did it help to fund such research.

During our 2011 fiscal year, we focus on increasing the number of our cafes in Shenzhen. We expect our future growth to be driven by a number of factors and trends including:

1. Our ability to expand our client base through promotion of our services
2. Our ability to integrate cafes we acquired in the previous years
3. Our ability to identify and integrate joint venture target companies in the coming years

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

**Improved Disposable Income** - We believe as the Shenzhen 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 with increased home computer and home game console ownership. We believe, however, the home computer and game console penetration rate is relatively low in the PRC as compared to that of America and Europe. In addition, young people in the PRC prefer internet cafes to home computers 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. In order to meet the basic requirements to acquire a national internet chain license, the Company's primary objective is to acquire and open at least 20 internet cafes in two provinces other than Guangdong province. The Company has conducted research in the south western provinces and cities including Chongqing, Sichuan, Guizhou, and Yunnan and is focusing on targets in these areas for acquisition purposes. The Company believes the national license is imperative for the development of a nationwide market.

## Recent Developments and Reorganizations

On July 2, 2010, we completed a reverse acquisition transaction (“Reverse Acquisition”) through a share exchange with Classic Bond Development Limited, a BVI company, (“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, \$0.00001 par value (the “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 stockholders.

Upon the closing of the Reverse Acquisition, Xuezheng Yuan, our sole director and officer, submitted a resignation letter pursuant to which he resigned from all offices that he held with immediate effect and from his position as our sole director effective August 13, 2010. Also upon the closing of the Reverse Acquisition, our Board of Directors 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. Mr. Dishan Guo's appointment became effective upon closing of the Reverse Acquisition, while the remaining appointments became effective on August 13, 2010. In addition, upon the closing of the Reverse Acquisition, our executive officers were replaced by the Classic Bond executive officers as discussed below.

For accounting purposes, the share exchange transaction was treated as a reverse acquisition, with Classic Bond as the acquirer and China Internet Café Holdings Group, Inc. as the acquired party.

On January 20, 2011, we filed with the Nevada Secretary of a Certificate of Amendment to Articles of Incorporation to give effect to a name change from “China Unitech Group, Inc.” to “China Internet Café Holdings Group, Inc.” The Certificate of Amendment was approved by our Board of Directors on July 30, 2010 and was approved by a stockholder holding 59.45% of our outstanding Common Stock by written consent on July 30, 2010.

On February 22, 2011 (the “Closing Date”), in connection with a security purchase agreement between the Company and certain investors (the “Investors”), we closed a private placement (the “Offering”) of approximately \$6.4 million from offering a total of 474,967 units (the “Units”) at a purchase price of \$13.50 per Unit, each consisting of: (i) nine shares of the Company’s Preferred Shares, 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, 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, each exercisable for the purchase of one share of Common Stock at an exercise price of \$3.00 per share.



As a condition to the Offering, we agreed to grant certain registration rights to the Investors pursuant to a Registration Rights Agreement dated February 22, 2011. We agreed to register for resale with the Securities and Exchange Commission (i) the shares of Common Stock issuable upon conversion of the Preferred Shares (4,274,703); (ii) the Common Shares (474,967); (iii) the shares of Common Stock issuable upon exercise of the Warrants (1,899,868); and (iv) any securities issued or issuable upon any stock split, dividend or other distribution, recapitalization or similar event with respect to the foregoing.

In 2011, we opened 15 internet cafés. As a result, we currently own 59 internet cafés within the city of Shenzhen in Guangdong province, PRC.

**Results of Operations for the Years Ended December 31, 2011 and 2010**

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 Year Ended December 31, 2011		2010		As percentage	As percentage	Amount change	% change	
	As percentage		As percentage						
Revenue	\$32,597,144	100 %	\$20,460,459	100 %		12,136,685	59 %		
Cost of revenue	20,270,919	62 %	11,823,456	58 %		8,447,463	71 %		
Gross profit	12,326,225	38 %	8,637,003	42 %		3,689,222	43 %		
Operating Expenses									
General and administrative expenses	2,274,760	7 %	634,739	3 %		1,640,021	258 %		
Total operating expenses	2,274,760	7 %	634,739	3 %		1,640,021	258 %		
Income from operations	10,051,465	31 %	8,002,264	39 %		2,049,201	26 %		
Non-operating income (expenses)									
Change in fair value of derivative financial instrument - preferred stock	1,457,090	4 %	-	-		1,457,090	100 %		
Change in fair value of derivative financial instrument - warrants	783,290	2 %	-	-		783,290	100 %		
Reorganizational expenses	-		-435,086	-2 %		435,086	-100 %		
Interest income	12,439	0 %	8,265	0 %		4,174	51 %		
Interest expenses	-9,303	0 %	-9,437	0 %		134	-1 %		
Other expenses	-563	0 %	-43	0 %		-520	1209 %		
Total non-operating income (expenses)	2,242,953	7 %	-436,301	-2 %		2,679,254	-614 %		
Net income before income taxes	12,294,418	38 %	7,565,963	37 %		4,728,455	62 %		
Income taxes	2,786,097	9 %	1,819,380	9 %		966,717	53 %		
Net income attributable to China Internet Cafe Holdings Group, Inc.	9,508,321	29 %	5,746,583	28 %		3,761,738	65 %		

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Dividend on preferred stock	-247,486	-1	%	-	-	-247,486	100	%	
Net income attributable to China Internet Cafe Holdings Group, Inc.	\$9,260,835	28	%	\$5,746,583	28	%	3,514,252	61	%
Common stockholders									
Other comprehensive income									
Net income	\$9,508,321	29	%	5,746,583	28	%	3,761,738	65	%
Foreign currency translation	843,432	3	%	400,949	2	%	442,483	110	%
Net Comprehensive income	\$10,351,753	32	%	\$6,147,532	30	%	4,204,221	68	%

### **Comparison of Fiscal Years Ended December 31, 2011 and 2010**

**Revenue** . Our revenue is primarily generated from sales of prepaid IC cards which include stored value that will be deducted based on time usage of computers at the internet cafe. Sales revenue increased approximately \$12.1 million, or 59%, from \$20.5 million for the fiscal year ended December 31, 2010 to \$32.6 million for the fiscal year ended December 31, 2011. The increase was mainly due to the revenue generated by the new cafes opened in 2011. Our management expects this trend to continue in 2012 as we continue to focus on organic growth within Shenzhen while simultaneously pursuing options for expansion through establishment and acquisition in other provinces.

**Cost of Revenue** . Our cost of sales is primarily composed of depreciation and amortization, salary, rent, utility business tax and surcharge. Our cost of sales increased approximately \$8.4 million, or 71%, to approximately \$20.3 million for the fiscal year ended December 31, 2011 from approximately \$11.8 million for the same period in 2010. The increase was mainly attributable to increased labor cost and taxes in 2011 as compared to the same period in 2010. During 2011, the increased business tax was a direct result of the higher revenue generated from the business. We expect this trend to continue in 2012 as we continue to expand our revenue base. In addition, we expect to slightly increase our average employees' salary as the Shenzhen Government moves forward with its plan to increase the minimum wage.

**Gross Profit** . Gross profit is the difference between sales revenue and cost of sales. Our gross profit increased by approximately \$3.7 million, or 43%, to approximately \$12.3 million for the fiscal year ended December 31, 2011 from approximately \$8.6 million for the same period in 2010. Gross profit as a percentage of sales was 38% for the fiscal year ended December 31, 2011, as compared to 42% for the same period in 2010. The slight decrease of our gross profit margin was mainly attributable to the increase in salary, depreciation and other costs as compared to the same period in 2010. Our management expects gross profit margin to remain relatively unchanged in the year of 2012 as cost drivers increase in proportionate with the revenue growth.

**Operating Expenses** . Our administrative expenses mainly consist of fees paid to legal counsel, auditor, and consultants. Our administrative expenses increased by approximately \$1.6 million, or 258%, to approximately \$2.3 million for the fiscal year ended December 31, 2011 from approximately \$0.63 million for the same period in 2010. The increase was mainly attributable to increase in advisory, legal, investor relations and audit fees incurred as a publicly traded company. We expect that our operating expenses will remain relatively unchanged in the year 2012.

**Non-operating Income/Expenses** . Our other income increased by approximately \$2.7 million from approximately \$0.44 million non-operating expense, to \$2.2 million non-operating income for the fiscal year ended December 31, 2011 compared to the same period in 2010. The increase was primarily due to the proceeds of \$2.2 million from the securities offering conducted in February 2011.

**Income before Income Taxes** . Income before income taxes increased by approximately \$4.7 million, or 62%, to \$12.3 million for the fiscal year ended December 31, 2011 from approximately \$7.6 million for the same period in 2010. The increase in income before income tax was mainly attributable to increase in revenues as a result of our business expansion in 2011.

**Income Taxes** . Our income taxes increased by approximately \$0.97 million during the fiscal year ended December 31, 2011 to approximately \$2.8 million from approximately \$1.8 million during the same period in 2010. The primary reason for the increase in income taxes was the higher taxable income generated by the opening of new internet cafés and an increase in tax rate.

**Net Income** . Our net income increased by approximately \$3.8 million, or 65%, to approximately \$9.5 million for the fiscal year ended December 31, 2011 from approximately \$5.7 million during the same period in 2010 as a result of the factors described above. We expect to generate higher net profit after the expansion of our business in the coming year 2012.

## Liquidity and Capital Resources

As of December 31, 2011, we had cash and cash equivalents of approximately \$19.63 million. The following table provides detailed information about our net cash flow for each financial statement period presented in this report.

### Cash Flow

	Fiscal Year Ended	
	December 31,	
	2011	2010
Net cash provided by (used in) operating activities	\$ 15,715,394	\$ 6,554,675
Net cash provided by (used in) investing activities	(5,895,841 )	(6,151,671)
Net cash provided by (used in) financing activities	5,520,681	253,054
Effect of foreign currency translation on cash and cash equivalents	452,622	118,910
Net cash flows	15,792,856	774,968

### *Operating Activities*

Net cash provided by operating activities was approximately \$15.7 million for the fiscal year ended December 31, 2011, as compared to \$6.6 million of net cash provided by operating activities for the same period in 2010. The change was mainly attributable to the change in deferred revenue, and a loan from one of our directors. The Company has relied on the advances from a director to pay certain public company expenses. Going forward, our management intends to pay for these expenses using our proceeds from the securities offering.

### *Investing Activities*

Net cash used in investing activities was \$5.9 million for the fiscal year ended December 31, 2011, as compared to \$6.2 million net cash used in investing activities for the same period in 2010. The change was mainly attributable to the acquisition of property, plant and equipment, as well as the return of a prepayment made to Yunnan province due to the cancellation of the Company's plan to establish a subsidiary in Kunming city.

### *Financing Activities*

Net cash provided by financing activities was approximately \$5.5 million for the fiscal year ended December 31, 2011, as compared to \$0.25 million for the same period in 2010. The increase in net cash provided by financing activities was mainly due to proceeds from the securities offering conducted in February 2011.

### **Critical Accounting Policies**

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

***Revenue recognition***

Internet café members purchase prepaid IC cards, which include stored value that will be deducted based on time usage of computers at the internet café. Revenues derived from the prepaid IC cards at the internet café are recognized when services are provided. This is based upon usage of computer time at the internet café. Outstanding customer balances in the IC cards are included in deferred revenue on the balance sheets. The Company does not charge any service fees that cause a decrement to customer balances. There is no expiration date for IC cards.

The Company also records revenue from commission 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 items are sold to customers.

***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 20% on gross revenue generated from our internet cafés. Our other surcharges are an education surcharge of 3%, city development surcharge of 1%, a culture development surcharge of 3%, and a snacks and drinks business tax of 5%. All surcharges are calculated on the basis of business tax amount.

***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	5 years
Café furniture and fixtures	5 years
Office furniture, fixtures and equipments	5 years
Motor vehicles	5 years



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

### ***Deferred Revenue***

Deferred revenue represents unused balances of the prepaid amounts from the IC cards that are unused balance. The Outstanding customer balances are \$2,084,086 and \$579,822 as at December 31, 2011 and December 31, 2010, 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, 2011.

### ***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:

	2011	2010
Year end RMB : USD exchange rate	6.3523	6.6118
Average yearly RMB : USD exchange rate	6.4544	6.7788

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.

**Results of Operations for the Quarters Ended March 31, 2012 and 2011**

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

	For The Three Months Ended March 31, 2012		2011 Restated		Amount change	% change
	As percentage		As percentage			
Revenue	\$7,134,204	100 %	\$6,489,581	100 %	644,623	10 %
Cost of revenue	5,005,431	70 %	3,995,342	62 %	1,010,089	25 %
Gross profit	2,128,773	30 %	2,494,239	38 %	(365,466 )	-15 %
<b>Operating Expenses</b>						
General and administrative expenses	569,894	8 %	444,467	7 %	125,427	28 %
Total operating expenses	569,894	8 %	444,467	7 %	125,427	28 %
Income from operations	1,558,879	22 %	2,049,772	32 %	(490,893 )	-24 %
<b>Non-operating income (expenses)</b>						
Change in fair value of derivative financial instrument - preferred stock	(432,178 )	-6 %	(1,439,326)	-	1,007,148	-70 %
Change in fair value of derivative financial instrument - warrants	(306,279 )	-4 %	(762,643 )	-	456,364	-60 %
Interest income	3,730	0 %	1,994	0 %	1,736	87 %
Interest expenses	-		(2,531 )	0 %	2,531	-100 %
Other expenses	(143 )	0 %	-		(143 )	100 %
Total non-operating income (expenses)	(734,870 )	-10 %	(2,202,506)	-34 %	1,467,636	-67 %
Net income(loss) before income taxes	824,009	12 %	(152,734 )	-2 %	976,743	640 %
Income taxes	495,450	7 %	559,689	9 %	(64,239 )	-11 %
Net income(loss) attributable to China Internet Cafe Holdings Group, Inc.	328,559	5 %	(712,423 )	-11 %	1,040,982	146 %
Dividend on preferred stock	(71,938 )	-1 %	(33,202 )	-	(71,938 )	217 %
Net income(loss) attributable to China Internet Cafe Holdings Group, Inc. Common stockholders	\$256,621	4 %	\$(745,625 )	-11 %	1,002,246	-134 %
<b>Other comprehensive income</b>						
Net income(loss)	\$328,559	5 %	(712,423 )	-11 %	1,040,982	-146 %
Foreign currency translation	180,058	3 %	55,373	1 %	124,685	225 %
Net Comprehensive income(loss)	\$508,617	7 %	\$(657,050 )	-10 %	1,165,667	-177 %

**Comparison of Fiscal Quarters Ended March 31, 2012 and 2011**

**Revenue** . Our revenue is primarily generated from sales of prepaid IC cards which include stored value that will be deducted based on time usage of computers at the internet cafe. Sales revenue increased approximately \$0.64 million, or 10%, from \$6.49 million for the quarter ended March 31, 2011 to \$7.13 million for the quarter ended March 31, 2012. The increase in revenue was mainly contributed by the 15 new internet cafes opened in 2011. We continue to focus on growth within Shenzhen while simultaneously pursuing options for expansion through establishment and acquisition in other cities and provinces.

**Cost of Revenue** . Our cost of revenue is primarily composed of depreciation and amortization, salary, rent, utility, business tax and surcharge. Our cost of sales increased by approximately \$1.01 million, or 25%, to approximately \$5.01 million for the quarter ended March 31, 2012 from approximately \$4.00 million for the same period in 2011. The increase was mainly attributable to the 15 new internet cafes opened in 2011 with increase in depreciation, amortization, salary, rent, utility cost and taxes in the quarter ended March 31, 2012 as compared to the same period in 2011. In addition, our average employees' salary and benefit contributed to the increase because the Shenzhen municipal government increased the minimum wage. We expect this trend of cost increase to continue in 2012 as we continue to expand our revenue base.

**Gross Profit** . Gross profit is the difference between sales revenue and cost of revenue. Our gross profit decreased by approximately \$0.37 million, or 15%, to approximately \$2.13 million for the quarter ended March 31, 2012 from approximately \$2.49 million for the same period in 2011. Gross profit as a percentage of sales was 30% for the quarter ended March 31, 2012, as compared to 38% for the same period in 2011. The decrease in our gross profit margin was mainly attributable to the increase in salary, depreciation and other costs as compared to the same period in 2011, as well as the decrease in revenue from some cafes due to the lay-off of migrant workers caused by manufacturing factories' relocation to other provinces in January 2012. Our management will relocate those cafes and expects gross profit margin to remain relatively stable in the next two quarters as cost drivers increase in proportion to the revenue growth.

**Operating Expenses** . Our administrative expenses mainly consist of fees paid to legal counsel, auditor, and consultants. Our administrative expenses increased by approximately \$0.13 million, or 28%, to approximately \$0.57 million for the quarter ended March 31, 2012 from approximately \$0.44 million for the same period in 2011. The increase was mainly attributable to a stock option expense of \$0.11 million as we granted stock options to Potomac Investment LLC in consideration of their service rendered in 2011. We expect that our operating expenses will remain relatively unchanged in the future.

