

China Internet Cafe Holdings Group, Inc.
Form 10-Q
November 14, 2013

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

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

COMMISSION FILE NUMBER: 000-52832

CHINA INTERNET CAFE HOLDINGS GROUP, INC.

(Exact Name of small business issuer as specified in its charter)

Nevada

(State or other jurisdiction of
incorporation or organization)

98-0500738

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

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

(Address of principal executive offices) (Zip Code)

Issuer's telephone Number: **+86-755-8989-6008**

N/A

(Former Address)

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

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

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

As of November 13, 2013, there were 25,689,524 shares of \$0.00001 par value common stock issued and outstanding.

FORM 10-Q
CHINA INTERNET CAFE HOLDINGS GROUP, INC.
INDEX

	Page
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited).	1
Condensed Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012	2
Condensed Consolidated Statements of Operations and Other Comprehensive Income for the Three and Nine Months Ended September 30, 2013 and 2012	3
Condensed Consolidated Statements of Cash Flows for the Three and Nine Months Ended September 30, 2013 and 2012	5
Notes to Condensed Consolidated Financial Statements as of September 30, 2013	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.	24
Item 3. Quantitative and Qualitative Disclosures About Market Risk.	33
Item 4. Controls and Procedures.	34
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings.	35
Item 1A. Risk Factors.	35
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.	35
Item 3. Defaults Upon Senior Securities.	35
Item 4. Mine Safety Disclosures.	35
Item 5. Other Information.	35
Item 6. Exhibits.	35
Signatures	36

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited).

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2013

(UNAUDITED)

Condensed Consolidated Balance Sheets	2
Condensed Consolidated Statements of Income and Comprehensive Income	3
Condensed Consolidated statements of Stockholders' Equity for the nine months ended September 30, 2013	4
Condensed Consolidated Statements of Cash Flows	5
Notes to Condensed Consolidated Financial Statements	6-23

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

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 37,380,471	\$ 25,818,041
Rental deposit	38,207	34,121
Equipment deposit	7,627	7,427
Inventory	70,682	49,681
Deferred tax assets	75,871	76,982
Total current assets	37,572,858	25,986,252
Property, plant and equipment, net	10,199,441	12,730,766
Intangible assets, net	98,296	124,274
Rental deposit-long-term portion	423,387	416,066
Total assets	\$ 48,293,982	\$ 39,257,358
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short term loan	\$ 162,962	\$ 158,702
Accounts payable	214,833	-
Registration penalties payable	641,200	641,200
Deferred revenue	2,101,891	1,505,699
Payroll and payroll related liabilities	371,646	350,277
Income and other taxes payable	1,117,130	754,709
Accrued expenses	547,687	396,878
Amount due to a shareholder	2,937,567	2,634,163
Dividend payable on preferred stock	186,565	72,729
Derivative financial instrument - preferred stock	-	64,280
Derivative financial instrument - warrants	19,081	329,254
Total current liabilities	8,300,562	6,907,891
Commitments and contingencies (Note 17)		
Convertible Preferred stock (\$0.00001 par value, 100,000,000 shares authorized, -0- and 4,274,703 shares issued and outstanding as of September 30, 2013 and December 31, 2012; preference in liquidation -\$0 and \$5,770,849, respectively)	-	3,682,473
Stockholders' Equity:		
Common stock (\$0.00001 par value, 100,000,000 shares authorized, 25,689,524 and 21,414,821 shares issued and outstanding as of September 30, 2013 and December 31, 2012)	257	214
Additional paid-in capital	5,732,759	2,050,329
Statutory surplus reserves	718,744	718,744
Retained earnings	30,985,266	24,320,169
Accumulated other comprehensive income	2,556,394	1,577,538
Total stockholders' equity	39,993,420	28,666,994

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Total liabilities and stockholders' equity	\$	48,293,982	\$	39,257,358
--	----	------------	----	------------