**Non-operating Income/Expenses** . Our other expenses decreased by approximately \$1.47 million from approximately \$2.20 million non-operating expense, to \$0.73 million non-operating income for the quarter ended March 31, 2012 compared to the same period in 2011. The decrease was primarily due to the lower unrealized loss of our derivative instruments in the quarter ended March 31, 2012 than the same period of 2011.

**Income before Income Taxes** . Income before income taxes increased by approximately \$0.98 million, or 640%, to \$0.82 million for the quarter year ended March 31, 2012 from loss of approximately \$0.15 million for the same period in 2011. The increase in income before income tax was mainly attributable to the increase in revenues as a result of our business expansion in 2011 and lower unrealized loss of our derivative instruments in the quarter ended March 31, 2012 compared to the same period of 2011.

**Income Taxes** . Our income taxes decreased by approximately \$0.06 million during the quarter ended March 31, 2012 to approximately \$0.50 million from approximately \$0.56 million during the same period in 2011. The primary reason for the decrease in income taxes was the decrease in income from operations in the quarter ended March 31, 2012 compared to the same period of 2011.

**Net Income** . Our net income increased by approximately \$1.04 million, or 146%, to approximately \$0.33 million for the quarter ended March 31, 2012 from net loss of approximately \$0.71 million during the same period in 2011 as a result of the factors described above. We expect to generate higher net profit after the expansion of our business in the future.

## **Liquidity and Capital Resources**

As of March 31, 2012, we had cash and cash equivalents of approximately \$21.99 million. The following table provides detailed information about our net cash flow for each financial statement period presented in this report:

### **Cash Flow**

	Three Months Ended	
	March 31,	
	2012	2011
Net cash provided by operating activities	\$2,239,937	\$3,884,561
Net cash provided by investing activities	-	1,837,355
Net cash provided by financing activities	-	5,675,614
Effect of foreign currency translation on cash and cash equivalents	119,123	3,556
Net cash flows	2,359,060	11,401,086

### *Operating Activities*

Net cash provided by operating activities was approximately \$2.24 million for the quarter ended March 31, 2012, as compared to \$3.88 million of net cash provided by operating activities for the same period in 2011. The change was mainly attributable to (1) an increase in depreciation expense of \$0.91 million generated from computers and leasehold improvements; (2) a decrease in tax payable of \$0.28 million generated from increased net income; (3) an increase in accrued expenses of \$0.18 million generated from a registration penalty of \$0.19 million; and (4) an increase in an unsecured loan due to a director of \$0.1 million for paying related expenses in the US.

### *Investing Activities*

Net cash used in investing activities was \$0 for the quarter ended March 31, 2012, as compared to net cash used in investing activities \$1.84 million of the same period in 2011. In the quarter ended March 31, 2012, we did not open any new cafes and thus no new computers or leasehold improvements were purchased.

### ***Financing Activities***

Net cash provided by financing activities was \$0 for the quarter ended March 31, 2012, as compared to \$5.68 million for the same period in 2011. The change was primarily due to the securities offering conducted in February 2011.

### **Critical Accounting Policies**

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

#### ***Revenue recognition***

Internet café members purchase prepaid IC cards, which include stored value that will be deducted based on time usage of computers at the internet café. Revenues derived from the prepaid IC cards at the internet café are recognized when services are provided. This is based upon usage of computer time at the internet café. Outstanding customer balances in the IC cards are included in deferred revenue on the balance sheets. The Company does not charge any service fees that cause a decrement to customer balances. There is no expiration date for IC cards.

The Company also records revenue from commission 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 items are sold to customers.

#### ***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 20% on gross revenue generated from our internet cafés. Our other surcharges are an education surcharge of 3%, city development surcharge of 1%, a culture development surcharge of 3%, and a snacks and drinks business tax of 5%. All surcharges are calculated on the basis of business tax amount.

***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	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 that are unused balance. The outstanding customer balances were \$2,057,586 and \$2,084,086 as at March 31, 2012 and December 31, 2011, respectively, and were 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 quarter ended March 31, 2012.

### ***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.

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

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

	March 31, 2012	March 31, 2011
Quarter ended RMB : USD exchange rate (closing buying rate)	6.3122	6.5701
Three months average RMB : USD exchange rate (average ask rate)	6.2976	6.5894

	December 31, 2011
Year ended RMB : USD exchange rate (closing buying rate)	6.3523
Average yearly RMB : USD exchange rate (average ask rate)	6.4544

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**

### ***Accounting Standards Codification***

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which is a new accounting guidance to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This guidance is effective for the Company's fiscal year beginning January 1, 2012. The Company adoption of this guide did not have material effect on our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, which is a new guidance on the presentation of comprehensive income that will require a company to present components of net income and other comprehensive income in one continuous statement or in two separate, but consecutive statements. There are no changes to the components that are recognized in net income or other comprehensive income under current GAAP. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with early adoption permitted. It is applicable to the Company's fiscal year beginning January 1, 2012. The adoption of ASU 2011-05 did not have material impact on the Company's consolidated financial statements.

ASU 2011-05 was modified by the issuance of ASU 2011-12 - Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 in December 2011, which indefinitely deferred certain provisions of ASU 2011-05, including the requirement to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. This amendment is effective for both annual and interim financial statements beginning after December 15, 2011. The adoption of ASU 2011-12 did not have any material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11 - Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities, which requires entities to disclose both gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement. The objective of the disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards ("IFRS"). This ASU is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective presentation for all comparative periods presented is required. Its adoption of ASU 2011-11 is not expected to have material impact

on its consolidated financial statements.

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

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition or results of operations.

## CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS

None.

## DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS

### AND CONTROL PERSONS

#### Our Directors and Executive Officers

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

NAME	AGE	POSITION
Dishan Guo	47	Chairman, Chief Executive Officer and Chief Financial Officer
Zhenquan Guo	34	Director
Lei Li	47	Director
Wenbin An	72	Director
Lizong Wang	47	Director

**Dishan Guo.** Mr. Guo became our Chairman and CEO 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 CEO 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.

**Zhenquan Guo.** Mr. Zhenquan Guo joined our board on August 23, 2010. Mr. Guo joined Junlong in 2003, working in a variety of roles. Since 2006, he has been the Operation Director. He is in charge of the daily operations of Junlong's wholly owned internet cafés. Over the past five years, he has taken part in all the internet cafe set up and license application tasks and gained extensive experience in the internet cafe industry. Mr. Guo graduated from Gannan Normal University in 2000, majoring in Mathematics and Applied Mathematics. He obtained his master's

degree in marketing from Shenzhen University in 2008. Mr. Guo'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.

**Lei Li.** Mr. Lei Li joined our board on August 23, 2010. In 2009, Mr. Li is founded the Boardroom Advisors Company Limited, a Beijing-based financial advisory firm, and has been the managing director ever since. Since August 2008, and continuing to the present, Mr. Li has been a director of Universal Travel Group, a NYSE-listed travel services provider in the PRC engaged in providing reservation, booking, and domestic and international travel and tourism services throughout China. From October 2007 to November 2009 he served as chief financial officer of Synutra International, Inc., a NASDAQ-listed company that focuses on selling premium infant formula products throughout China. From August 2004 to September 2007, Mr. Li was vice president and chief financial officer of Kasen International Holdings Limited, a public company listed on the Hong Kong Stock Exchange that manufactures upholstered furniture, furniture leather and automotive leather in China. Prior to that, from July 2001 through April 2004, Mr. Li served as chief financial officer at Eagle Brand Holdings Limited, a company listed on the Singapore Stock Exchange. Mr. Li's experience also includes serving as a financial controller at the Korean division of Exel Plc between January 1997 and July 2001, and serving as a senior auditor at Waste Management Inc.'s international department in London between February 1995 and December 1996. Mr. Li is a fellow member of the Association of Chartered Certified Accountants (ACCA) in the UK. He received a bachelor's degree in management and engineering from Beijing Institute of Technology in 1984, a master's degree in economics from Renmin University of China in 1987, and a master's degree in accounting and finance from the London School of Economics in 1992. Mr. Li'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.

**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. 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, and he should serve as a director of our company.

**Lizong Wang.** Mr. Lizong Wang joined the board on August 23, 2010. Mr. Wang has been serving as deputy secretary of China Society for Promotion of The Glory Program, a program initiated and implemented by PRC private enterprises to alleviate poverty since 2010. Mr. Wang has served as the Secretary General of the Guangdong High-tech Industry Association since 2004 and has served as the Secretary General of the Shenzhen Association of Social Organization since 2008. Since 2008, he also serves as a strategic advisor and independent director of Universal Travel Group, a travel services provider in the PRC engaged in providing reservation, booking, and domestic and international travel and tourism services throughout China, Shenzhen 3nod Electronics Co., Ltd, a radio amplifier, home theater, computer peripherals and LED provider in the PRC, and Shenzhen Ruidefeng Pesticide, one of China's leading enterprise in the field of pesticide formulation and Pesticide research and development. In addition, he acts as economic consultant to a number of municipalities in the PRC as well as Asan in Korea. Mr. Wang is a frequent lecturer at higher education institutions in the Greater China Region. In 2007, Mr. Wang was nominated Honorary Citizen by the U.S. cities of Dallas and Los Angeles. He has also been elected the member of the Guangdong chapter of the Chinese People's Political Consultative Conference (CPPCC). In light of our business and structure, Mr. Wang'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.



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 officer.

### **Family Relationships**

Zhenquan Guo, one of our directors, is the nephew of our Chairman and CEO, Dishan Guo. There are no other family relationships between any of our directors or executive officers.

### **Involvement in Certain Legal Proceedings**

To our knowledge, during the last ten years, none of our directors and executive officers (including those of our subsidiaries) has:

Had a bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time.

Been convicted in a criminal proceeding or been subject to a pending criminal proceeding, excluding traffic violations and other minor offenses.

Been subject to any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities or banking activities.

Been found by a court of competent jurisdiction (in a civil action), the SEC, or the Commodities Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended or vacated.

Been the subject to, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization, any registered entity, or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

### **Meetings of Our Board of Directors**

During fiscal year ended December 31, 2011, our Board of Directors did not meet. We did not hold an annual meeting in 2011.

## **Board Committees**

### **Audit Committee**

Our Audit Committee is led by Lei Li as the chairperson. Lizong Wang, Wenbin An, Dishan Guo and Zhenquan 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. Mr. Li is an independent director of the Company and is our audit committee financial expert.

### **Compensation Committee**

Our compensation committee is led by Wenbin An as the chairperson. Lei Li, Lizong Wang, Dishan Guo and Zhenquan 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.

### **Nominating Committee**

Our nominating committee is led by Lizong Wang as the chairperson. Lei Li, Wenbin An, Dishan Guo and Zhenquan 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.chinainternetcafe.com](http://www.chinainternetcafe.com), and are filed herewith

### **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. A copy of our code of ethics is attached hereto as Exhibit 14.1 and can also be found on the Company's website, [www.chinainternetcafe.com](http://www.chinainternetcafe.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.

### **Indemnification of Directors and Officers**

Section 78.138 of the Nevada Revised Statutes ("NRS") provides that a director or officer will not be individually liable unless it is proven that (i) the director's or officer's acts or omissions constituted a breach of his or her fiduciary duties, and (ii) such breach involved intentional misconduct, fraud or a knowing violation of the law.

Section 78.7502 of NRS permits a company to indemnify its directors and officers against expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred in connection with a threatened, pending or completed action, suit or proceeding if the officer or director (i) is not liable pursuant to NRS 78.138 or (ii) acted in good faith and in a manner the officer or director reasonably believed to be in or not opposed to the best interests of the corporation and, if a criminal action or proceeding, had no reasonable cause to believe the conduct of the officer or director was unlawful.

Section 78.751 of NRS permits a Nevada company to indemnify its officers and directors against expenses incurred by them in defending a civil or criminal action, suit or proceeding as they are incurred and in advance of final disposition thereof, upon receipt of an undertaking by or on behalf of the officer or director to repay the amount if it is ultimately determined by a court of competent jurisdiction that such officer or director is not entitled to be indemnified by the company. Section 78.751 of NRS further permits the company to grant its directors and officers additional rights of indemnification under its articles of incorporation or bylaws or otherwise.

Section 78.752 of NRS provides that a Nevada company may purchase and maintain insurance or make other financial arrangements on behalf of any person who is or was a director, officer, employee or agent of the company, or is or was serving at the request of the company as a director, officer, employee or agent of another company, partnership, joint venture, trust or other enterprise, for any liability asserted against him and liability and expenses incurred by him in his capacity as a director, officer, employee or agent, or arising out of his status as such, whether or not the company has the authority to indemnify him against such liability and expenses.

Our Articles of Incorporation provide that no director or officer will be personally liable to us or any of our stockholders for damages for breach of fiduciary duty as a director or officer; provided, however, that the foregoing provision shall not eliminate or limit the liability of a director or officer (i) for acts or omissions which involve intentional misconduct, fraud or knowing violation of law, or (ii) the payment of dividends in violation of Section 78.300 of NRS. In addition, our Articles of Incorporation and bylaws implement the indemnification and insurance provisions permitted by Chapter 78 of the NRS by providing that:

We shall indemnify its directors and officers, or any person serving at our request, to the fullest extent permitted by the NRS.

We may at the discretion of the Board of Directors purchase and maintain insurance on behalf of any person who holds or who has held any position identified in the paragraph above against any and all liability incurred by such person in any such position or arising out of his status as such.

Insofar as indemnification by us for liabilities arising under the Securities Act may be permitted to our directors, officers or persons controlling the company pursuant to provisions of our articles of incorporation and bylaws, or otherwise, we have been advised that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable. In the event that a claim for indemnification by such director, officer or controlling person of us in the successful defense of any action, suit or proceeding is asserted by such director, officer or controlling person in connection with the securities being offered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by us is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

### **Director Independence**

Except for Dishan Guo and Zhenquan Guo, all our other directors are independent directors, as the term “independent” is defined by the rules of the Nasdaq Stock Market.

### **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, except as disclosed below, we believe that with respect to the fiscal year ended December 31, 2011, our directors, executive officers and 10% stockholders complied with all Section 16(a) filing requirements:

- Form 3s were not filed by Lei Li, Lizong Wang, Wenbin An, or Zhenquan Guo upon their appointment as officers and directors on until August 17, 2011 and August 19, 2011.

### **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 in excess of \$100,000 during the stated periods.

**Summary Compensation Table — Fiscal Years Ended December 31, 2011 and December 31, 2010**

Name and Principal Position	Fiscal Year	Salary (\$)	Total (\$)
Dishan Guo,	2011	46,480	46,480
Chief Executive Officer, Chief Financial Officer and director (1)	2010	44,118	44,118

(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 \$46,480).

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.

### ***Compensation Discussion and Analysis***

We strive to provide our named executive officers (as defined in Item 402 of Regulation S-K) with a competitive base salary that is in line with their roles and responsibilities when compared to peer companies of comparable size in similar locations.

It is not uncommon for PRC private companies in the PRC to have base salaries as the sole form of compensation. The base salary level is established and reviewed based on the level of responsibilities, the experience and tenure of the individual and the current and potential contributions of the individual. The base salary is compared to the list of similar positions within comparable peer companies and consideration is given to the executive's relative experience in his or her position. Base salaries are reviewed periodically and at the time of promotion or other changes in responsibilities.

We plan to implement a more comprehensive compensation program, which takes into account other elements of compensation, including, without limitation, short and long term compensation, cash and non-cash, and other equity-based compensation such as stock options. We expect that this compensation program will be comparable to the programs of our peer companies and aimed to retain and attract talented individuals.

### ***Outstanding Equity Awards at Fiscal Year End***



There were no equity awards, including, options, restricted stock or other equity incentives that were outstanding as of December 31, 2011.

### *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 years ended December 31, 2011 and 2010:

#### **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 (\$)	<b>Total (\$)</b>
Lei Li	2011	\$18,592	-	-	-	-	-	18,592
Director	2010	5,901	-	-	-	-	-	5,901
Lizong Wang,	2011	\$18,592	-	-	-	-	-	18,592
Director	2010	5,901	-	-	-	-	-	5,901
Wenbin An	2011	\$18,592	-	-	-	-	-	18,592
Director	2010	5,901	-	-	-	-	-	5,901
Zhenquan Guo	2011	\$-	-	-	-	-	-	-
Director	2010	\$-	-	-	-	-	-	-

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth information regarding beneficial ownership of our common stock as of July 16, 2012 (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, 1-D-1010, Yuanjing Park, Long Xiang Road, Long Gang District, Shenzhen, Guangdong Province, People's Republic of China.