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

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

	For The Nine Months Ended		For The Three Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Revenue	\$ 21,166,465	\$ 21,504,955	\$ 6,959,619	\$ 7,494,842
Cost of revenue	12,045,782	15,305,121	3,980,038	5,361,585
Gross profit	9,120,683	6,199,834	2,979,581	2,133,257
Operating Expenses				
General and administrative expenses	512,795	975,491	145,746	164,804
Cafe relocation costs	-	762,602	-	229,389
Total operating expenses	512,795	1,738,093	145,746	394,193
Income from operations	8,607,888	4,461,741	2,833,835	1,739,064
Non-operating income (expenses)				
Change in fair value of derivative financial instrument - preferred stock	64,280	117,452	-	241,153
Change in fair value of derivative financial instrument - warrants	310,173	(98,538)	2,123	124,632
Interest income	13,630	14,158	4,596	4,233
Interest expense	(9,116)	(9,495)	(3,724)	(5,045)
Other expenses	(232)	(14,450)	(42)	(1,980)
Total non-operating income (expenses)	378,735	9,127	2,953	362,993
Income before income taxes	8,986,623	4,470,868	2,836,788	2,102,057
Income taxes	2,207,690	1,260,470	718,954	448,828
Net income	6,778,933	3,210,398	2,117,834	1,653,229
Dividend on preferred stock	(113,836)	(216,605)	(113,836)	(72,729)
Net income attributable to China Internet Cafe Holdings Group, Inc. common stockholders	\$ 6,665,097	\$ 2,993,793	\$ 2,003,998	1,580,500
Other comprehensive income				
Net income	\$ 6,778,933	\$ 3,210,398	2,117,834	1,653,229
Foreign currency translation	978,856	113,514	237,854	(58,668)
Total comprehensive income	\$ 7,757,789	\$ 3,323,912	\$ 2,355,688	\$ 1,594,561
Earnings per share				
- Basic	\$ 0.27	\$ 0.14	0.08	0.07
- Diluted	\$ 0.26	\$ 0.13	0.08	0.06
Weighted average common stock outstanding				
- Basic	24,878,266	21,335,184	25,689,524	21,388,178

- Diluted	25,689,524	25,609,887	25,689,524	25,662,881
-----------	------------	------------	------------	------------

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013

	Common Stock Number of Shares	Additional Paid-in Capital	Statutory Reserves	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity	
Balance at January 1, 2013	21,414,821	\$214	\$2,050,329	\$718,744	\$24,320,169	\$1,577,538	\$28,666,994
Converted preferred stock	4,274,703	43	3,682,430	-	-	-	3,682,473
Preferred stock dividend	-	-	-	-	(113,836)	-	(113,836)
Net income for the period	-	-	-	-	6,778,933	-	6,778,933
Foreign currency translation difference	-	-	-	-	-	978,856	978,856
Balance at September 30, 2013	25,689,524	\$257	\$5,732,759	\$718,744	\$30,985,266	\$2,556,394	\$39,993,420

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

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

	For The Nine Months Ended	
	September 30,	
	2013	2012
Cash flows from operating activities		
Net income	\$ 6,778,933	\$ 3,210,398
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in fair value of derivative financial instrument - preferred stock	(64,280)	(117,452)
Change in fair value of derivative financial instrument- warrants	(310,173)	98,538
Advisory fee	-	105,000
Depreciation	2,909,561	2,075,449
Amortization	28,952	28,554
Loss on disposal of fixed assets	-	762,602
Deferred tax assets	3,138	(6,358)
Changes in operating assets and liabilities:		
Rental deposit	579	(45,584)
Inventory	(19,425)	147,868
Accounts payable	212,175	156,658
Deferred revenue	548,909	(296,199)
Payroll and payroll related liabilities	11,819	22,825
Income and other taxes payable	337,936	(272,756)
Accrued expenses and penalties payable	140,795	206,142
Amount due to a shareholder	264,146	350,358
Net cash provided by operating activities	10,843,065	6,426,043
Cash flows from investing activities		
Purchase of property, plant and equipment	(72,056)	(3,136,105)
Deposits paid for property, plant and equipment	-	994,220
Net cash used in investing activities	(72,056)	(2,141,885)
Cash flows from financing activities		
Proceeds from short term loan	161,991	158,516
Short term loan repayments	(161,991)	-
Net cash flows used in financing activities:	-	158,516
Effect of foreign currency translation on cash	791,421	63,598
Net increase in cash and cash equivalents	11,562,430	4,506,272
Cash and cash equivalents - beginning of period	25,818,041	19,629,680
Cash and cash equivalents - end of period	\$ 37,380,471	\$ 24,135,952
Cash paid during the year for:		
Interest paid	\$ 9,116	\$ 9,495
Income taxes paid	\$ 1,409,950	\$ 1,410,297
Supplemental disclosures of non-cash transactions:		
Transfer of equipment deposits paid in property and equipment	\$ 7,627	\$ 987,326

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Dividend payable on preferred stock	\$ 186,565	\$ 72,729
Registration penalties	\$ -	\$ 192,356

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

1. Organization, Recapitalization and Nature of Business

China Internet Cafe Holdings Group, Inc.

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, through its variable interest entity in People’s Republic of China (“PRC”), is currently engaged in 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 Company, entered into a share exchange transaction with Classic Bond and the shareholders of Classic Bond. Pursuant to the Share Exchange Agreement, the Company 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 the Company 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 the Company. 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 Company’s common stock. In other words, the 2,000,000 Classic Bond shares outstanding are restated as 20,200,000 shares of common stock of the Company, as of July 2, 2010. Each share of Classic Bond is restated to 10.10 shares of the Company.