Name and Address of Beneficial Owner	Position	Title of Class	Nature of Beneficial Ownership (1)	Amount and Percent of Class (2)
<b>Officers and Directors</b>				
Dishan Guo	Chairman, Chief Executive Officer and Chief Financial Officer	Common stock, \$0.00001 par value	12,008,750	56.21 %
Zhenquan Guo	Director	Common stock, \$0.00001 par value	600,020	2.81 %
Lei Li	Director	Common stock, \$0.00001 par value	—	—
Wenbin An	Director	Common stock, \$0.00001 par value	—	—
Lizong Wang	Director	Common stock, \$0.00001 par value	100,000	0.47 %
All officers and directors as a group (5 persons named above)		Common stock, \$0.00001 par value	12,708,770	59.49 %
<b>5% Security Holders</b>				
Dishan Guo		Common stock, \$0.00001 par value	12,008,750	56.21 %

(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 July 16, 2012, (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 shares of common stock outstanding on July 16, 2012, 21,361,534, and (ii) the total number of shares that the beneficial owner may acquire upon conversion of the preferred on an 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 21,361,534 shares of our Common Stock are considered to be outstanding pursuant to SEC Rule 13d-3(d)(1) as of July 16, 2012.

## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The following includes a summary of transactions since the beginning of our 2009 fiscal year, 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 or one percent of the average of our total assets at year end for the last two completed fiscal years, and in which any related person had or will have a direct or indirect material interest (other than compensation described under “Executive Compensation”). We believe the terms obtained or consideration that we paid or received, as applicable, in connection with the transactions described below were comparable to terms available or the amounts that would be paid or received, as applicable, in arm’s-length transactions.

On June 11, 2010, Zhonghefangda entered into the Management and Consulting Services Agreement with Junlong, pursuant to which Zhonghefangda agreed to provide management and consulting services to the VIE in exchange for service fees up to 100% of the VIE’s aggregate net profits during the term of the agreement.

On June 11, 2010, Zhonghefangda entered into the Option Agreement with Junlong and the VIE Shareholders, whereby the VIE and the VIE Shareholders granted Zhonghefangda an exclusive, irrevocable option to purchase all or part of their equity interests in Junlong.

On June 11, 2010, Zhonghefangda entered into the Equity Pledge Agreement with Junlong and the VIE Shareholders, whereby the VIE Shareholders have pledged their entire equity interest in the VIE to Zhonghefangda. The equity interests are pledged as collateral to secure the respective obligations of the VIE and the VIE Shareholders under the Management and Consulting Services Agreement, the Option Agreement and the Voting Rights Proxy Agreement.

On June 11, 2010, Zhonghefangda entered into the Voting Rights Proxy Agreement with the VIE and the VIE Shareholders. The agreement requires the VIE Shareholders to grant and entrust Zhonghefangda with all of the voting rights as shareholders of the VIE for the maximum period of time permitted by law.

On July 2, 2010, we entered into a cancellation agreement with certain shareholders, namely, Xuezheng Yuan, First Prestige, Inc., Shuihua Cheng, Catalfa Holdings, Inc. and JD Infinity Holdings, Inc., whereby these shareholders agreed to the cancellation of 4,973,600 shares of our common stock owned by him. At the time he entered into the Cancellation Agreement, Mr. Yuan was our sole director and officer.

In connection with the Offering, we entered into a securities escrow agreement with TriPoint Global Equities, LLC, as representative of the purchasers of certain Unites offered in the Offering, Mr. Dishan Guo, our chairman and largest shareholder and Sichenzia Ross Friedman Ference LLP as escrow agent. As an inducement for the purchasers entering into and consummating the Offering, Mr. Guo agreed to deliver into an escrow account one share of the Company’s Common Stock for each \$10 sold to the purchasers in the Offering to be used as escrow shares, equal to 641,205 shares of common stock (the “Escrow Shares”). The distribution of the Escrow Shares shall be based on a performance threshold for the Company. With respect to the 2011 fiscal year, if we earn less than \$9,500,000 then the Escrow Shares for such year will be delivered to the purchasers in the amount of 10% of the Escrow Shares for each full percentage point by which such threshold was not achieved up to a maximum of the Escrow Shares.

Other than Dishan Guo, who is a party to the Securities Escrow Agreement (defined herein), Option Agreement, Equity Pledge Agreement and Voting Rights Proxy Agreement, none of our directors, director nominees or executive officers has been involved in any transactions with us or any of our directors, executive officers, affiliates or associates which are required to be disclosed pursuant to the rules and regulations of the SEC except as provided as

follows:

Before the Company opened a U.S. bank account in February 2011, various listing and other public company operating expenses were paid by the personal account of Dishan Guo, the Company's Chief Executive Officer. To date, Mr. Guo has lent the Company \$1,397,776. This amount is considered to be a unsecured related party loan due to Mr. Guo Dishan with no stated interest and is payable on demand. This loan is not in writing and the Company keeps track of it through bank statements and intends to repay Mr. Guo in future.

Dishan Guo, Jinzhou Zeng and Xiaofen Wang are each parties to the Option Agreement, Equity Pledge Agreement and Voting Rights Proxy Agreement described above. Dishan Guo is the Company's chief executive officer and all three individuals are shareholders of our VIE, Junlong, and hold controlling interests in Classic Bond.

### **Promoters and Certain Control Persons**

We did not have any promoters at any time during the past five fiscal years.

## **Director Independence**

Except for Dishan Guo and Zhenquan Guo, all our other directors are independent directors, as the term “independent” is defined by the rules of the Nasdaq Stock Market.

## **LEGAL MATTERS**

Our legal counsel, Sichenzia Ross Friedman Ference LLP, located at 61 Broadway, 32nd Floor, New York, NY 10006 is passing on the validity of the issuance of the Common Stock offered under this prospectus.

## **EXPERTS**

Our financial statements as of and for the years ended December 31, 2010 and 2011, included in this prospectus, have been audited by EFP Rotenberg, LLP, our independent registered public accountants, as stated in their report appearing herein and are so included herein in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

## **AVAILABLE INFORMATION**

We have filed a registration statement on Form S-1 under the Securities Act of 1933 with the Securities and Exchange Commission with respect to the shares of our Common Stock offered through this prospectus. This prospectus is filed as a part of that registration statement and does not contain all of the information contained in the registration statement and exhibits. We refer you to our registration statement and each exhibit attached to it for a more complete description of matters involving us, and the statements we have made in this prospectus are qualified in their entirety by reference to these additional materials. You may inspect the registration statement and exhibits and schedules filed with the Securities and Exchange Commission at the Commission’s principal office in Washington, D.C. Copies of all or any part of the registration statement may be obtained from the Public Reference Section of the Securities and Exchange Commission, 100 F Street NE, Washington, D.C. 20549. Please call the Commission at 1-800-SEC-0330 for further information on the operation of the public reference rooms. The Securities and Exchange Commission also maintains a web site at <http://www.sec.gov> that contains reports, proxy statements and information regarding registrants that file electronically with the Commission. In addition, we will file electronic versions of our annual and quarterly reports on the Commission’s Electronic Data Gathering Analysis and Retrieval, or EDGAR System. Our registration statement and the referenced exhibits can also be found on this site as well as our quarterly and annual reports. We will not send the annual report to our shareholders unless requested by the individual shareholders.

**FINANCIAL STATEMENTS**

China Internet Cafe Holdings Group, Inc.'s consolidated financial statements for the years ended December 31, 2010 and 2011, together with the report of the independent certified public accounting firm thereon and the notes thereto are presented beginning at page F-2. The Company's consolidated financial statements for the three months ended March 31, 2012 and 2011 and the notes thereto are presented beginning at page F-33.

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

**CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	Page
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets - at December 31, 2011 and 2010	F-3
Consolidated Statements of Income and Comprehensive Income	F-4
Consolidated Statements of Stockholders' Equity	F-5
Consolidated Statements of Cash Flows	F-6
Notes to Consolidated Financial Statements	F-7 - F-31

F-1



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

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and

Stockholders of China Internet Cafe Holdings Group, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of China Internet Cafe Holdings Group, Inc. and Subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2011. China Internet Cafe Holdings Group, Inc. and Subsidiaries' management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Internet Cafe Holdings Group, Inc. and Subsidiaries as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

/s/ EFP Rotenberg, LLP

EFP Rotenberg, LLP

Rochester, New York

March 30, 2012

F-2

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	December 31, 2011	December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash	\$ 19,629,680	\$ 3,836,824
Restricted cash	-	945,280
Loan receivable	-	2,419,916
Rental deposit	86,580	55,512
Equipment deposit	994,732	1,300,650
Inventory	212,607	180,582
Deferred tax assets	69,405	-
Total current assets	20,993,004	8,738,764
Property, plant and equipment, net	13,000,745	6,848,342
Intangible assets, net	161,083	191,087
Rental deposit-long term portion	314,736	235,509
Total assets	\$ 34,469,568	\$ 16,013,702
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Short term loan	\$ -	\$ 151,245
Accounts payable	100,480	69,373
Registration penalties payable	448,844	-
Deferred revenue	2,084,086	579,822
Payroll and payroll related liabilities	323,286	199,548
Income and other taxes payable	1,316,209	987,194
Accrued expenses	365,696	102,018
Amount due to a shareholder	2,135,218	465,741
Dividend payable on preferred stock	72,729	-
Derivative financial instrument - preferred stock	147,704	-
Derivative financial instrument - warrants	129,496	-
Total current liabilities	7,123,748	2,554,941
Commitments and contingencies (Note 20)		
Preferred stock (\$0.00001 par value, 100,000,000 shares authorized, 4,274,703 and 0 shares issued and outstanding; preference in liquidation - \$5,770,849 and \$0)	3,682,473	-
Stockholders' Equity:		
Common stock (\$0.00001 par value, 100,000,000 shares authorized, 21,124,967 and 20,200,000 shares issued and outstanding as of December 31, 2011 and 2010, respectively)	212	202
Additional paid in capital	1,728,726	1,628,417
Statutory surplus reserves	718,744	718,744
Retained earnings	19,760,289	10,499,454

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Accumulated other comprehensive income	1,455,376	611,944
Total stockholders' equity	23,663,347	13,458,761
Total liabilities and stockholders' equity	\$ 34,469,568	\$ 16,013,702

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

F-3

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

	For The Year Ended December 31,	
	2011	2010
Revenue	\$32,597,144	\$20,460,459
Cost of revenue	20,270,919	11,823,456
Gross profit	12,326,225	8,637,003
Operating Expenses		
General and administrative expenses	2,274,760	634,739
Total operating expenses	2,274,760	634,739
Income from operations	10,051,465	8,002,264
Non-operating income (expenses)		
Change in fair value of derivative financial instrument - preferred stock	1,457,090	-
Change in fair value of derivative financial instrument – warrants	783,290	-
Interest income	12,439	8,265
Interest expenses	(9,303 )	(9,437 )
Other expenses	(563 )	(43 )
Reorganizational expenses		(435,086 )
Total non-operating income (expenses)	2,242,953	(436,301 )
Income before income taxes	12,294,418	7,565,963
Income taxes	2,786,097	1,819,380
Net income	9,508,321	5,746,583
Dividend on preferred stock	(247,486 )	-
Net income attributable to China Internet Cafe Holdings Group, Inc. common stockholders	\$9,260,835	\$5,746,583
Other comprehensive income		
Net income	\$9,508,321	\$5,746,583
Foreign currency translation	843,432	400,949
Total comprehensive income	\$10,351,753	\$6,147,532
Earnings per share		
- Basic	\$0.44	\$0.29
- Diluted	\$0.39	\$0.29
Weighted average common stock outstanding		
- Basic	20,990,725	19,601,644
- Diluted	23,656,429	19,601,644

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

F-4

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

	Common stock Number of shares	Amount	Additional paid-in capital	Statutory reserves	Retained Earnings	Accumulated other comprehensive income	Total Stockholders' Equity
Balance at December 31, 2008	19,000,000	\$ 190	\$ 1,367,032	\$ 399,802	\$ 683,364	\$ 202,037	\$ 2,652,425
Contributed capital by existing shareholders	-	-	6,452	-	-	-	6,452
Transfers to statutory reserves	-	-	-	318,942	(318,942 )	-	-
Net income for the year	-	-	-	-	4,388,449	-	4,388,449
Foreign currency translation difference	-	-	-	-	-	8,958	8,958
Balance at December 31, 2009	19,000,000	190	1,373,484	718,744	4,752,871	210,995	7,056,284
Contributed capital by existing shareholders	-	-	251,612	-	-	-	251,612
Reorganization for reverse merger	1,200,000	12	3,321	-	-	-	3,333
Net income for the year	-	-	-	-	5,746,583	-	5,746,583
Foreign currency translation difference	-	-	-	-	-	400,949	400,949
Balance at December 31, 2010	20,200,000	202	1,628,417	718,744	10,499,454	611,944	13,458,761
Issuance of common stock	924,967	10	100,309	-	-	-	100,319
Preferred stock dividend	-	-	-	-	(247,486 )	-	(247,486 )
Net income for the year	-	-	-	-	9,508,321	-	9,508,321
Foreign currency translation difference	-	-	-	-	-	843,432	843,432
Balance at December 31, 2011	21,124,967	\$ 212	\$ 1,728,726	\$ 718,744	\$ 19,760,289	\$ 1,455,376	\$ 23,663,347

(1) See footnote 1 regarding the recapitalization of Classic Bond Development Limited

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

F-5



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

	For The Year Ended December 31,	
	2011	2010
Cash flows from operating activities		
Net income	\$9,508,321	\$5,746,583
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Change in fair value of derivative financial instrument - preferred stock	(1,457,090 )	-
Change in fair value of derivative financial instrument- warrants	(783,290 )	-
Advisory fee	450,000	-
Depreciation	2,948,401	1,664,405
Amortization	37,212	23,540
Deferred tax assets	(68,307 )	-
Changes in operating assets and liabilities:		
Restricted cash	968,332	737,599
Prepayment	-	(2,360,317)
Rental deposit	(96,983 )	(114,027 )
Inventory	(24,259 )	30,604
Accounts payable	29,718	31,592
Deferred revenue	1,457,156	(217,133 )
Payroll and payroll related liabilities	113,758	69,171
Income and other taxes payable	284,120	432,880
Accrued expenses	704,897	52,936
Amount due to a shareholder	1,643,408	456,842
Net cash provided by operating activities	15,715,394	6,554,675
Cash flows from investing activities		
Purchase of property, plant and equipment	(7,477,866 )	(4,152,294)
Receipt of loan receivable due to termination of an investment agreement	2,478,929	-
Deposits paid for property, plant and equipment	(896,904 )	(1,270,511)
Assets acquisition of cafes	-	(728,866 )
Net cash used in investing activities	(5,895,841 )	(6,151,671)
Cash flows from financing activities		
Net proceeds from issuance of preferred stock and warrants	5,675,614	-
Increase/(Decrease) from short term loan	(154,933 )	-
Cash acquired from reverse merger	-	1,442
Capital contribution by shareholder	-	251,612
Net cash flows provided by financing activities:	5,520,681	253,054
Effect of foreign currency translation on cash	452,622	118,910
Net increase in cash	15,792,856	774,968

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Cash - beginning of year	3,836,824	3,061,856
Cash - end of year	\$19,629,680	\$3,836,824

Cash paid during the period for:

Interest paid	\$9,303	\$9,437
Income taxes paid	\$2,775,996	\$1,630,711

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

Summary of Assets Acquired from Acquisitions:

Net property and equipment	-	503,492
Other current assets	-	15,792
Intangible assets	-	209,582
Net assets acquired	-	728,866

Transfer of equipment deposits paid in property and equipment	\$1,250,275	\$83,811
Registration penalties	\$448,844	
Advisory fee	\$450,000	\$-

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

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

**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.) (“the Company”, “we”, “us”, “our”) was incorporated in the State of Nevada on March 14, 2006. The Company was a development company from incorporation on 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.

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 China Internet Cafe Holdings Group, Inc. (“China Internet Cafe”), 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 which have a net effect of increase of 1,200,000 shares. The business, assets and liabilities did not change as a result of the reverse acquisition.

This share exchange transaction resulted in those shareholders 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 which recorded as reorganizational expenses in statement of income.

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

Classic Bond Development Limited was incorporated on November 2, 2009 in the British Virgins Islands (“BVI”) with 50,000 authorized common 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 to 42 individuals to raise fund of \$84,093 (HK\$651,721) for 651,721 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. At December 31, 2011 and 2010, the issued and outstanding of Common Stock were 21,124,967 and 20,200,000 shares.

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 the 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.

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 the 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 the common control.

On June 10, 2010, Classic Bond formed Shenzhen Zhonghefangda Network Technology Co., Ltd. (“Zhonghefangda”) and Mr. Guo Dishan is the legal representative of Zhonghefangda and thereafter Zhonghefangda becomes a wholly owned subsidiary of Classic Bond and the whole reorganization is completed.

**Exclusive Management and Consulting Agreement**

On June 11, 2010, Zhonghefangda signed 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 in consideration for its right to receive the aggregate net profit of Junlong for a period of twenty (20) years and for succeeding periods of the same duration until terminated by both parties under agreed conditions. Zhonghefangda will reimburse to 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 should be 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 2005, Junlong obtained internet cafe licenses to operate an internet café chain from the Ministry of Culture, and opened the internet first cafe in April, 2006 and our members can access the internet at our venues. We started our internet cafes in 2006 and 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 and 16 internet cafes opened in 2010, 13 internet cafes opened during the year of 2011. In total, we own 57 internet cafes within Shenzhen, Guangdong through December 31, 2011.

**2. Summary of Significant Accounting Policies**

(a)

*Basis of presentation*

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

(b)

*Principle of consolidation*

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

(c)

*Use of estimates*

In preparing financial statements in conformity with US GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reported periods. Actual results could differ from those estimates

Significant Estimates

These financial statements include some amounts that are based on management's best estimates and judgments. The most significant estimates relate to depreciation of property, plant and equipment, deferred revenue, impairment testing of long-lived assets and various contingent liabilities. It is reasonably possible that the above-mentioned estimates and others may be adjusted as more current information becomes available, and any adjustment could be significant in future reporting periods.

(d)

*Revenue recognition*

Internet café members purchase prepaid IC cards which include stored value that will be deducted based on time usage of computer at the internet cafe. Revenues derived from the prepaid IC cards 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 are included in deferred revenue on the balance sheets. The Company does not charge any service fees that cause a decrement to customer balances. There is no expiration date for IC cards.

The Company also records revenue from commission received from the sale of third parties on-line gaming cards, snacks and drinks. Commission revenue amounted 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, 2011 and 2010, the commission income was \$249,430 and \$162,976, less than 1% 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, business taxes and surcharges. Our internet surfing business tax is 20% on gross revenue generated from our internet cafes. Our other surcharges are an education surcharge of 3%, city development surcharge of 1%, a culture development surcharge of 3%, and a snacks and drinks business tax of 5%. All surcharges are calculated on the basis of business tax amount.

(f) *Credit risk*

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

(g) *Cash and cash equivalents*

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

(h) *Restricted cash*

At December 31, 2011 and 2010, restricted cash of \$0 and \$945,280 (equivalent to RMB6,250,000) represented cash held by two escrow agents on behalf of the Company for registered capital.

(i) *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.

(j) *Fair Value of Financial Instruments*

FASB accounting standard requires disclosing fair value to the extent practicable for financial instruments that are recognized or unrecognized in the balance sheet. The fair value of the financial instruments disclosed herein is not necessarily representative of the amount that could be realized or settled, nor does the fair value amount consider the tax consequences of realization or settlement.

For certain financial instruments, including cash, accounts payable, short-term loans, accruals and other payables, it was assumed that the carrying amounts approximate fair value because of the near term maturities of such obligations.

(k) *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 shall 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.

(l)

*Equipments deposits*

The Company prepaid the equipments deposits to the computer suppliers for purchase of computer and equipments for the new internet cafes.

(m)

*Property, plant and equipment*

Property, plant and equipment, comprising computer equipment and hardware, leasehold improvement, 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
Cafe computer equipment and hardware	5 years
Cafe furniture and fixtures	5 years
Office furniture, fixtures and equipments	5 years
Motor vehicles	5 years

Leasehold improvement mainly results from the decoration expense. All of the Company's lease contracts state lease terms of 5 years and leasehold improvement is amortized over 5 years, which represents the shorter of useful life and lease term.

(n)

*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 by 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 has been recorded as expense in the period such cost occurs.

(o)

*Deferred Revenue*

Deferred revenue represents unused balances of the prepaid amounts from the IC cards that are unused balance. The Outstanding customer balances are \$2,084,086 and \$579,822 as of December 31, 2011 and 2010, 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, 2011.

(p)

*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.

(q)

*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.

*(r) 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 all of these VIE that are being consolidated in the accompanying financial statements.

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

	December 31, 2011	December 31, 2010
Current assets and Long term rental deposit	\$ 21,256,846	\$ 8,968,001
Property, plant and equipment	13,000,745	6,848,343
Intangible assets	161,083	191,087
Total assets	34,418,674	16,007,431
Total liabilities	(11,064,894 )	(2,182,851 )
Net assets	\$ 23,353,780	\$ 13,824,580

*(s) 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:

	12/31/2011	12/31/2010
Year end RMB : USD exchange rate	6.3523	6.6118
Average yearly RMB : USD exchange rate	6.4544	6.7788

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.

(t) *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 provides any other post-retirement or post-employment benefits.

(u) *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 reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. See Note 16.

(v) *Retained earnings-appropriated*

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

(w) *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.

As of December 31, 2011 and 2010, the statutory surplus reserves of the subsidiary already reached 50% of the registered capital of the subsidiary and the Company did not have any further allocation on 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)

*Reclassification*

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

(y)

*Recent Accounting Pronouncements*

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which is a new accounting guidance to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This guidance is effective for the Company's fiscal year beginning January 1, 2012. The Company is currently evaluating the impact of this guidance but believes the adoption of it will have no material effect on our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, which is a new guidance on the presentation of comprehensive income that will require a company to present components of net income and other comprehensive income in one continuous statement or in two separate, but consecutive statements. There are no changes to the components that are recognized in net income or other comprehensive income under current GAAP. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with early adoption permitted. It is applicable to the Company's fiscal year beginning January 1, 2012. Currently, the Company evaluated the effect of ASU 2011-05 on its financial statements and has concluded that it would have no material impact on the Company's consolidated financial statements.

ASU 2011-05 was modified by the issuance of ASU 2011-12 - Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 in December 2011, which indefinitely deferred certain provisions of ASU 2011-05, including the requirement to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. This amendment is effective for both annual and interim financial statements beginning after December 15, 2011. The Company believes that its adoption of ASU

2011-12 will not have any material impact on its consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11 - *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*, which requires entities to disclose both gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement. The objective of the disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards ("IFRS"). This ASU is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective presentation for all comparative periods presented is required. Its adoption of ASU 2011-11 is not expected to have material impact on its consolidated financial statements.

F-13



### 3. Business Acquisitions

#### **Assets Acquisition of Langman internet café on April 6, 2010 and Chaosu internet café on April 16, 2010.**

The Company acquired property, plant and equipment, other current assets and intangible assets of Langman internet café on April 6, 2010 and Chaosu internet café on April 16, 2010 for total gross consideration amount of \$497,457 (RMB3,400,000) and the Company paid the whole purchase consideration on July 28, 2010. The intangible assets are comprised of business licenses and customer lists. In accordance with the purchase method of accounting, the estimated fair market value of these assets has been included in the consolidated financial statements from the date of acquisitions.

The primary reason for business acquisitions of Langman and Chaosu are for the development of market ownership in Longgang district. Langman and Chaosu Internet cafes are located in the center of Longgang Center City. For each individual internet café has a coverage of 5kms, after the acquisition of these two cafes, Junlong has developed full coverage in Longgang Center City.

All intangible and tangible assets acquired, based on their appraised fair values, were as follows:

Property, plant, and equipment	\$346,003
Other current assets	10,973
Intangible assets	140,481
Net assets acquired	\$497,457

#### **Assets Acquisition of Gainianshikong internet café on July 1, 2010.**

The Company acquired property, plant and equipment, other current assets and intangible assets of Gainianshikong internet café on July 1, 2010 for total gross consideration amount of \$231,409 (RMB1,550,000) and the Company paid the whole purchase consideration on October 29, 2010. The intangible assets are comprised of business licenses and customer lists. In accordance with the purchase method of accounting, the appraised fair market value of these assets has been included in the consolidated financial statements from the date of acquisitions.

Acquisition of Gainianshikong internet café is for the expansion of business in Baoan District. Baoan is a recent fast developing district of west Shenzhen, which is next to Dongguan City of Guangdong.

All intangible and tangible assets acquired, based on their appraised fair values, were as follows:

Property, plant, and equipment	\$ 157,489
Other current assets	4,819
Intangible assets	69,101
Net assets acquired	\$231,409

These acquisitions were asset acquisitions, and there was no goodwill resulting from these acquisitions because the fairly market values were equal to the purchase prices.

#### 4. Cash

Cash is summarized as follows:

	December 31, 2011	December 31, 2010
Cash at bank	\$ 19,609,650	\$ 3,811,136
Cash in hand	20,030	25,688
	\$ 19,629,680	\$ 3,836,824

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, 2011 and 2010, \$19,585,062 and \$3,836,824 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 \$44,618 and \$0 of the Company's cash and cash equivalents were held by JP Morgan Chase bank in USA.

**5. Restricted Cash**

	December 31, 2011	December 31, 2010
Bank deposits held by:		
Mr. Fangrong, Zheng – Anshun city in Guizhou province	\$ -	\$ 945,280
	\$ -	\$ 945,280

As December 31, 2010, the restricted cash represented the bank deposits of \$945,280 (equivalent to RMB6,250,000) held by an escrow agent on behalf of the Company for registered capital and operating cash flow purposes of a new subsidiary company to be established in Anshun city in Guizhou province.

*Incorporation of Two New Subsidiary Companies*

The Company was committed to establish two new subsidiary companies, which are located in Yiwu city, Zhejiang province and Anshun city, Guizhou province with the investment of approximately \$2.195 million (equivalent to RMB15 million) each, with total of \$4.39 million as registered capital and operating cash flow purposes. The registered capital of each subsidiary company will be \$0.439 million (RMB3,000,000). As of December 31, 2010, the Company paid approximately \$0.95 million (RMB6.25 million) in total to two escrow agents and the amounts were recorded under restricted cash.

The company decided to close down the subsidiary company located in Yiwu city, Zhejiang province and withdraw the investment of approximately \$737,59 (equivalent to RMB5,000,000) on 30th November, 2010 due to the change in the national expansion strategy.

**6. Loan receivable**

Loan receivable consists of:

	December 31, 2011	December 31, 2010
Name of Payee: Mr. Long Weijun		
Terms: Interest free, unsecured and repayment date is February 28, 2011	\$ -	\$ 2,419,916

The Company entered into a trust agreement with Mr. Long Weijun on 25th December 2010 and appointed Mr. Long Weijun as the General Manger of Yunnan subsidiary company. The Company was committed to establish a new subsidiary company located in Kunming city, Yunnan province with the total investment of approximately \$3.02 million (equivalent to RMB 20 million) with 1.51 million (equivalent to RMB 10 million) as registered capital and 1.51 million (equivalent to RMB 10 million) as capital proceeds. The initial proceed was released to Long Weijun on 31st December 2010 of total sum of \$2.42 million (equivalent to RMB 16 million), the rest \$0.6 million (equivalent to RMB 4 million) was released on 7th January 2011. On February 13, 2011, the Company entered into a termination agreement with Mr. Long Weijun to terminate the trust agreement signed on December 25, 2010. The total proceed of \$3.02 million (RMB 20 million) was returned to the Company on February 28, 2011.

## 7. Equipment Deposit

Equipment deposit consists of:

December 31, 2011	December 31, 2010
\$ 994,732	\$ 1,300,650

As of December 31, 2010, equipment deposit for purchase computers for 4 new internet cafés. Three of them were opened in March 2011 and one of them was opened in April, 2011. As of December 31, 2011, equipment deposit for purchase computers for three new internet cafes. They will be opened in May 2012.

**8. Inventory**

Inventory consists of:

December 31, 2011	December 31, 2010
-------------------------	-------------------------

Purchased IC cards	\$ 212,607	\$ 180,582
--------------------	------------	------------

There was no allowance made for obsolete or slow moving inventory as of December 31, 2011 and 2010.

**9. Property, Plant and Equipment, net**

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

	December 31, 2011	December 31, 2010
Leasehold improvement	\$4,535,898	\$3,178,890
Cafe computers equipments and hardware	14,130,446	7,045,296
Cafe furniture and fixtures	1,746,164	1,320,392
Office furniture, fixtures and equipments	303,318	52,293
Motor vehicles	468,169	252,967
	\$21,183,995	\$11,849,838
Less: Accumulated depreciation	(8,183,250 )	(5,001,496 )
Property, plant and equipment, net	\$13,000,745	\$6,848,342

During the year ended December 31, 2011, depreciation expenses amounted to \$2,948,401, of which \$2,263,198 and \$685,203 were recorded as cost of sales and general and administrative expense, respectively.

During the year ended December 31, 2010, depreciation expenses amounted to \$1,664,405, of which \$1,615,096 and \$49,309 were recorded as cost of sales and general and administrative expense, respectively.

**10. Intangible Assets**

Intangible assets are summarized as follows:

	December 31, 2011	December 31, 2010
Business License	\$ 99,000	\$ 95,115
Customer Lists	125,012	120,106
	224,012	215,221
Less: Accumulated Amortization	(62,929 )	(24,134 )
Total	\$ 161,083	\$ 191,087

During the years ended December 31, 2011 and 2010, amortization expenses amounted to \$37,212 and \$ 23,540 respectively which was recorded under cost of sales.

F-16

Estimated amortization for the next five years and thereafter is as follows:

Year ending December 31,

2012	\$37,810
2013	37,810
2014	37,810
2015	20,931
2016	9,087
Thereafter	17,635
Total	\$161,083

## 11. Short Term Loan

The short term loan due within one year as of December 31, 2011 and 2010 consist of the following:

Bank	Loan Period	Interest rate	December 31, 2011	December 31, 2010
China Construction Bank	November 15, 2010 to November 14, 2011	6.372 %	-	151,245

On November 15, 2010, the Company entered into a loan agreement with China Construction Bank for \$151,245 (RMB1,000,000) which was secured by director's guarantee. The annual interest rate is 6.372% and is due on November 14, 2011. The loan was paid in full on November 10, 2011.

## 12. Income and Other Taxes Payable

Income and other tax payables consist of the following:

	December 31, 2011	December 31, 2010
Business tax payable	\$605,274	\$420,236
Income tax	582,406	483,006
Withhold individual income tax payable	1,300	4,022
Other tax payable	127,229	79,930

Total	\$1,316,209	\$ 987,194
-------	-------------	------------

**13. Due To A Shareholder**

	December 31, 2011	December 31, 2010
--	-------------------------	-------------------------

Mr. Guo Di Shan, a shareholder of the Company	\$2,135,218	\$ 465,741
---	-------------	------------

The amount due to Mr. Guo Di Shan is unsecured with no stated interest and payable on demand.

**14. Cost of revenue**

Cost of revenue consists of the following:

	For The Year Ended December 31,	
	2011	2010
Cost of revenue consists of		
Depreciation and amortization	\$2,368,935	\$ 1,615,096
Salary	2,446,447	1,746,098
Rent	1,886,295	1,089,910
Utility	2,143,416	1,541,090
Business tax and surcharge	7,841,367	4,839,276
Others	3,584,459	991,986
	\$20,270,919	\$ 11,823,456



**15. Income Tax**

The components of income before income taxes from continuing operations consisted of the following:

	2011 US\$	2010 US\$
Income (loss) subject to domestic income taxes only	685,681	(626,899 )
Income (loss) subject to foreign income taxes only	11,608,737	8,192,862
	12,294,418	7,565,963

The Company is subject to U.S. federal and state income taxes. The Company's subsidiaries incorporated in the PRC are subject to enterprise income taxes in China. The provision for income taxes from continuing operations consisted of the following:

	2011 US\$	2010 US\$
Current:		
Federal	-	-
State	-	-
PRC	2,855,502	1,819,380
	2,855,502	1,819,380
Deferred:		
Federal	-	-
State	-	-
PRC	(69,405 )	-
Total provision for income taxes	2,786,097	1,819,380

On March 16, 2007, the National People's Congress enacted a new enterprise income tax law ("New EIT Law"), which took effect on January 1, 2008. The New EIT Law applies a uniform 25% enterprise income tax rate to both foreign invested enterprises and domestic enterprises. While the New EIT Law equalizes the tax rates for foreign invested enterprises and domestic companies, preferential tax treatment would continue to be given to companies in certain encouraged economic sectors in PRC. Based on Circular 39—Circular on the Implementation of the Preferential Policies for Corporate Income Tax during the Transition Period, which was issued by the PRC State Council in 2007, enterprises that previously enjoyed a preferential tax rate, would transit to the statutory enterprise income tax rate of 25% over five years starting from January 1, 2008. During this transition period, for enterprises which previously enjoyed preferential tax rate of 15%, the applicable tax rate would increase to 18% for 2008, 20% for 2009, 22% for 2010, 24% for 2011 and 25% for 2012.

Prior to 2008, Junlong enjoyed a preferential tax rate of 15% as a foreign invested enterprise because it was located in Shenzhen Special Economic Zone. Under the New EIT Law, Junlong was no longer entitled to 15% preferential tax

rate but still enjoyed the reduced transitional tax rate at 22% for 2010 and 24% for 2011.

The aggregate dollar effect of preferential tax rate is as follows:

	2011	2010
Aggregate dollar effect of tax holiday	(116,087 )	(245,786 )
Per share effect—basic	\$ 0.01	\$ 0.01
Per share effect—diluted	\$ -	\$ 0.01

The following is a reconciliation of the difference between the actual provision for income taxes and the provision computed by applying the federal statutory rate on income from continuing operations before income taxes:

	2011 US\$	2010 US\$
Tax at federal statutory rate	3,073,604	1,891,491
Permanent differences	(560,095 )	-
Loss not benefited	388,675	156,725
Prior year true ups	-	16,950
Tax holiday	(116,087 )	(245,786 )
	2,786,097	1,819,380

Deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred taxes are comprised of the following:

	2011 US\$	2010 US\$
DTA:		
Deferred assets - others	69,405	-
Deferred assets - NOL	666,516	137,918
Total Deferred assets	735,921	137,918
Total Gross DTA	735,921	137,918
Valuation allowance	(666,516 )	(137,918 )
Net deferred assets	69,405	-

The Company has recorded a valuation allowance against all of its US deferred tax assets at December 31, 2011 and 2010. In accordance with ASC 740 Accounting for Income Taxes, based on all available evidence, including the Company's historical results and the forecast of its future income, it is more likely than not that its US entity will not be able to realize its deferred tax assets, and that all of its PRC entities will be able to realize the deferred tax assets.