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

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

Classic Bond Development Limited

Classic Bond was incorporated on November 2, 2009 in the British Virgins Islands with 50,000 shares of 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 consideration of \$6,452 (HK\$50,000) to several shareholders including Mr. Guo Dishan who is a shareholder, officer and director of the Company.

On June 23, 2010, the Company further issued 1,950,000 shares of common stock to 42 individuals to raise funds 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 (as defined below). At September 30, 2013 and December 31, 2012, the issued and outstanding common stock was 25,689,524 and 21,414,821 shares, respectively.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

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

The Company is in the business of operating internet cafés, throughout the Longang District of Shenzhen in Province of Guangdong of the PRC. The Company conducts its operations through the following entities: (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, Classic Bond’s wholly-owned subsidiary, was incorporated in PRC on June 10, 2010 with a 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.

Exclusive Management and Consulting Agreement

On June 11, 2010, Zhonghefangda signed an exclusive management and consulting services agreement with Junlong. Pursuant to the agreement, Zhonghefangda agreed to provide management and consulting services to Junlong, upon request, in connection with the operation of the business. In return, Zhonghefangda will 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 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 VIE and Junlong should be consolidated in the accompanying financial statements.

Shenzhen Jun Long Culture Communication Co., Ltd.

Junlong is a Chinese enterprise organized in the PRC on December 26, 2003 with a 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 (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. As of June 30, 2013, we owned 62 internet cafes within Shenzhen, Guangdong.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

2. Summary of Significant Accounting Policies

(a) Basis of presentation

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

(b) Principle of consolidation

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

(c) Use of estimates

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

Warrants that could require cash settlement or have anti-dilution price protection provisions are recorded as liabilities at their estimated fair value at the date of issuance, with subsequent changes in estimated fair value recorded in other income (expense) in our statement of loss and comprehensive loss in each subsequent period. In general, warrants with anti-dilution provisions are measured using the binomial valuation model. The methodology based, in part, upon inputs for which there is little or no observable market date requiring the Group to develop its own assumptions. The assumptions used in calculating the estimate fair value of the warrants represent our best estimates; however these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and different assumptions are used, the warrant liability and the change in estimated fair value could be materially different. Also see Note 11.

(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 and is recognized at the time the gaming cards, etc. are sold to customers. For the nine months ended September 30, 2013 and 2012, the commission income was \$338,798 and \$259,059, respectively.

(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, value added 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. Our value added taxes is 3% of gross revenue generated from selling time of internet surfing in our internet cafes. Since November 2012, the Company has paid value added taxes instead of business taxes.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

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

(i) Fair Value of Financial Instruments

The Company applies the provisions of accounting guidance, FASB Topic ASC 820 that requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value, and defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of September 30, 2013, the fair value of cash and cash equivalents, accounts payable, and accrued expenses approximated carrying value due to the short maturity of the instruments, or are based on quoted market prices or interest rates which fluctuate with market rates except for related party debt or receivables for which it is not practicable to estimate fair value.

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

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

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

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

The following are the major categories of assets and liabilities measured at fair value on a recurring basis as of September 30, 2013, using quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3).

Level 1:		
Quoted Prices	Level 2:	
in Active	Significant	Level 3:
Markets for	Other	Significant

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Description	Identical Assets	Observable Inputs	Unobservable Inputs	Total September 30, 2013
Derivative Liability - Warrants	\$ -	\$ -	\$ 19,081	\$ 19,081
Total	\$ -	\$ -	\$ 19,081	\$ 19,081

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

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

(j) Stock-Based Compensation

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

(l) 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 improvements	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 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.

(m) Intangible Assets

Our intangible assets consist of definite-lived assets subject to amortization such as business license and customer lists. The useful lives of the Business License are 9 to 15 years and we amortized the customer lists 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 were \$2,101,891 and \$1,505,699 as of September 30, 2013 and December 31, 2012, 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 September 30, 2013.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

(o) Comprehensive income

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

(p) Income taxes

Income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Current tax is based on the profit or loss from ordinary activities adjusted for items that are non-assessable or disallowable for income tax purpose and is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date. Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 740-10-50-2 requires deferred tax assets and liabilities be recognized for future tax consequence attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain. Losses incurred by the Company in prior years provide for a net operating loss carry-forward. However, due to the fact that all net operating losses are from the U.S. shell company which we currently anticipate insufficient income to utilize in the future, the assets balance has been fully reserved for.

(q) Consolidation of Variable Interest Entities

According to the requirements of Statement of Financial Accounting Standards No. 810-10, "Variable Interest Entities", the Company has evaluated the economic relationships of its wholly owned subsidiary, Shenzhen Zhonghefangda 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 all of these VIE that are being consolidated in the accompanying financial statements.

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

	September 30, 2013	December 31, 2012
Current assets and long term rental deposit	\$ 37,985,008	\$ 26,392,390
Property, plant and equipment	10,199,441	12,730,766
Intangible assets	98,296	124,275
Total assets	48,282,745	39,247,431
Total liabilities	(11,677,671)	(10,129,831)
Net assets	\$ 36,605,074	\$ 29,117,600

(r) Foreign currency translation

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Assets and liabilities of the Company with a functional currency other than US dollars (“USD”) are translated into USD 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:

	September 30, 2013	September 30, 2012
Nine month-end RMB : USD exchange rate	6.1364	-
Nine months average RMB : USD exchange rate	6.2132	6.3085
Three months average RMB : USD exchange rate	6.1613	6.3200

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

Year-end RMB : USD exchange rate	December 31, 2012 6.3011
----------------------------------	-----------------------------

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 is calculated in accordance with ASC 260-10 which requires the Company to calculate net income (loss) per share based on basic and diluted net income (loss) per share, as defined. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted EPS is similar to basic EPS but presents the dilutive effect on a per share basis of potential common shares (e.g., convertible securities, preferred stock and warrants) as if they had been converted at the beginning of the periods presented, or issuance date, if later. Potential common shares that have an anti-dilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted EPS. See Note 15 for details.

(u) Retained earnings-appropriated

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

(v) Statutory surplus reserves

In accordance with the relevant laws and regulations of the PRC and the articles of associations of Junlong, Junlong is required to allocate 10% of its net income reported in the PRC statutory accounts, after offsetting any prior years' losses, to the statutory surplus reserve, on an annual basis. When the balance of such reserve reaches 50% of the respective registered capital, any further allocation is optional.

As of September 30, 2013 and December 31, 2012, the statutory surplus reserves of Junlong already reached 50% of the registered capital of Junlong and the Company did not have any further allocation on it.

Because Zhonghefangda has been operating at a loss, no statutory reserve has been set aside for Zhonghefangda as of September 30, 2013 and December 31, 2012.

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

(w) Recent Accounting Pronouncements

In January 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. This ASU clarifies that ordinary trade

receivables and receivables are not in the scope of ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. Specifically, ASU 2011-11 applies only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the FASB Accounting Standards Codification (Codification) or subject to a master netting arrangement or similar agreement. The FASB undertook this clarification project in response to concerns expressed by U.S. stakeholders about the standard's broad definition of financial instruments. After the standard was finalized, companies realized that many contracts have standard commercial provisions that would equate to a master netting arrangement, significantly increasing the cost of compliance at minimal value to financial statement users. An entity is required to apply the amendments in ASU 2013-01 for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The effective date is the same as the effective date of ASU 2011-11. The adoption of ASU 2013-01 is not expected to have a material impact on the Company's financial position or results of operations.

In February 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU improves the transparency of reporting these reclassifications. Other comprehensive income includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in this ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. All of the information that this ASU requires already is required to be disclosed elsewhere in the financial statements under U.S. GAAP.

The new amendments will require an organization to:

Present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income - but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period.

Cross-reference to other disclosures currently required under U.S. GAAP for other reclassification items (that are not required under U.S. GAAP) to be reclassified directly to net income in their entirety in the same reporting period. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is initially transferred to a balance sheet account (e.g., inventory for pension-related amounts) instead of directly to income or expense.

The amendments apply to all public and private companies that report items of other comprehensive income. Public companies are required to comply with these amendments for all reporting periods (interim and annual). A private company is required to meet the reporting requirements of the amended paragraphs about the roll forward of accumulated other comprehensive income for both interim and annual reporting periods. However, private companies are only required to provide the information about the effect of reclassifications on line items of net income for annual reporting periods, not for interim reporting periods. The amendments are effective for reporting periods beginning after December 15, 2012, for public companies. The adoption of ASU 2013-02 is not expected to have a material impact on the Company's financial position or results of operations.

In February 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. This ASU provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments in this ASU should be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU's scope that exist at the beginning of an entity's fiscal year of adoption. An entity may elect to use hindsight for the comparative periods (if it changed its accounting as a result of adopting the amendments in this ASU) and should disclose that fact. Early adoption is permitted. The adoption of ASU 2013-04 is not expected to have a material impact on the Company's financial position or results of operations.