For U.S. federal income tax purposes, the Company has net operating loss, or NOL carry forwards of approximately \$0.69 million and \$0.16 million, at December 31, 2011 and 2010, respectively. The 2011 net operating loss carry forwards will expire after 20 years beginning 2029 and the 2010 net operating loss carry forwards will expire after 20 years beginning 2028, if not utilized. The Company has no net operating loss carry forwards for PRC enterprise income tax purposes, at December 31, 2011 and 2010, respectively.

On March 16, 2007, the PRC National People's Congress passed the PRC Enterprise Income Tax Law ("New EIT Law") which became effective on January 1, 2008. The New EIT Law applies a uniform 25% enterprise income tax rate to both foreign invested enterprises and domestic enterprises. The New EIT Law provides a five-year transition period from its effective date for those enterprises which were established before the promulgation date of the New EIT Law and which were entitled to a preferential tax treatment such as a reduced tax rate or a tax holiday. On December 26, 2007, the PRC State Council issued the Notice of the State Council Concerning Implementation of Transitional Rules for Enterprise Income Tax Incentives ("Circular 39"). Based on Circular 39, certain specifically listed categories of enterprises which enjoyed a preferential tax rate are eligible for a graduated rate increase to 25% over the 5-year period beginning from January 1, 2008.

Undistributed earnings of the Company's PRC subsidiary amounted to approximately \$21 million as of December 31, 2011. Those earnings are considered to be permanently reinvested and accordingly, no deferred tax expense is recorded for U.S. federal and state income tax or applicable withholding taxes. The PRC tax authorities have clarified that dividend distributions made out of pre-January 1, 2008 retained earnings will not be subject to withholding taxes.

The Company and its subsidiaries are subject to taxation in the U.S. and the PRC. Our U.S. federal and state income tax returns are generally not subject to examination by the tax authorities for tax years before 2006. The tax authorities in the PRC may examine the tax returns of the Company three years after its fiscal year ended.

## **16. 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

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

numerators and denominators used in the computations of basic and dilutive earnings per share are presented in the following table:

	For The Years Ended Dec 31,	
	2011	2010
<b>BASIC</b>		
Numerator for basic earnings per share attributable to the Company's common stockholders:		
Net income	\$9,508,321	\$5,746,583
Dividend on preferred stock	(247,486 )	-
Net income used in computing basic earnings per share	\$9,260,835	\$5,746,583
Basic weighted average shares outstanding	20,990,725	19,601,644
Basic earnings per share	\$0.44	\$0.29
	For The Years Ended Dec 31,	
	2011	2010
<b>DILUTED</b>		
Numerator for diluted earnings per share attributable to the Company's common stockholders:		
Net income	\$9,260,835	\$5,746,583
Dividend on preferred stock	247,486	-
Net income used in computing diluted earnings per share	\$9,508,321	\$5,746,583
Weighted average outstanding shares of common stock	20,990,725	19,601,644
Weighted average preferred stock	3,665,704	-
Diluted weighted average shares outstanding	24,656,429	19,601,644
Diluted earnings per share	\$0.39	\$0.29
Potential common shares outstanding as of December 31:		
Series A preferred stock	4,274,703	-
Warrants	2,498,326	-
	6,773,029	-

During the year ended December 31, 2011, the average market price of the common stock during the period was less than the exercise price of the Warrants. Accordingly, the Warrants were anti-dilutive and have not been included in the calculation of diluted earnings per share.

## **17. 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, which is calculated at a range of 8% of the average monthly salary. The pension expense was \$ 13,833 and \$9,555 for the year ended December 31, 2011 and 2010, respectively.

## **18. Stockholders' Equity**

### **Common Stock**

On July 2, 2010, the China Internet Cafe Holdings Group, Inc. ("China Internet Cafe"), 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 which have a net effect of increase of 1,200,000 shares. The business, assets and liabilities did not change as a result of the reverse acquisition.

As of December 31, 2011 and 2010, there are 21,124,967 and 20,200,000 shares of Common Stock issued and outstanding respectively.

### **Series A Preferred Stock**

On February 16, 2011, the Company filed with the Secretary of State of Nevada 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"), as an amendment to its Articles of Incorporation.

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 June, September, December and March 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.

Upon liquidation of the Company, holders of Series A Preferred Stock are entitled to be paid, prior to any distribution to any holders of common stock, or any other class or series of stock issued hereafter or junior to the Series A Preferred Stock, an amount equal to \$1.35 per share plus the amount of any accrued but unpaid dividends thereon, as of the date of liquidation (the "Series A Liquidation Preference"). Until conversion, the Series A Preferred Stock has no voting rights other than with respect to matters that may adversely affect the rights of the holders of the Series A Preferred Stock.

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 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 is \$1.35 per share. The conversion price is subject to adjustment for standard anti-dilution events, including stock splits or similar adjustments. In addition, for a period of 12 months following the effective date of the Registration Statement required to be filed under the Registration Rights Agreement discussed below, in the event the Company issues or sells any additional shares of Common Stock or any securities convertible into or exchangeable for, directly or indirectly, Common Stock at a price per share less than the then-applicable Conversion Price or without consideration, then the Conversion Price upon each such issuance will be reduced to the price determined by multiplying the Conversion Price by a fraction: (1) the numerator of which is equal to the sum of (i) the number of shares of outstanding Common Stock immediately prior to the issuance of such additional shares of Common Stock plus (ii) the number of shares of Common Stock which the aggregate consideration for the total number of such additional shares of Common Stock so issued would purchase at a price per share equal to the outstanding Conversion Price in effect immediately prior to such issuance; and (2) the denominator of which is equal to the number of shares of outstanding Common Stock immediately after the issuance of such additional shares of Common Stock.

The Series A Preferred Stock is not subject to mandatory redemption (except on liquidation) but is redeemable in certain circumstances:

If, upon the Company's receipt of a Conversion Notice, the Company cannot issue shares of Common Stock registered for resale under the Registration Statement for any reason, including, without limitation, because the Company (i) does not have a sufficient number of shares of Common Stock authorized and available, (ii) is otherwise prohibited by applicable law or by the rules or regulations of any stock exchange, interdealer quotation system or other self-regulatory organization with jurisdiction over the Company or its securities from issuing all of the Common Stock which is to be issued to a holder of Series A Preferred Stock pursuant to a Conversion Notice or (iii) subsequent to the effective date of the Registration Statement, fails to have a sufficient number of shares of Common Stock registered for resale under the Registration Statement, then the Company shall issue as many shares of Common Stock as it is able to issue in accordance with such holder's Conversion Notice and with respect to the unconverted Series A Preferred Stock, the holder, solely at such holder's option, can require the Company to redeem the shares that cannot be converted at their Series A Liquidation Preference of \$1.35 per share.

If an "Organic Change" occurs (defined as (i) a capital reorganization of the Company (other than by way of a stock split or combination of shares or stock dividends or distributions or similar events, or (ii) a merger or consolidation of the Company with or into another corporation where the holders of the Company's outstanding voting securities prior to such merger or consolidation do not own over 50% of the outstanding voting securities of the merged or consolidated entity, immediately after such merger or consolidation, or (iii) the sale of all or substantially all of the Company's properties or assets to any other person, the holders of the Series A Preferred Stock may request redemption at 110% of the Series A Liquidation Preference of \$1.35 per share. Because of the possible redemption conditions, the Series A Preferred Stock is classified as mezzanine equity.

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 will automatically convert into shares of Common Stock (subject to a restriction that the holder may not convert if it would result in them holding in excess of 9.99% of the then issued and outstanding shares of Common Stock, unless they waive such restriction in writing at least 61 days prior) at the earlier to occur of (i) the 24 month anniversary of the Closing Date, 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.

As of December 31, 2011, there were 4,274,703 shares of Series A Preferred Stock outstanding, which were issued on February 22, 2011. No shares were outstanding at December 31, 2010.

## **19. Sale of Common Stock, Series A Preferred Stock and Warrants**

### Securities Purchase Agreement

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



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

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

The conversion price of the Series A Preferred Stock is subject to adjustment if the Company subsequently sells Common Stock at a lower price. Also, as described below for the Warrants, the conversion option is denominated in U.S. dollars, a currency other than the Company's functional currency. Accordingly, the embedded conversion option is not considered to be indexed only to the Company's common stock. In addition, the Company may be required to redeem the Series A Preferred Stock for cash if, on receipt of a conversion request, it is unable to issue shares registered for resale for any reason. In addition, the conversion price of the Series A Preferred Stock is subject to adjustment if the Company subsequently sells Common Stock at a lower price but there is no explicit limit on the number of shares that the Company may be required to issue. As a result of the foregoing, the exemption provided by ASC 815-10-15-74a is not available and the embedded conversion option has been bifurcated and accounted for as a derivative liability. Because the embedded conversion option has been bifurcated and accounted for as a derivative liability, no beneficial conversion option was required to be recognized.

### Warrants

The Series A and Series B Warrants are exercisable at any time and from time to time at an exercise price of \$2.00 and \$3.00 per share, respectively, and expire 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.

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, 2011, the Company has accrued, \$448,844 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.

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.

F-24

### *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.

At December 31, 2011, the Warrants, the Placement Agent Warrants and the embedded derivative instrument related to the Series A Preferred Stock were re-valued at \$84,951, \$44,545 and \$147,704, respectively, using a binomial model, based on the quoted market price of \$0.44, a term equal to the remaining life of the instruments, an expected dividend yield of 0%, risk-free interest rates of 0.14% to 0.27% based on constant maturity rates published by the U.S. Federal Reserve applicable to the remaining life of the instruments and estimated volatility of 85%. The aggregate change in the fair value of the derivative liabilities between February 22, 2011 and December 31, 2011 of \$2,240,380 has been credited to income.

### *Accounting for Series A Preferred Stock*

\$3,682,473 of the proceeds received were 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.

F-25



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.

#### *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.

The following represents a reconciliation of the changes in fair value of financial instruments measured at fair value using Level 3 inputs during the year ended December 31, 2011:

	Preferred – Embedded Derivative	Warrants	Total
Beginning balance, December 31, 2010	\$-	\$-	\$-
Issued – February 22, 2011	1,604,794	912,786	2,517,580
Fair value adjustments	(1,457,090)	(783,290)	(2,240,380)
Ending balance, December 31, 2011	\$147,704	\$129,496	\$277,200

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.

## **20. 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, 2011, the Company was obligated under operating leases requiring minimum rentals as follows:

Fiscal year	
2012	\$2,015,003
2013	1,645,219
2014	1,543,118
2015	1,127,831
2016	185,300
	\$6,516,471

During the year ended December 31, 2011, rent expenses amounted to \$ 2,074,611, of which \$1,886,295 and \$188,316 was recorded as cost of sales and general and administrative expense, respectively.

During the year ended December 31, 2010, rent expenses amounted to \$1,153,802, of which \$1,089,910 and \$63,892 was recorded as cost of sales and general and administrative expense, respectively.

*Purchase of Plant & Equipment of a total consideration of \$1.24 million*

During the fiscal year ended December 31, 2011, the Company signed six contracts for leasehold improvement and to purchase of equipment for the three internet cafes under construction, totaling \$1,243,416 (representing RMB7,898,549). As of December 31, 2011, the Company paid \$994,732 (representing RMB6,318,839) was recorded in Equipments Deposits for those leasehold improvement and equipments not delivered yet.

*Purchase of Plant & Equipment of a total consideration of \$1.74 million*

During the fiscal year ended December 31, 2010, the Company signed two contracts for leasehold improvement and to purchase of plant and equipment for the four internet cafes under construction, totaling \$1,743,587 (representing RMB11,528,250). As of December 31, 2010, the Company paid \$1,300,650 (representing RMB8,599,635) was recorded in Equipments Deposits for those plant and equipments not delivered yet.

*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.

## **21. Concentrations**

The Company did not have any customer constituting greater than 10% of net sales for the years ended December 31, 2011 and 2010.

At December 31, 2011 and 2010, there was one supplier of consignment snacks and drinks with amount of \$100,480 and \$67,224 respectively, which accounted for 100% and 97% of the Company's account payable.

## **22. Operating Risk and Uncertainties**

### *Interest rate risk*

The interest rates and terms of repayment of bank and other borrowings are disclosed in Note 11. 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 since 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 for regional internet café chain is required and RMB50,000,000 for 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 of other service providers available to the Company.

## **23. Segment Information**

The Company applies the provisions of ASC 280, "Disclosures about Segments of an Enterprise and Related Information". The Company views its operations and manages its business as one segment: the operation of internet 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.

## **24. Subsequent Events**

As of December 31, 2011, the Company evaluated subsequent events for potential recognition and disclosure through the date of the financial statement issuance.

## **25. Additional Information - Condensed Financial Statements of the Company**

The Company is required to include the condensed financial statements of the Company in accordance with Regulation S-X promulgated by the United States Securities and Exchange Commission. The separate condensed financial statements of the Company as presented below have been prepared in accordance Securities and Exchange Commission Regulation S-X Rule 5-04 and Rule 12-04 and present the Company's investments in its subsidiaries under the equity method of accounting. Subsidiaries income is included as the Company's "Share of income from subsidiaries" on the condensed statement of income and comprehensive income.

As of December 31, 2011 and 2010, there were no material contingencies, significant provisions for long-term obligations, or guarantees of the Company, except for those which have been separately disclosed in the Consolidated Financial Statements, if any.

## FINANCIAL INFORMATION OF CHINA INTERNET CAFE HOLDINGS GROUP, INC.

**Condensed Balance Sheets**

	December 31, 2011	December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalent	\$ 44,618	\$ -
Rental deposit	3,333	3,333
Due from subsidiaries	5,959,933	-
Investment in subsidiaries	52,268,833	44,100,984
<b>Total assets</b>	<b>\$ 58,276,717</b>	<b>\$ 44,104,317</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accrued expenses	\$ 54,401	\$ 54,401
Amount due to a shareholder	630,000	300,000
Registration penalties payable	448,844	-
Dividend payable on preferred stock	72,729	-
Derivative financial instrument - preferred stock	147,704	-
Derivative financial instrument - warrants	129,496	-
<b>Total current liabilities</b>	<b>1,483,174</b>	<b>354,401</b>
Stockholders' Equity		
Preferred stock (\$0.00001 par value, 100,000,000 shares authorized, 4,274,703 and 0 shares issued and outstanding; preference in liquidation - \$5,770,849 and \$0)	3,682,473	
Common stock (\$0.00001 par value, 100,000,000 shares authorized, 21,124,967 and 20,200,000 shares issued and outstanding as of December 31, 2011 and 2010, respectively)	212	202
Additional paid in capital	38,103,440	38,003,131
Retained earnings	15,007,418	5,746,583
<b>Total stockholders' equity</b>	<b>56,793,543</b>	<b>43,749,916</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 58,276,717</b>	<b>\$ 44,104,317</b>

**Condensed Statements of Income and Comprehensive Income**

	December 31 2011	December 31 2010
Operating Expenses		
General and administrative expenses	\$ 899,927	\$ 54,401
Total operating expenses	899,927	54,401
Loss from operations	(899,927 )	(54,401 )
Non-operating income (expenses)		
Change in fair value of derivative financial instrument - preferred stock	1,457,090	-
Change in fair value of derivative financial instrument - warrants	783,290	-
Equity in earnings of unconsolidated subsidiaries	8,167,849	6,100,984
Interest income	18	9,168
Other expenses	-	(3,114 )
Reorganizational expenses	-	(306,054 )
Total non-operating expenses	10,408,248	5,800,984
Income before income taxes	9,508,321	5,746,583
Income taxes	-	-
Net income	9,508,321	5,746,583
Dividend on preferred stock	(247,486 )	-
Net income attributable to China Internet Cafe Holdings Group, Inc. common stockholders	9,260,835	5,746,583
Other comprehensive income		
Foreign currency translation adjustment	\$ 843,432	400,949
Comprehensive income	\$ 10,104,267	\$ 6,147,532



**Condensed Statements of Cash Flows**

	December 31 2011	December 31 2010
Cash flows from operating activities		
Net income/(loss)	\$9,508,321	\$5,746,583
Adjustments to reconcile net income to net cash provided by operating activities		
Investment (income)/loss from unconsolidated subsidiaries	(8,167,849 )	(6,100,984 )
Gain on derivative financial instrument - preferred stock	(1,457,090 )	-
Gain on derivative financial instrument - warrants	(783,290 )	-
Advisory fee	450,000	-
Changes in operating assets and liabilities:		
Rental deposit	-	3,333
Due from subsidiaries	(5,959,932 )	-
Accrued expenses	448,844	54,401
Amount due to a shareholder	330,000	300,000
Net cash used in operating activities	(5,630,996 )	3,333
Cash flows from financing activities		
Net proceeds from issuance of preferred stock and warrants	5,675,614	-
Capital contribution by shareholder	-	(3,333 )
Net cash provided by financing activities:	5,675,614	(3,333 )
Effect of foreign currency translation on cash and cash equivalents		-
Net increase in cash	44,618	-
Cash - beginning of year	-	-
Cash - end of year	\$44,618	\$-