In March 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-05, Foreign Currency Matters (Topic 830). This ASU resolve the diversity in practice about whether Subtopic 810-10, Consolidation Overall, or Subtopic 830-30, Foreign Currency Matters Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign

entity. In addition, the amendments in this Update resolve the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. This ASU is the final version of Proposed Accounting Standards Update EITF11Ar Foreign Currency Matters (Topic 830), which has been deleted. The amendments in this Update are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. The amendments should be applied prospectively to derecognition events occurring after the effective date. Prior periods should not be adjusted. Early adoption is permitted. If an entity elects to early adopt the amendments, it should apply them as of the beginning of the entity's fiscal year of adoption. The adoption of ASU 2013-05 is not expected to have a material impact on the Company's financial position or results of operations.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

In August 2012, the FASB issued ASU 2012-03, “Technical Amendments and Corrections to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 114, Technical Amendments Pursuant to SEC Release No. 33-9250, and Corrections Related to FASB Accounting Standards Update 2010-22 (SEC Update)” in Accounting standards Update No. 2012-03. This update amends various SEC paragraphs pursuant to the issuance of SAB No. 114. The adoption of ASU 2012-03 is not expected to have a material impact on the Company’s financial position or results of operations.

In July 2012, the FASB issued ASU 2012-02, “Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment” in Accounting Standards Update No. 2012-02. This update amends ASU 2011-08, Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment and permits an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles - Goodwill and Other - General Intangibles Other than Goodwill. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity’s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The adoption of ASU 2012-02 is not expected to have a material impact on the Company’s financial position or results of operations.

3. Cash and cash equivalents

Cash and cash equivalents are summarized as follows:

	September 30, 2013	December 31, 2012
Cash and cash equivalents at bank	\$ 37,363,141	\$ 25,800,930
Cash on hand	17,330	17,111
	\$ 37,380,471	\$ 25,818,041

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents. As of September 30, 2013 and December 31, 2012, \$37,355,237 and \$25,794,334 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 \$3,261 and \$1,951 of the Company’s cash and cash equivalents were held by Chase bank and JP Morgan Chase bank in USA, respectively.

4. Property, Plant and Equipment, net

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

	September 30, 2013	December 31, 2012
Leasehold improvements	\$ 4,512,074	\$ 4,394,136

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Cafe computers equipment and hardware	17,293,652	16,770,575
Cafe furniture and fixtures	2,153,278	2,096,995
Office furniture, fixtures and equipment	347,132	338,059
Motor vehicles	484,641	471,973
	\$ 24,790,777	\$ 24,071,738
Less: Accumulated depreciation	(14,591,336)	(11,340,972)
Property, plant and equipment, net	\$ 10,199,441	\$ 12,730,766

For the nine months ended September 30, 2013, depreciation expense amounted to \$2,909,561, of which \$2,834,370 and \$75,191 were recorded as cost of sales and general and administrative expense, respectively.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

5. Short Term Loan

The short term loan due within one year as of September 30, 2013 and December 31, 2012 consist of the following:

Bank	Loan Period	Interest rate	September 30, 2013	December 31, 2012
China Construction Bank	April 1, 2012 to March 26, 2013	12.5 %	\$ -	\$ 158,702
China Construction Bank	June 13, 2013 to June 12, 2014	9 %	\$ 162,962	\$ -

On March 27, 2012, the Company entered into a loan agreement with China Construction Bank for \$158,702 (RMB 1,000,000), which was secured by a director's guarantee. The annual interest rate was approximately 12.46% and was due on March 26, 2013. The loan has been paid in full on March 26, 2013.

On June 13, 2013, the Company entered into a loan agreement with China Construction Bank for \$162,962 (RMB 1,000,000), which was secured by a director's guarantee. The annual interest rate is approximately 9% and is due on June 12, 2014.

For the three and nine months ended September 30, 2013, the interest expense on these loans was \$3,876 and \$9,116, respectively.

6. Income and Other Taxes Payable

Income and other tax payables consist of the following:

	September 30, 2013	December 31, 2012
Value added taxes	\$ 209,575	\$ 78,013
Income tax	667,958	586,908
Withholding individual income tax payable	4,314	2,208
Other tax payable	235,283	87,580
Total	\$ 825,304	\$ 754,709

7. Due To Related Party

	September 30, 2013	December 31, 2012
Mr. Dishan Guo	\$ 2,937,567	\$ 2,634,163

The amount due to Mr. Dishan Guo, a shareholder, director and officer of the Company, is unsecured and bears no interest. The amount is payable on demand. The advance by Mr. Guo is used to pay daily operating expenses and professional fees. As of September 30, 2013, the total amount of approximately \$2.94million was accumulated.

8. Income Tax

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

PRC is 25% of its net income.

For the nine months ended September 30, 2013 and 2012, the Company did not record any uncertain tax benefits.

Aggregate undistributed earnings of approximately \$34.5 million as of September 30, 2013 of the Company's affiliated entity that are available for distribution to the Company are considered to be indefinitely reinvested, and, accordingly, no provision has been made for the Chinese dividend withholding taxes that would be payable upon distribution to the Company. Additionally, the Chinese tax authorities have clarified that distributions made out of pre-January 1, 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.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

9. 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 \$9,506 and \$9,200 for the nine months ended September 30, 2013 and 2012, respectively. The pension expense was \$3,536 and \$2,693 for the three months ended September 30, 2013 and 2012, respectively.

10. Stockholders' Equity

Common Stock

On July 2, 2010, the Company entered into a share exchange transaction with Classic Bond and the shareholders of Classic Bond. Pursuant to the share exchange agreement, the Company acquired 100% of the issued and outstanding capital stock of Classic Bond in exchange for 19,000,000 newly issued shares of the Company's common stock, which represented approximately 94% of the 20,200,000 issued and outstanding shares of common stock after the transaction and after the coincident cancellation of 4,973,600 shares of common stock held by the Company's former majority stockholder. The business, assets and liabilities of the Company did not change as a result of the reverse acquisition.

As of September 30, 2013 and December 31, 2012, there were 25,689,524 and 21,414,821 shares, respectively, of common stock issued and outstanding.

Series A Preferred Stock

On February 16, 2011, the Company filed with the Secretary of State of Nevada, as an amendment to its Articles of Incorporation, a Certificate of Designation, Preferences and Rights for the 5% Series A Convertible Preferred Stock, par value \$0.00001 per share (the "Series A Preferred Stock"). On February 22, 2011, the Company issued 4,274,703 shares of its Series A Preferred Stock.

For each outstanding share of Series A Preferred Stock, dividends are payable quarterly, at the rate of 5% per annum (\$0.675 per share), on or before each date that is thirty days following the last day of March, June, September, and December of each year, commencing September 30, 2011. Dividends on the Series A Preferred Stock accrue and are cumulative from and after the date of initial issuance. For the quarter ended September 30 and December 31 of 2012 and from January 1, 2013 to February 22, 2012, dividends have been accrued as dividends payable and are not paid as of September 30, 2013.

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

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

In addition to the holder's right to convert the Series A Preferred Stock at any time, provided that the Common Stock underlying the Series A Preferred Stock is registered under an effective registration statement or is available for resale

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

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

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

11. 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”).

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.

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 was 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 was not available and the embedded conversion option was bifurcated and accounted for as a derivative liability. As noted above, on February 22, 2013, in accordance with its terms, all 4,274,703 shares of Series A Preferred Stock outstanding automatically converted into 4,274,703 shares of common stock. As a result of the conversion, the carrying value of the Series A Preferred Stock has been transferred to equity.

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.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

11. Sale of Common Stock, Series A Preferred Stock and Warrants (Continued)

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 March 31, 2013, 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.

Lock-up Agreement

On the Closing Date, the Company entered into a lock-up agreement (the "Lock-Up Agreement") with Mr. Dishan Guo (the "Stockholder"), the Company's chairman and principal 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"). The Registration Statement became effective on August 31, 2012 and the Lock-Up period ends on May 31, 2013. 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.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

11. Sale of Common Stock, Series A Preferred Stock and Warrants (Continued)

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 were 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. We concluded that the exemption in FASB ASC 815-10-15-74 was not available and that 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.

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

At September 30, 2013, the Warrants, were re-valued at \$19,081, using a binomial model, based on the quoted market price of \$0.35, a term equal to the remaining life of the instruments, an expected dividend yield of 0%, risk-free interest rates of 0.03% based on constant maturity rates published by the U.S. Federal Reserve applicable to the remaining life of the instruments and estimated volatility of 146%. The aggregate change in the fair value of the derivative liabilities between December 31, 2012 and September 30, 2013 of \$310,173 has been credited to income.

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 had a liquidation value of \$5,770,849. Because the Series A Preferred Stock had conditions for its redemption that are outside our control, it was classified outside of Stockholders' Equity, in the mezzanine section of our balance sheet, in accordance with ASC 480-10-S99-3A. All outstanding shares of Series A Preferred Stock were converted to common stock on February 22, 2013 and the carrying value of the Series A Preferred Stock was transferred to equity.

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, were charged to additional paid-in capital.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

11. Sale of Common Stock, Series A Preferred Stock and Warrants (Continued)

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 September 30, 2013.

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 nine months ended September 30, 2013:

	Preferred Embedded Derivative	Warrants	Total
Beginning balance, December 31, 2012	\$ 64,280	\$ 329,254	\$ 393,534
Fair value adjustments	(64,280)	(310,173)	(374,453)
Ending balance, September 30, 2013	\$ -	\$ 19,081	\$ 19,081

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.

12. 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 September 30, 2013, the Company was obligated under operating leases requiring minimum rentals as follows:

Fiscal year

Remainder of 2013	\$648,396
2014	2,578,361
2015	1,472,620
2016	323,211
2017	4,889
	\$5,027,477

During the three and nine months ended September 30, 2013, rent expenses amounted to \$877,862 and \$2,149,059, respectively, of which \$863,596 and \$2,107,465 was recorded as cost of sales, respectively.