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

**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2012**

Consolidated Balance Sheets at March 31, 2012 (unaudited) and December 31, 2011	F-33
Consolidated Statements of Income and Comprehensive Income (unaudited)	F-34
Consolidated Statements of Cash Flows (unaudited)	F-35
Notes to Consolidated Financial Statements (unaudited)	F-36 - F-56

F-32

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2012 Unaudited	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash	\$21,988,739	\$19,629,680
Rental deposit	81,089	86,580
Equipment deposit	1,001,052	994,732
Inventory	116,426	212,607
Deferred tax assets	71,323	69,405
Total current assets	23,258,629	20,993,004
Property, plant and equipment, net	12,174,366	13,000,745
Intangible assets, net	152,593	161,083
Rental deposit-long term portion	322,756	314,736
Total assets	\$35,908,344	\$34,469,568
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$148,564	\$100,480
Registration penalties payable	641,200	448,844
Deferred revenue	2,057,586	2,084,086
Payroll and payroll related liabilities	364,083	323,286
Income and other taxes payable	1,041,810	1,316,209
Accrued expenses	361,814	365,696
Amount due to a shareholder	2,245,464	2,135,218
Dividend payable on preferred stock	71,938	72,729
Derivative financial instrument - preferred stock	579,882	147,704
Derivative financial instrument - warrants	435,775	129,496
Total current liabilities	7,948,116	7,123,748
Commitments and contingencies (Note 11)		
Preferred stock as of March 31, 2012 and December 31, 2011 (\$0.00001 par value, 100,000,000 shares authorized, 4,274,703 shares issued and outstanding as of March 31, 2012 and December 31, 2011; preference in liquidation - \$5,770,849)	3,682,473	3,682,473
Stockholders' Equity:		
Common stock (\$0.00001 par value, 100,000,000 shares authorized, 21,254,377 shares issued and outstanding as of March 31, 2012 and December 31, 2011)	212	212
Additional paid in capital	1,906,455	1,728,726
Statutory surplus reserves	718,744	718,744
Retained earnings	20,016,910	19,760,289
Accumulated other comprehensive income	1,635,434	1,455,376
Total stockholders' equity	24,277,755	23,663,347

Total liabilities and stockholders' equity	\$35,908,344	\$34,469,568
--	--------------	--------------

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

F-33

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

	For The Three Month Ended March 31,	
	2012	2011 Restated
Revenue	\$ 7,134,204	\$ 6,489,581
Cost of revenue	5,005,431	3,995,342
Gross profit	2,128,773	2,494,239
Operating Expenses		
General and administrative expenses	569,894	444,467
Total operating expenses	569,894	444,467
Income from operations	1,558,879	2,049,772
Non-operating income (expenses)		
Change in fair value of derivative financial instrument - preferred stock	(432,178 )	(1,439,326 )
Change in fair value of derivative financial instrument - warrants	(306,279 )	(762,643 )
Interest income	3,730	1,994
Interest expenses	-	(2,531 )
Other expenses	(143 )	-
Total non-operating income (expenses)	(734,870 )	(2,202,506 )
Income(Loss) before income taxes	824,009	(152,734 )
Income taxes	495,450	559,689
Net income(loss)	328,559	(712,423 )
Dividend on preferred stock	(71,938 )	(33,202 )
Net income(loss) attributable to China Internet Cafe Holdings Group, Inc. common stockholders	\$ 256,621	\$ (745,625 )
Other comprehensive income		
Net income	\$ 328,559	\$ (712,423 )
Foreign currency translation	180,058	55,373
Total comprehensive income	\$ 508,617	\$ (657,050 )
Earnings per share		
- Basic	\$ 0.01	\$ (0.04 )
- Diluted	\$ 0.01	\$ (0.04 )
Weighted average common stock outstanding		
- Basic	21,254,377	20,580,542
- Diluted	25,529,080	22,527,907

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

F-34

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

	For The Three Months Ended March 31,	
	2012	2011 Restated
Cash flows from operating activities		
Net income(loss)	\$ 328,559	\$ (712,423 )
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Change in fair value of derivative financial instrument - preferred stock	432,178	1,439,326
Change in fair value of derivative financial instrument- warrants	306,279	762,643
Stock based compensation	105,000	-
Advisory fee	-	192,466
Depreciation	911,076	621,998
Amortization	9,535	9,112
Deferred tax assets	(1,481 )	(55,532 )
Changes in operating assets and liabilities:		
Prepayment	-	(73,592 )
Rental deposit	-	(23,398 )
Inventory	97,757	6,642
Accounts payable	47,556	37,676
Deferred revenue	(39,832 )	351,300
Payroll and payroll related liabilities	38,833	9,840
Income and other taxes payable	(283,416 )	188,166
Accrued expenses and penalties payable	186,610	201,752
Amount due to a shareholder	101,281	928,585
Net cash provided by operating activities	2,239,937	3,884,561
Cash flows from investing activities		
Receipt of loan receivable due to termination of an investment agreement	-	2,428,142
Assets acquisition of cafes	-	(590,787 )
Net cash provided by investing activities	-	1,837,355
Cash flows from financing activities		
Net proceeds from issuance of preferred stock and warrants	-	5,675,614
Net cash flows provided by financing activities:	-	5,675,614
Effect of foreign currency translation on cash	119,123	3,556
Net increase in cash	2,359,060	11,401,086
Cash - beginning of period	19,629,680	3,836,824
Cash - end of period	\$ 21,988,739	\$ 15,237,910

Cash paid during the period for:

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Interest paid	\$ -	\$ 2,531
Income taxes paid	\$ 600,199	\$ 484,648

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

Transfer of equipment deposits paid in property and equipment	\$ -	\$ 1,224,660
Dividend payable on preferred stock	71,938	33,202
Registration penalties	\$ 192,356	-
Advisory fee	\$ -	\$ 192,466

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

F-35



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

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2012**

**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.) (“the Company”, “we”, “us”, “our” or “China Internet Cafe”) was incorporated in the State of Nevada on March 14, 2006. The Company was a development company from incorporation to 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.

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, China Internet Cafe completed a reverse acquisition transaction through a share exchange with Classic Bond Development Limited, a British Virgin Islands corporation (“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 business, assets and liabilities did not change as a result of the reverse acquisition.

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 common stock.

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 fees of \$129,033 and interest expenses of \$6,053 related to the short-term loan for the payment of restructuring expenses. All of these expenses amounting to a total of \$435,086, which was recorded as reorganizational expenses in the statement of income.

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

Classic Bond Development Limited was incorporated on November 2, 2009 in the British Virgins Islands (“BVI”) with 50,000 authorized common stock with no par value. On November 2, 2009, 50,000 shares of 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, 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 to 42 individuals to raise \$84,093 (HK\$651,721) for 651,721 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 the existing shareholders of Junlong Culture Communication Co., Ltd., a company controlled by China Internet Cafe (as explained herein) and the total amount was \$251,612. At December 31, 2010 and December 31, 2009, the issued and outstanding of common stock were 2,000,000 and 50,000 shares.

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

Classic Bond is in the business of operating internet cafes throughout the Longgang District of Shenzhen in Guangdong Province in the People’s Republic of China (“PRC”). The Company conducts its operations through the following subsidiaries: (a) Shenzhen Zhonghefangda Network Technology Co., Ltd. (“Zhonghefangda”), a wholly-owned subsidiary of the Company located in the PRC, and (b) Shenzhen Junlong Culture Communication Co., Ltd. (“Junlong”), an entity located in the PRC, 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 was incorporated in the PRC on June 10, 2010 with registered capital of \$129,032 (HK\$1 million). Zhonghefangda is engaged in the provision of management and consulting services.

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 was able to consolidate the assets, liabilities, and results of operations and cash flows of Junlong in the financial statements. Because the legal representatives and ultimate major stockholder of Zhonghefangda and Junlong is the same person, Mr. Gou Dishan, Zhonghefangda and Junlong were deemed, until June 11, 2010, to be under the 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 Junlong's business. The agreement provides that Junlong will compensate Zhonghefangda in consideration for its right to receive the aggregate net profit of Junlong for a period of twenty (20) years and for succeeding periods of the same duration until terminated by both parties under agreed to 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 is deemed to control Junlong as a VIE and should be consolidated in the accompanying financial statements.

**Shenzhen Junlong Culture Communication Co., Ltd.**

Junlong is a Chinese enterprise organized in the PRC on December 26, 2003 in accordance with the Laws of the People's Republic of China with registered capital of \$0.136 million (Renminbi ("RMB") 1 million). In 2001, the Chinese government imposed higher capital and facility requirements for the establishment of internet cafes (RMB 10 million for regional internet cafe chains and RMB 50 million for national internet cafe chains). 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). Its capital verification process has been completed.

In 2005, Junlong obtained licenses to operate internet cafe chains from the Ministry of Culture, and opened their first internet cafe in April, 2006. We continued to open a total of 7 internet cafes in 2006, 5 internet cafes in 2007, 11 internet cafes in 2008, 5 internet cafes in 2009, 16 internet cafes in 2010 and 15 internet cafes in 2011. In total, we own 59 internet cafes within Shenzhen of China.

## 2. Summary of Significant Accounting Policies

### (a) *Basis of presentation*

The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The functional currency is the Chinese Renminbi, however the accompanying condensed consolidated financial statements have been translated and presented in United States Dollars (\$).

It is management's opinion that the unaudited condensed consolidated financial statements include all adjustments necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company for the periods presented. All adjustments are of a normal recurring nature. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of operating results expected for the full year or future interim periods. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, filed on March 30, 2012 (the "Annual Report").

Results of operations for the interim periods are not indicative of annual results.

### (b) *Principle of consolidation*

The condensed consolidated financial statements include the accounts of China Internet Cafe, Classic Bond, Zhonghefangda and the Junlong. All significant intercompany balances and transactions have been eliminated in the consolidation. The condensed 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 US GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reported periods. Actual results could differ from those estimates.

Significant Estimates

These financial statements include some amounts that are based on management's best estimates and judgments. The most significant estimates relate to depreciation of property, plant and equipment, deferred revenue, impairment testing of long-lived assets and various contingent liabilities. It is reasonably possible that the above-mentioned estimates and others may be adjusted as more current information becomes available, and any adjustment could be significant in future reporting periods.

(d)

*Revenue recognition*

Internet cafe members' purchase prepaid IC cards which include stored value that will be deducted based on time usage of computer at the internet cafe. Revenues derived from the prepaid IC cards at the internet cafe 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 are included in deferred revenue on the balance sheets. The Company does not charge any service fees that cause a decrement to customer balances. There is no expiration date for IC cards.

The Company also records revenue from commission received from the sale of third parties on-line gaming cards, snacks and drinks. Commission revenue amounted to 20% of the value of the on-line gaming cards, snacks and drinks is recognized at the time the gaming cards, etc. are sold to customers. During the three months ended March 31, 2012 and 2011, the commission income was \$71,963 and \$51,740, respectively, less than 1% 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, business taxes and surcharges. Our internet surfing business tax is 20% on gross revenue generated from our internet cafes. Our other surcharges are an education surcharge of 3%, city development surcharge of 1%, a culture development surcharge of 3%, and a snacks and drinks business tax of 5%. All surcharges are calculated on the basis of business tax amount.

(f) *Credit risk*

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

(g) *Cash and cash equivalents*

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

(h) *Inventory*

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

(i) *Fair Value of Financial Instruments*

The Financial Accounting Standards Board ("FASB") accounting standards require disclosing fair value to the extent practicable for financial instruments that are recognized or unrecognized in the balance sheet. The fair value of the financial instruments disclosed herein is not necessarily representative of the amount that could be realized or settled, nor does the fair value amount consider the tax consequences of realization or settlement.

For certain financial instruments, including cash, accounts payable, short-term loans, accruals and other payables, it was assumed that the carrying amounts approximate fair value because of the near term maturities of such obligations.

(j)

*Stock-Based Compensation*

Our advisor assists the Company with ongoing corporate compliance and developments are accounted for under ASC 505-50. ASC 505-50-30-11 (previously EITF 96-18) which provides that an issuer shall 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 the equipment deposits to the computer suppliers for purchase of computer and equipment for new internet cafes.



(l) *Property and equipment*

Property and equipment, comprising computer equipment and hardware, leasehold improvement, office furniture and vehicles and 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
Cafe computer equipment and hardware	5 years
Cafe furniture and fixtures	5 years
Office furniture, fixtures and equipment	5 years
Motor vehicles	5 years

Leasehold improvements mainly result from decoration expenses. All of our 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 amortize the customer lists by 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 has been 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 \$2,057,586 and \$2,084,086 as of March 31, 2012 and December 31, 2011, respectively, and are included in deferred revenue on the balance sheets. Management has evaluated the deferred revenue balance and has determined any potential revenue from the unused balance to be immaterial at the quarter ended March 31, 2012.

(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. 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 quarter-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.

*(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 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 100% ownership of Zhonghefangda. Classic Bond, as mentioned above, will absorb a majority of the economic risks and rewards of the VIEs being consolidated in the accompanying financial statements.

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

	March 31, 2012	December 31, 2011
Current assets and Long term rental deposit	\$23,558,288	\$21,256,846
Property, plant and equipment	12,174,366	13,000,745
Intangible assets	152,594	161,083
Total assets	35,885,248	34,418,674
Total liabilities	(10,900,195)	(11,064,894)
Net assets	\$24,985,053	\$23,353,780

*(r) Foreign currency translation*

Assets and liabilities of the Company with a functional currency of RMB is 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 (source: [www.onanda.com](http://www.onanda.com)):

	March 31, 2012	March 31, 2011
Quarter ended RMB : USD exchange rate (closing buying rate)	6.3122	6.5701
Three months average RMB : USD exchange rate (average ask rate)	6.2976	6.5894
	December 31, 2011	
Year ended RMB : USD exchange rate (closing buying rate)	6.3523	
Average yearly RMB : USD exchange rate (average ask rate)	6.4544	

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 provides any other post-retirement or post-employment benefits.

(t) *Earnings per share (EPS)*

Earnings per share (“EPS”) 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 reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

There is a dilution factor related to dividend on preferred stock occurred during the year. See related details in note 16.

(u) *Statutory surplus reserves (Appropriated retained earnings)*

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.

As of March 31, 2012, the statutory surplus reserves of the subsidiary already reached 50% of the registered capital of the subsidiary and the Company did not have any further allocation requirement.

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.

(v) *Recent Accounting Pronouncements*

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which is a new accounting guidance to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This guidance is effective for the Company's fiscal year beginning January 1, 2012. The Company adoption of this guide did not have material effect on our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, which is a new guidance on the presentation of comprehensive income that will require a company to present components of net income and other comprehensive income in one continuous statement or in two separate, but consecutive statements. There are no changes to the components that are recognized in net income or other comprehensive income under current GAAP. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with early adoption permitted. It is applicable to the Company's fiscal year beginning January 1, 2012. The adoption of ASU 2011-05 did not have material impact on the Company's consolidated financial statements.

ASU 2011-05 was modified by the issuance of ASU 2011-12 - Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 in December 2011, which indefinitely deferred certain provisions of ASU 2011-05, including the requirement to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. This amendment is effective for both annual and interim financial statements beginning after December 15, 2011. The adoption of ASU 2011-12 did not have any

material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11 - *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*, which requires entities to disclose both gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement. The objective of the disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards ("IFRS"). This ASU is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective presentation for all comparative periods presented is required. Its adoption of ASU 2011-11 is not expected to have material impact on its consolidated financial statements.

**3. Equipment Deposit**

Equipment deposit consists of:

March	December
31,	31,
2012	2011

\$1,001,052	\$994,732
-------------	-----------

As of March 31, 2012 and December 31, 2011, equipment deposit \$1,001,052 (RMB 6,318,839) and \$994,732 (RMB 6,318,839) for purchase computers for three new internet cafes. One internet cafe will be opened in June 2012 and another two internet cafes will be opened in the third quarter..

**4. Inventory**

Inventory consists of:

March	December
31,	31,
2012	2011

Purchased IC cards	\$116,426	\$212,607
--------------------	-----------	-----------

There was no allowance made for obsolete or slow moving inventory as of March 31, 2012 and December 31, 2011.

**5. Income and Other Taxes Payable**

Income and other tax payables consist of the following:

	March	December
	31,	31,
	2012	2011
Business tax payable	\$459,268	\$605,274
Income tax	483,076	582,406
Withhold individual income tax payable	2,968	1,300
Other tax payable	96,498	127,229
Total	\$1,041,810	\$1,316,209

**6. Amount Due To a Shareholder (Related party loan)**

	March	December
	31,	31,
	2012	2011

Mr. Guo Di Shan, a shareholder of the Company    \$2,245,464    \$2,135,218

The amount due to Mr. Guo Di Shan is unsecured with no stated interest and payable on demand.

F-43



## **7. Income Tax**

The Company is subject to U.S. federal income tax, and the Company's subsidiaries incorporated in the People's Republic of China (the "PRC") are subject to enterprise income taxes in the PRC.

During the three months ended March 31, 2012 and 2011, the Company recorded an income tax expense of approximately \$0.50 million and \$0.56 million, respectively. The decrease of approximately \$0.06 million in the Company's income tax expense was primarily due to the decrease in profits of its PRC subsidiaries.

The effective tax rate increased by 1% from a 24% effective rate for the three months ended March 31, 2011 to a 25% effective rate for the three months ended March 31, 2012.

For the three months ended March 31, 2012 and 2011, the Company recorded uncertain tax benefits of approximately \$0 and \$0, respectively.

Aggregate undistributed earnings of approximately \$23 million as of March 31, 2012 of the Group's PRC subsidiaries 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, 2008 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.

## **8. Employee Benefits**

The Company contributes to a state pension scheme organized by municipal and provincial governments with respect to 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 \$3,452 and \$2,826 for the three months ended March 31, 2012 and 2011, respectively.



## 9. Stockholders' Equity

### Common Stock

On July 2, 2010, the China Internet Cafe Holdings Group, Inc. ("China Internet Cafe"), 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 which have a net effect of increase of 1,200,000 shares. The business, assets and liabilities did not change as a result of the reverse acquisition.

As of March 31, 2012 and December 31, 2011, there are 21,254,377 shares of Common Stock issued and outstanding respectively.

### Series A Preferred Stock

On February 16, 2011, the Company filed with the Secretary of State of Nevada 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"), as an amendment to its Articles of Incorporation.

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.

Upon liquidation of the Company, holders of Series A Preferred Stock are entitled to be paid, prior to any distribution to any holders of common stock, or any other class or series of stock issued hereafter or junior to the Series A Preferred Stock, an amount equal to \$1.35 per share plus the amount of any accrued but unpaid dividends thereon, as of the date of liquidation (the "Series A Liquidation Preference"). Until conversion, the Series A Preferred Stock has no voting rights other than with respect to matters that may adversely affect the rights of the holders of the Series A Preferred Stock.

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

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 is \$1.35 per share. The conversion price is subject to adjustment for standard anti-dilution events, including stock splits or similar adjustments. In addition, for a period of 12 months following the effective date of the Registration Statement required to be filed under the Registration Rights Agreement discussed below, in the event the Company issues or sells any additional shares of Common Stock or any securities convertible into or exchangeable for, directly or indirectly, Common Stock at a price per share less than the then-applicable Conversion Price or without consideration, then the Conversion Price upon each such issuance will be reduced to the price determined by multiplying the Conversion Price by a fraction: (1) the numerator of which is equal to the sum of (i) the number of shares of outstanding Common Stock immediately prior to the issuance of such additional shares of Common Stock plus (ii) the number of shares of Common Stock which the aggregate consideration for the total number of such additional shares of Common Stock so issued would purchase at a price per share equal to the outstanding Conversion Price in effect immediately prior to such issuance; and (2) the denominator of which is equal to the number of shares of outstanding Common Stock immediately after the issuance of such additional shares of Common Stock.

The Series A Preferred Stock is not subject to mandatory redemption (except on liquidation) but is redeemable in certain circumstances:

F-45

If, upon the Company's receipt of a Conversion Notice, the Company cannot issue shares of Common Stock registered for resale under the Registration Statement for any reason, including, without limitation, because the Company (i) does not have a sufficient number of shares of Common Stock authorized and available, (ii) is otherwise prohibited by applicable law or by the rules or regulations of any stock exchange, interdealer quotation system or other self-regulatory organization with jurisdiction over the Company or its securities from issuing all of the Common Stock which is to be issued to a holder of Series A Preferred Stock pursuant to a Conversion Notice or (iii) subsequent to the effective date of the Registration Statement, fails to have a sufficient number of shares of Common Stock registered for resale under the Registration Statement, then the Company shall issue as many shares of Common Stock as it is able to issue in accordance with such holder's Conversion Notice and with respect to the unconverted Series A Preferred Stock, the holder, solely at such holder's option, can require the Company to redeem the shares that cannot be converted at their Series A Liquidation Preference of \$1.35 per share.

If an "Organic Change" occurs (defined as (i) a capital reorganization of the Company (other than by way of a stock split or combination of shares or stock dividends or distributions or similar events, or (ii) a merger or consolidation of the Company with or into another corporation where the holders of the Company's outstanding voting securities prior to such merger or consolidation do not own over 50% of the outstanding voting securities of the merged or consolidated entity, immediately after such merger or consolidation, or (iii) the sale of all or substantially all of the Company's properties or assets to any other person, the holders of the Series A Preferred Stock may request redemption at 110% of the Series A Liquidation Preference of \$1.35 per share. Because of the possible redemption conditions, the Series A Preferred Stock is classified as mezzanine equity.

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 will automatically convert into shares of Common Stock (subject to a restriction that the holder may not convert if it would result in them holding in excess of 9.99% of the then issued and outstanding shares of Common Stock, unless they waive such restriction in writing at least 61 days prior) at the earlier to occur of (i) the 24 month anniversary of the Closing Date, 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.

As of March 31, 2012 and December 31, 2011, there were 4,274,703 shares of Series A Preferred Stock outstanding, which were issued on February 22, 2011.

## **10. Sale of Common Stock, Series A Preferred Stock and Warrants**

### Securities Purchase Agreement

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

Because certain of the instruments issued in the Offering are derivative instruments which will be initially and continuously carried at fair value, we believe the aggregate proceeds received should be allocated following the principles implicit in the guidance at ASC 815-15-30-2. The proceeds are first allocated to those derivative instruments that will initially and continuously be carried at fair value. The remaining proceeds, if any, are then allocated between the non-derivative host contract and other non-derivative instruments on a relative fair value basis. The Company reviewed the features of the Series A Preferred Stock, other than the conversion feature, and concluded that, on balance, the terms and features of the host contract should be considered to be more akin to a debt instrument. Accordingly, the embedded conversion option may be required to be bifurcated and accounted for as a derivative instrument unless it meets the exemption provided by ASC 815-10-15-74a.

The conversion price of the Series A Preferred Stock is subject to adjustment if the Company subsequently sells Common Stock at a lower price. Also, as described below for the Warrants, the conversion option is denominated in U.S. dollars, a currency other than the Company's functional currency. Accordingly, the embedded conversion option is not considered to be indexed only to the Company's common stock. In addition, the Company may be required to redeem the Series A Preferred Stock for cash if, on receipt of a conversion request, it is unable to issue shares registered for resale for any reason. In addition, the conversion price of the Series A Preferred Stock is subject to adjustment if the Company subsequently sells Common Stock at a lower price but there is no explicit limit on the number of shares that the Company may be required to issue. As a result of the foregoing, the exemption provided by ASC 815-10-15-74a is not available and the embedded conversion option has been bifurcated and accounted for as a derivative liability. Because the embedded conversion option has been bifurcated and accounted for as a derivative liability, no beneficial conversion option was required to be recognized.

### Warrants

The Series A and Series B Warrants are exercisable at any time and from time to time at an exercise price of \$2.00 and \$3.00 per share, respectively, and expire 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.

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 815-40-15-71, 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.

F-47



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 March 31, 2012, 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.

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.

#### *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.

At March 31, 2012, the Warrants, the Placement Agent Warrants and the embedded derivative instrument related to the Series A Preferred Stock were re-valued at \$318,324, \$117,451 and \$579,882, respectively, using a binomial model, based on the quoted market price of \$0.40, a term equal to the remaining life of the instruments, an expected dividend yield of 0%, risk-free interest rates of 0.18% to 0.32% based on constant maturity rates published by the U.S. Federal Reserve applicable to the remaining life of the instruments and estimated volatility of 155% to 175%. The aggregate change in the fair value of the derivative liabilities between December 31, 2011 and March 31, 2012 of \$738,457 has been debited to income.

F-49

*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.

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. During the year ended 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.

*Consulting services and compensation*

On January 1, 2012, the Company issued 300,000 common stock options exercisable at \$0.64 per share vesting on January 1, 2012 to Potomac Investments, LLC for its service rendered. The options are exercisable until November 15, 2014. The company records the expense of the stock options over the related vesting period. The options were valued using the Binomial Model at the date of grant. The total fair market value at grant date is \$108,000 based on the following assumptions: dividend yield: 0%; volatility: 164.33%, risk free rate: 0.36%, expected term: 3 years. All options remain outstanding at March 31, 2012.

*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.

The following represents a reconciliation of the changes in fair value of financial instruments measured at fair value using Level 3 inputs during the year ended March 31, 2012:

	Preferred – Embedded Derivative	Warrants	Total
Beginning balance, December 31, 2010	\$-	\$-	\$-
Issued – February 22, 2011	1,604,794	912,786	2,517,580
Fair value adjustments	(1,457,090)	(783,290)	(2,240,380)
Ending balance, December 31, 2011	\$147,704	\$129,496	\$277,200
Fair value adjustments	432,178	306,279	738,457
Ending balance, March 31, 2012	\$579,882	\$435,775	\$1,015,657

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.

## 11. Commitments and Contingencies

### *Operating Leases*

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

As of March 31, 2012, the Company was obligated under operating leases requiring minimum rentals as follows:

Fiscal year	
Remainder of 2012	\$1,707,086
2013	1,895,786
2014	1,365,516
2015	1,271,876

2016	415,396
2017	11,592
	\$7,186,519

During the three months ended March 31, 2012 and 2011, rent expenses amounted to \$556,099 and \$423,588, respectively, of which \$523,410 and \$389,144 were recorded as cost of sales, respectively.

## **12. Concentrations**

The Company did not have any customer constituting greater than 10% of net sales for the three months ended March 31, 2012 and 2011.

At March 31, 2012 and December 2011, there was one supplier of consignment snacks and drinks in the amount of \$148,564 and \$100,480, respectively, which accounted for 100% and 100% of the Company's accounts payable.

F-51



### 13. Operating Risk and Uncertainties

#### *Foreign currency risk*

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

#### *Company's operations are substantially in a foreign country*

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 the 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 and facility requirements for the establishment of internet cafes (RMB 10,000,000 for regional internet cafe chains and RMB 50,000,000 for national internet cafe chains). 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 operations.

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 of other service providers available to the Company.

### 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 Three Months Ended March	
	31,	2011
	2012	
<b>BASIC</b>		
Numerator for basic earnings per share attributable to the Company's common stockholders:		
Net income	\$ 328,559	\$ (712,423 )
Dividend on preferred stock	(71,938 )	(33,202 )
Net income used in computing basic earnings per share	\$ 256,621	\$ (745,625 )
Basic weighted average shares outstanding	21,254,377	20,580,542
Basic earnings per share	\$ 0.01	\$ (0.04 )

F-52

	For The Three Months Ended March 31,	
	2012	2011
<b>DILUTED</b>		
Numerator for diluted earnings per share attributable to the Company's common stockholders:		
Net income	\$ 256,621	\$ (745,625 )
Dividend on preferred stock	71,938	33,202
Net income used in computing diluted earnings per share	\$ 328,559	\$ (712,423 )
Weighted average outstanding shares of common stock	21,254,377	20,580,542
Weighted average preferred stock	4,274,703	1,947,365
Diluted weighted average shares outstanding	25,529,080	22,527,907
Diluted earnings per share	\$ 0.01	\$ (0.04 )
Potential common shares outstanding as of March 31:		
Series A preferred stock	4,274,703	4,274,703
Warrants	2,498,326	2,498,326
	6,773,029	6,773,029

During the three months ended March 31, 2012 and 2011, the average market price of the common stock during the period was less than the exercise price of the Warrants. Accordingly, the Warrants were anti-dilutive and have not been included in the calculation of diluted earnings per share.

## 15. Segment Information

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

## 16. Subsequent Event

As of March 31, 2012, the Company has evaluated subsequent events for potential recognition and disclosure through the date of the financial statement issuance.

**17. Restatement of previously issued unaudited quarterly financial information (unaudited)**

The unaudited quarterly financial statements for the three months ended March 31, 2011 have been restated to correct the errors in the valuation of derivative instruments. The quoted market prices to value the derivatives were used to replace an enterprise value approach even though the limited trading of the Company's stock.

The effect of restatements to correct the errors referred impact on the quarterly consolidated balance sheets as of March 31, 2011, the consolidated statement of income and comprehensive income and the consolidated statement of cash flows for the three months ended March 31, 2011 are presented below.

The following restatements impact the quarterly financial statements:

Decreased advisory fees expenses \$223,260 and derivative financial instruments – day one loss approximately \$1.12 million.

Increased loss of derivative financial instrument in preferred stock and warrants approximately \$1.53 million and \$0.82 million, respectively

Increased net loss of approximately \$1.0 million

Basic and diluted earnings per shares decreased from earning \$0.01 per share to loss \$0.04 per share

Fair market value of financial instruments in preferred stock and warrants decreased approximately \$2.26 million and \$1.20 million, respectively

Additional paid in capital decreased approximately \$0.48 million and retained earnings decreased approximately \$1.01 million

Preferred stock increased approximately \$3.68 million from \$-0-

**CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2011	March 31, 2011	
	As restated	As previously reported	Changes
<b>ASSETS</b>			
Current assets:			
Cash	\$15,237,910	\$15,237,910	\$-
Restricted cash	951,278	951,278	-
Rental deposit	27,534	27,534	-
Prepayment	73,808	73,808	-
Inventory	175,066	175,066	-
Deferred advisory fee	257,534	556,274	(298,740 )
Deferred tax assets	55,695	55,695	-
Total current assets	16,778,825	17,077,565	(298,740 )
			-
Property, plant and equipment, net	8,169,399	8,169,399	-
Intangible assets, net	183,160	183,160	-
Rental deposit-long term portion	288,780	288,780	-
Total assets	\$25,420,164	\$25,718,904	\$(298,740 )
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Short term loan	\$152,204	\$152,204	\$-
Accounts payable	105,742	105,742	-
Deferred revenue	935,833	935,833	-
Payroll and payroll related liabilities	210,684	210,684	-
Income and other taxes payable	1,182,176	1,182,175	-
Accrued expenses	306,455	306,455	-
Amount due to a shareholder	1,397,776	1,397,776	-
Dividend payable on preferred stock	33,202	33,202	-
Derivative financial instrument - preferred stock	3,044,120	5,304,176	(2,260,056)
Derivative financial instrument - warrants	1,675,429	2,871,523	(1,196,094)
Total current liabilities	9,043,621	12,499,770	(3,456,149)
Commitments and contingencies			
Preferred stock (\$0.00001 par value, 100,000,000 shares authorized, 4,274,703 shares issued and outstanding as of March 31, 2011; preference in liquidation - \$5,770,849 )	3,682,473	-	3,682,473

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Stockholders' Equity

Common stock (\$0.00001 par value, 100,000,000 shares authorized, 21,124,967 and 20,200,000 shares issued and outstanding as of March 31, 2011)	211	211	-
Additional paid in capital	1,553,969	1,069,050	484,919
Statutory surplus reserves	718,744	718,744	-
Retained earnings	9,753,829	10,763,812	(1,009,983)
Accumulated other comprehensive income	667,317	667,317	-
Total stockholders' equity	12,694,070	13,219,134	(525,064 )
			-
Total liabilities and stockholders' equity	\$25,420,164	\$25,718,904	\$(298,740 )

F-54

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

	For The Three Months Ended March 31, 2011		
	As restated	As previously reported	Changes
Revenue	\$6,489,581	\$6,489,581	\$-
Cost of revenue	3,995,342	3,995,342	-
Gross profit	2,494,239	2,494,239	-
Operating Expenses			
General and administrative expenses	444,467	667,727	(223,260 )
Total operating expenses	444,467	667,727	(223,260 )
Income from operations	2,049,772	1,826,512	223,260
Non-operating income (expenses)			
Derivative financial instruments - day-one loss	-	(1,120,072 )	1,120,072
Change in fair value of derivative financial instrument - preferred stock	(1,439,326 )	94,307	(1,533,633 )
Change in fair value of derivative financial instrument - warrants	(762,643 )	57,039	(819,682 )
Interest expenses	(2,531 )	(2,531 )	-
Other income	1,994	1,994	-
Total other income (expenses)	(2,202,506 )	(969,263 )	(1,233,243 )
Net income before income taxes	(152,734 )	857,249	(1,009,983 )
Income taxes	559,689	559,689	-
Net income attributable to China Internet Cafe Holdings Group, Inc.	(712,423 )	\$297,560	\$(1,009,983 )
Dividend on preferred stock	(33,202 )	(33,202 )	-
Net income attributable to China Internet Cafe Holdings Group, Inc. Common Stockholders	(745,625 )	264,358	(1,009,983 )
Other comprehensive income			-
Net income	\$(712,423 )	\$297,560	\$(1,009,983 )
Foreign currency translation	55,373	55,373	-
Net Comprehensive income	\$(657,050 )	\$352,933	\$(1,009,983 )
Earnings per share			