During the three and nine months ended September 30, 2012, rent expenses amounted to \$622,445 and \$1,743,556, respectively, of which \$609,982 and \$1,685,984 was recorded as cost of sales, respectively.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

13. Concentrations

The Company did not have any customer constituting greater than 10% of net sales for the three and nine months ended September 30, 2013 and 2012.

At September 30, 2013 and December 2012, there was one supplier of consignment snacks and drinks in the amount of \$214,833 and \$0, respectively, which accounted for 100% and 100% of the Company's accounts payable.

14. 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.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

15. 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 September 30,		For The Nine Months Ended September 30,	
	2013	2012	2013	2012
BASIC				
Numerator for basic earnings per share attributable to the Company's common stockholders:				
Net income	\$ 2,117,834	\$ 1,653,229	\$ 6,778,933	\$ 3,210,398
Dividend on preferred stock	(113,836)	(72,729)	(113,836)	(216,605)
Net income used in computing basic earnings per share	\$ 2,003,998	\$ 1,580,500	\$ 6,665,097	\$ 2,993,793
Basic weighted average shares outstanding	25,689,524	21,388,178	24,878,266	21,335,184
Basic earnings per share	\$ 0.08	\$ 0.07	\$ 0.27	\$ 0.14
	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2013	2012	2013	2012
DILUTED				
Numerator for diluted earnings per share attributable to the Company's common stockholders:				
Net income	\$ 2,003,998	\$ 1,580,500	\$ 6,665,097	\$ 2,993,793
Dividend on preferred stock	113,836	72,729	113,836	216,605
Net income used in computing diluted earnings per share	\$ 2,117,834	\$ 1,653,229	\$ 6,778,933	\$ 3,210,398
Weighted average outstanding shares of common stock	25,689,524	21,388,178	24,878,266	21,335,184
Weighted average preferred stock	-	4,274,703	811,258	4,274,703
Diluted weighted average shares outstanding	25,689,524	25,662,881	25,689,524	25,609,887
Diluted earnings per share	\$ 0.08	\$ 0.06	\$ 0.26	\$ 0.13

Potential common shares outstanding as of September 30:

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Series A preferred stock	-	4,274,703	-	4,274,703
Warrants	2,498,326	2,498,326	2,498,326	2,498,326
	2,498,326	6,773,029	2,498,326	6,773,029

During the three and nine months ended September 30, 2013 and 2012, 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.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND DECEMBER 31, 2012
(UNAUDITED)

16 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.

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

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

Overview

Prior to the consummation of the share exchange transaction described below, we were a shell company with nominal operations and nominal assets. Currently, through our affiliated entity, Junlong Culture Communication Co. Ltd. ("Junlong"), we operate in our belief the largest Internet café chain in Shenzhen city, People's Republic of China ("PRC"), consisting of 62 internet cafes in high traffic areas. Our focus is on providing top quality internet café facilities that offer a one-stop entertainment and media venue for customers, typically mature students and migrant workers, at reasonable prices. Although our cafes do sell snacks, drinks, and game access cards, more than 96% of our revenue comes directly from selling internet access time to our computers.

During the third quarter of 2013, we focused on integrating our existing cafes. 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
3. Our ability to identify and acquire target companies for joint venture in the coming years

For the quarter ended September 30, 2013, our revenue was approximately \$6.96 million and our net profit was approximately \$2.12 million, representing a decrease of 7% and an increase of 28%, respectively, from the revenue of approximately \$7.49 million and net profit of approximately \$1.65 million for the quarter ended September 30, 2012. As of September 30, 2013, we had 569 employees.

The discussion below of our performance is based upon our unaudited financial statements for the quarter ended September 30, 2013 and 2012, which are included in this report.

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

- **Improved Disposable Income.** We believe as the Shenzhen municipal government increases the minimum wage, migrant workers, who are our major customers, will have more disposable income. We are expecting the inflow of migrant workers to continue to contribute to our revenue growth.
- **Continued Internet Café Use.** Our business may be adversely affected by increased 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 the United States 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 of 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 targeting internet cafes these areas for acquisition purposes. The Company believes a national license is imperative for the development of a national 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, which 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.

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.”

On February 22, 2011, 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 at a purchase price of \$13.50 per unit. 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.

In the fiscal year of 2012, we opened three internet cafes and relocated 23 existing cafes to better business areas. As of the date of this report, we own 62 internet cafés within the city of Shenzhen in Guangdong province, PRC.