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

- Basic	\$ (0.04	) \$ 0.01	\$ (0.05	)
- Diluted	\$ (0.04	) \$ 0.01	\$ (0.05	)
Weighted average common stock outstanding				
- Basic	20,580,542	20,580,542	-	
- Diluted	22,527,907	20,580,542	1,947,365	

F-55



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

	For The Three Months Ended March 31		
	2011	2011	
	As restated	As previously reported	Changes
Cash flows from operating activities			
Net income	\$ (712,423 )	\$ 297,560	(1,009,983)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Derivative financial instruments - day-one loss	-	1,120,072	(1,120,072)
Change in fair value of derivative financial instrument - preferred stock	1,439,326	(94,307 )	1,533,633
Change in fair value of derivative financial instrument - warrants	762,643	(57,039 )	819,682
Advisory fee	192,466	415,726	(223,260 )
Depreciation	621,998	621,998	-
Amortization	9,112	9,112	-
Deferred tax assets	(55,532 )	(55,532 )	-
Changes in operating assets and liabilities:			
Prepayment	(73,592 )	(73,592 )	-
Rental deposit	(23,398 )	(23,398 )	-
Inventory	6,642	6,642	-
Accounts payable	37,676	37,676	-
Deferred revenue	351,300	351,300	-
Payroll and payroll related liabilities	9,840	9,840	-
Income and other taxes payable	188,166	188,166	-
Accrued expenses	201,752	201,752	-
Amount due to a shareholder	928,585	928,585	-
Net cash provided by (used in) operating activities	3,884,561	3,884,561	-
Cash flows from investing activities			
Acquisition of property, plant and equipment	(590,787 )	(590,787 )	-
Receipt of loan receivable due to termination of an investment agreement	2,428,142	2,428,142	-
Net cash used in investing activities	1,837,355	1,837,355	-
Cash flows from financing activities			
Net proceeds from issuance of preferred stock and warrants	5,675,614	5,675,614	-

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form S-1/A

Net cash flows provided by financing activities:	5,675,614	5,675,614	-
Effect of foreign currency translation on cash	3,556	3,556	-
Net increase in cash	11,401,086	11,401,086	-
Cash - beginning of period	3,836,824	3,836,824	-
Cash - end of period	\$15,237,910	\$15,237,910	-
Cash paid during the period for:			
Interest paid	\$2,531	\$2,531	-
Income taxes paid	\$484,648	\$484,648	-
			-
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>			
Transfer of equipment deposits paid in property and equipment	\$1,224,660	\$1,224,660	-
Dividend payable on preferred stock	\$33,202	\$33,202	-
Advisory fee	\$192,466	\$415,726	(223,260 )

F-56

## PART II – INFORMATION NOT REQUIRED IN PROSPECTUS

### OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

Although we will receive no proceeds from the sale of shares pursuant to this prospectus, we have agreed to bear the costs and expenses of the registration of the shares. Our expenses in connection with the issuance and distribution of the securities being registered are estimated as follows:

SEC Registration Fee	\$1,262
Printing Expenses	\$2,000
Professional Fees and Expenses	\$60,000
Blue Sky Fees and Expenses	\$3,000
Transfer Agent Fees	\$1,000
Miscellaneous Expenses	\$1,000
Total	\$68,262

All amounts are estimates other than the Securities and Exchange Commission's registration fee. We are paying all expenses of the offering listed above. No portion of these expenses will be borne by the selling shareholders. The selling shareholders, however, will pay any other expenses incurred in selling their Common Stock, including any brokerage commissions or costs of sale.

### INDEMNIFICATION OF DIRECTORS AND OFFICERS

Pursuant to the Articles of Incorporation and By-Laws of the corporation, we may indemnify an officer or director who is made a party to any proceeding, including a law suit, because of his position, if he acted in good faith and in a manner he reasonably believed to be in our best interest. In certain cases, we may advance expenses incurred in defending any such proceeding. To the extent that the officer or director is successful on the merits in any such proceeding as to which such person is to be indemnified, we must indemnify him against all expenses incurred, including attorney's fees. With respect to a derivative action, indemnity may be made only for expenses actually and reasonably incurred in defending the proceeding, and if the officer or director is judged liable, only by a court order. The indemnification is intended to be to the fullest extent permitted by the laws of the State of Nevada.

### Nevada Law

Nevada law also provides for discretionary indemnification for each person who serves as or at our request as an officer or director. We may indemnify such individual against all costs, expenses, and liabilities incurred in a threatened, pending or completed action, suit, or proceeding brought because such individual is a director or officer. Such individual must have conducted himself in good faith and reasonably believed that his conduct was in, or not opposed to, our best interests. In a criminal action, he must not have had a reasonable cause to believe his conduct was unlawful.

Pursuant to the provisions of Nevada Revised Statutes 78.751, we shall indemnify any director, officer and employee as follows: Every director, officer, or employee shall be indemnified by us against all expenses and liabilities, including counsel fees, reasonably incurred by or imposed upon him/her in connection with any proceeding to which he/she may be made a party, or in which he/she may become involved, by reason of being or having been a director, officer, employee or agent of the Company or is or was serving at the request of the Company as a director, officer, employee or agent of us, partnership, joint venture, trust or enterprise, or any settlement thereof, whether or not he/she is a director, officer, employee or agent at the time such expenses are incurred, except in such cases wherein the director, officer, employee or agent is adjudged guilty of willful misfeasance or malfeasance in the performance of his/her duties; provided that in the event of a settlement the indemnification herein shall apply only when the board of directors approves such settlement and reimbursement as being for the best interests of the Company. We shall provide to any person who is or was a director, officer, employee or agent of the Company or is or was serving at our request as a director, officer, employee or agent of the Company, partnership, joint venture, trust or enterprise, the indemnity against expenses of a suit, litigation or other proceedings which is specifically permissible under applicable law.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers and controlling persons pursuant to the provisions above, or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Securities Act, and is, therefore, unenforceable.

In the event that a claim for indemnification against such liabilities, other than the payment by us of expenses incurred or paid by one of our directors, officers, or controlling persons in the successful defense of any action, suit or proceeding, is asserted by one of our directors, officers, or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification is against public policy as expressed in the Securities Act, and we will be governed by the final adjudication of such issue.

## RECENT SALES OF UNREGISTERED SECURITIES

On February 22, 2011 (the “Closing Date”), in connection with a security purchase agreement between the Company and certain investors (collectively, the “Investors”), we closed a private placement (the “Offering”) of approximately \$6.4 million from offering a total of 474,967 units (the “Units”) at a purchase price of \$13.50 per Unit, each consisting of: (i) nine shares of the Company’s 5% Series A Convertible Preferred Stock, par value \$0.00001 per share (the “Preferred Shares”), convertible on a one to one basis into nine shares of the Company’s common stock, par value \$0.00001 per share (the “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, to purchase one share of Common Stock, at an exercise price of \$3.00 per share.

The Offering was conducted in accordance with and in reliance upon the exemption from securities registration afforded by Section 4(2) of the Securities Act and/or Rule 506 of Regulation D as promulgated by the United States Securities and Exchange Commission under the Securities Act of 1933, as amended (the “Securities Act”), or Regulation S (“Regulation S”) as promulgated under the Securities Act based on the following factors:

We did not use a general solicitation or advertisement to market the securities. Tripoint, our placement agent had an existing relationship with all the selling shareholders.

All investors were provided a PIPE acknowledgement letter required to be acknowledged in advance of any communication regarding the offering or issuer. In that regard, Tripoint had also ascertained that all the selling shareholders were either “accredited investors” or sophisticated investors — that is, they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment;

All investors were provided a copy of the company’s Private Placement Memorandum;

The company was available to answer questions by prospective investors;

Financial statements certified by a public accountant were made available to the prospective investors; and

All the investors were issued “restricted securities”.

In connection with the Offering, we also entered into a registration rights agreement (the “Registration Rights Agreement”) with the Investors, in which we agreed to file a registration statement (the “Registration Statement”) with the Commission to register for resale the Common Stock and the Common Stock issuable upon conversion of the Preferred Stock, the Series A Warrant Shares and the Series B Warrant Shares, 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 U.S. Securities

and Exchange Commission (“SEC”). If we do not comply with the foregoing obligations under the Registration Rights Agreement, we 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 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 registrable securities that may be sold pursuant to Rule 144 under the Securities Act, or are subject to an SEC comment with respect to Rule 415 promulgated under the Securities Act.

In connection with the Offering, we also entered into a securities escrow agreement with the Investors (the “Securities Escrow Agreement”) and Mr. Dishan Guo (the “Stockholder”), the Company’s chairman, pursuant to which, the Stockholder agrees to deliver into an escrow account one share of our Common Stock for each \$10 sold to the Purchasers in the Offering to be used as escrow shares, equal to 641,205 shares of Common Stock (the “Escrow Shares”). The distribution of the Escrow Shares shall be based on a performance threshold for the Company. With respect to the 2011 fiscal year, if we earn less than \$9,500,000, then the Escrow Shares for such year will be delivered to the Investors in the amount of 10% of the Escrow Shares for each full percentage point by which such threshold was not achieved up to a maximum of the Escrow Shares.

On the Closing Date, we entered into a lock-up agreement (the “Lock-Up Agreement”) with Mr. Dishan Guo (the “Affiliate”), whereby the Affiliate is prohibited from selling our securities that they directly or indirectly own (the “Lock-Up Shares”) until 9 months after the Registration Statement is declared effective by the SEC (the “Lock-Up Period”). In addition, the Affiliate further agrees that during the 12 months immediately following the Lock-Up Period, the Affiliate shall not offer, sell, contract to sell, assign, or transfer (the “Transfer”) more than 0.83333% 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.

The description of the Securities Purchase Agreement, Registration Rights Agreement, Securities Escrow Agreement and Lock-up Agreement is qualified in its entirety by reference to a copy of the agreements attached to this Registration Statement on Form S-1 as exhibits 10.13, 10.14, 10.15, and 10.16, respectively.

The Company engaged TriPoint Global Equities, LLC (the "Agent") as the placement agent in connection with the sale of securities in the Offering and agreed to pay the Agent (i) cash commissions equal to 7% of the gross proceeds received by the Company; (ii) a cash management finance fee equal to 1% of the gross proceeds raised by the Company in the Offering, payable at the time of each closing; (iii) a non-accountable expense fee equal to 0.5% of the gross proceeds; and (iv) warrants to purchase such number of securities equal to 9% of the aggregate number of shares of common stock issuable in connection with the Offering (the "Agent Warrants"). The Agent Warrants will all have three year terms and will be exercisable at the following prices: (i) \$1.35 per share (427,470 Placement Agent Warrants), (ii) \$2.00 per share (85,494 Series A Warrants) and (iii) \$3.00 per share (85,494 Series B Warrants). The Company also agreed to compensate the Agent for all of its reasonable expenses in connection with the Offering.

On July 27, 2011, the Company issued an aggregate of 75,540 shares of unregistered common stock to holders of its Series A Convertible Preferred Stock ("Preferred Stock").

The Preferred Stock was issued the Private Placement on February 22, 2011. Pursuant to the Certificate of Designation, Preferences and Rights for the Preferred Stock, the Company must pay a quarterly dividend at an annual rate of 5% for each outstanding share of Preferred Stock either in cash or by issuing to the holders of Preferred Stock such number of additional shares of Common Stock which when multiplied by \$1.35, would equal the amount of such quarterly dividend not paid in cash. The board of directors of the Company has decided to pay the dividends by issuing restricted Common Stock to the holders of Preferred Stock.

Subsequently the Company issued 53,870 shares, 53,870 shares, 53,287 shares of unregistered common stock to holders of its Preferred Stock as quarterly dividend on November 23, 2011, January 13, 2012, and May 14, 2012, respectively.

On January 1, 2012, the Company entered into an Option Agreement (the "Option Agreement") with Potomac Investments, LLC ("Potomac"), granting Potomac a stock option (the "Option") to purchase 300,000 shares of Common Stock from the Company at an exercise price of \$0.64 per share. According to the Option Agreement, the Option is exercisable on the execution date of the Option Agreement, and shall expire and terminate on November 15, 2014.

The said Option is granted in consideration of consulting services rendered by Potomac to the Company pursuant to a consulting agreement dated November 22, 2010, by and between the Company and Potomac.

The sales of the unregistered securities were made in accordance with and in reliance upon the exemption from securities registration afforded by Section 4(2) of the Securities Act of 1933, as amended and/or Regulation D or Regulation S promulgated thereunder.

**EXHIBITS**

Exhibit No.	Description
2.1 (1)	Form of Share Exchange Agreement, dated July 2, 2010, among the Company, Classic Bond Development Limited and its shareholders.
3.1 (2)	Articles of Incorporation of the Company
3.2 (2)	Bylaws of the Company
3.3 (7)	Amended and Restated Bylaws, adopted on July 30, 2010
3.4 (7)	Certificate of Amendment to the Articles of Incorporation, adopted on January 20, 2011
3.5 (6)	Certificate of Designations Preferences and Rights of the 5% Series A Convertible Preferred Stock of China Internet Cafe Holdings Group, Inc.
4.1 (1)	Form of Cancellation Agreement, dated July 2, 2010, among the Company and certain shareholders.
4.2 (7)	Specimen Stock Certificate
5.1 (8)	Opinion of Sichenzia Ross Friedman Ference LLP
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 Employment Agreement, dated April 1, 2009, between Junlong and Tu Fan.
10.6 (1)	English Translation of Form of Non-disclosure and Non-competition Agreement, dated March 11, 2010, between Junlong and its employees.
10.7 (1)	English Summary of Loan Agreement, dated October 23, 2009, between Junlong and Shenzhen Branch of China Construction Bank.
10.8 (1)	English Summary of Guaranty Contract of Maximum Amount, dated October 23, 2009, between Dishan Guo and Shenzhen Branch of China Construction Bank.
10.9 (1)	English Summary of Purchase Agreement, dated June 7, 2010, between Junlong and Shenzhen SEG Industrial Investment Co., Ltd.





- 10.10 English Summary of Lease Contract, dated September 1, 2006, between Junlong and Zou Zhiwei.  
(1)
- 10.11 English Summary of Lease Contract, dated December 15, 2009, between Junlong and Hao Changsheng  
(1)
- 10.12 Lease contract re: No. 1 Xinxin Garden, Fangjicun, Xudong Road, Wuchang, Wuhan, Hubei Province, China  
(5) 430062 between the Company and Xuezheng Yuan.
- 10.13 Securities Purchase Agreement, dated February 22, 2011, by and among China Internet Cafe Holdings  
(7) Group, Inc. and Investors identified therein
- 10.14 Registration Rights Agreement, dated February 22, 2011  
(7)
- 10.15 Securities Escrow Agreement, dated February 22, 2011  
(7)
- 10.16 Lock-up Agreement, dated February 22, 2011  
(7)
- 10.17 Form of Series A Warrant  
(7)
- 10.18 Form of Series B Warrant  
(7)
- 14.1 (7) Code of Ethics and Business Conduct
- 21 (1) Subsidiaries of the Company.
- 23.1 Consent of Independent Registered Public Accounting Firm.
- 23.2 Consent of China Commercial Law Firm
- 99.1 (7) Audit Committee Charter
- 99.2 (7) Compensation Committee Charter
- 99.3 (7) Nominating Committee Charter
- 99.4 (6) Press Release
- 99.5 (6) Investor Presentation

- (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 Registration Statement on Form SB-2 filed on August 30, 2006.
- (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 September 28, 2010.
- (6) Incorporated by reference to our Current Report on Form 8-K filed with the SEC on February 23, 2011
- (7) Incorporated by reference to our Registration Statement on Form S-1/A filed on July 12, 2011.
- (8) Previously filed with Amendment No. 3 to the Registration Statement on Form S-1/A filed on June 15, 2012 and incorporated herein by reference.

## UNDERTAKINGS

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

i. To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;

ii. To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement.

iii. To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against

such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

(5) Each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(6) That, for the purpose of determining liability of the registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities: The undersigned registrant undertakes that in a primary offering of securities of the undersigned registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

- i. Any preliminary prospectus or prospectus of the undersigned registrant relating to the offering required to be filed pursuant to Rule 424;
- ii. Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned registrant or used or referred to by the undersigned registrant;
- iii. The portion of any other free writing prospectus relating to the offering containing material information about the undersigned registrant or its securities provided by or on behalf of the undersigned registrant; and
- iv. Any other communication that is an offer in the offering made by the undersigned registrant to the purchaser.

## SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized in the City of New York State of New York on the 17th day of July, 2012.

CHINA INTERNET CAFE  
HOLDINGS GROUP, INC.

/s/ Dishan Guo  
By: Dishan Guo  
Chief Executive Officer and Chairman

In accordance with the requirements of the Securities Act of 1933, this registration statement was signed by the following person in the capacities and date stated.

Name	Title	Date
/s/ Dishan Guo Dishan Guo	Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer and Chairman	July 17, 2012
/s/ Zhenquan Guo Zhenquan Guo	Director	July 17, 2012
/s/ Lei Li Lei Li	Director	July 17, 2012
/s/ Wenbin An Wenbin An	Director	July 17, 2012
/s/ Lizong Wang Lizong Wang	Director	July 17, 2012