Results of Operations for the three months ended September 30, 2013 and 2012

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						Amount change	%	%
	September 30, 2013			2012					
	As percentage		%	As percentage		%			
Revenue	\$6,959,619	100	%	\$7,494,842	100	%	(535,223)	-7	%
Cost of revenue	3,980,038	57	%	5,361,585	72	%	(1,381,547)	-26	%
Gross profit	2,979,581	43	%	2,133,257	28	%	846,324	40	%
Operating Expenses									
General and administrative expenses	145,746	2	%	164,804	2	%	(19,058)	-12	%
Loss on disposal of fixed assets	-	0	%	229,389	3	%	(229,389)	-100	%
Total operating expenses	145,746	2	%	394,193	5	%	(248,447)	-63	%
Income from operations	2,833,835	41	%	1,739,064	23	%	1,094,771	63	%
Non-operating income (expenses)									
Derivative financial instruments - day-one loss	-								
Change in fair value of derivative financial instrument - preferred stock	-	0	%	241,153	-		(241,153)	-100	%

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Change in fair value of derivative financial instrument - warrants	2,123	0	%	124,632	-	(122,509)	-98	%
Interest income	4,596	0	%	4,233	0	% 363	9	%
Interest expenses	(3,724)	0	%	(5,045)	0	% 1,321	-26	%
Other expenses	(42)	0	%	(1,980)	0	% 1,938	-98	%
Total non-operating income (expenses)	2,953	0	%	362,993	5	% (360,040)	-99	%
Net income before income taxes	2,836,788	41	%	2,102,057	28	% 734,731	35	%
Income taxes	718,954	10	%	448,828	6	% 270,126	60	%
Net income attributable to China Internet Cafe Holdings Group, Inc.	\$2,117,834	30	%	\$1,653,229	22	% 464,605	28	%
Dividend on preferred stock	(113,836)	-2	%	(72,729)	-	(41,107)	57	%
Net income attributable to China Internet Cafe Holdings Group, Inc. Common stockholders	2,003,998	29	%	1,580,500	21	% 423,498	27	%
Other comprehensive income								
Net income	2,117,834	30	%	1,653,229	22	% 464,605	28	%
Foreign currency translation	237,854	3	%	(58,668)	-1	% 296,522	-505	%
Net Comprehensive income	\$2,355,688	34	%	\$1,594,561	21	% 761,127	48	%

Comparison of The Quarters Ended September 30, 2013 and 2012

Revenue

Our revenue is primarily generated from utilization of stored value in the prepaid IC cards sold based on time usage of computers at the internet cafe. Sales revenue decreased approximately \$0.54 million, or 7%, from approximately \$7.49 million for the quarter ended September 30, 2012 to approximately \$6.96 million for the quarter ended September 30, 2013. The slight decrease in revenue was due to normal fluctuation of business. We will continue to focus on growth within Shenzhen while simultaneously pursuing options for expansion through establishment and acquisition of internet cafes in other cities and provinces.

Cost of Revenue

Cost of revenue is primarily composed of depreciation and amortization, salary, rent, utility, business tax/value added tax and surcharge. Among the components of cost of revenue, depreciation and amortization, salary and rent are fixed costs while utility, business tax/value added tax and surcharge are variable costs, which change in proportion to the change in revenue. Our cost of revenue decreased by approximately \$1.38 million, or 26%, to approximately \$3.98 million for the quarter ended September 30, 2013 from approximately \$5.36 million for the same period in 2012. The decrease was mainly attributed to decrease in tax rate from 20% to 3% as a result of change in tax applicable to us from business tax to value added tax since the fourth quarter of 2012. We expect this trend of decrease in tax to continue in 2013 as we continue to be eligible to pay value added tax.

Gross Profit

Gross profit is the difference between sales revenue and cost of revenue. Our gross profit increased by approximately \$0.85 million, or 40%, to approximately \$2.98 million for the quarter ended September 30, 2013 from approximately \$2.13 million for the same period in 2012. Gross profit as a percentage of sales was 43% for the quarter ended September 30, 2013, as compared to 28% for the same period in 2012. The increase in our gross profit margin was mainly attributable to decrease in cost of revenue.

Operating Expenses

Operating expenses are composed of general and administrative expenses and loss on disposal of fixed assets. General and administrative expenses mainly consist of overheads of our headquarters in Shenzhen and fees paid to legal counsel, auditor, and consultants. Our operating expenses decreased by approximately \$0.25 million, or 63%, to approximately \$0.15 million for the quarter ended September 30, 2013 from approximately \$0.39 million for the same period in 2012. In the quarter ended September 30, 2012, we incurred loss of approximately \$0.23 million resulting from disposal of lease hold improvement due to the relocation of 13 internet cafes as compared to \$0 loss for the same period in 2013.

Non-Operating Income/Expenses

Our other income decreased by approximately \$0.36 million, or 99%, to \$2,953 for the quarter ended September 30, 2013 from approximately \$0.36 million for the same period in 2012. The significant change was mainly due to the decrease of approximately \$0.36 million in the fair value of derivative instruments from a gain of approximately \$0.37 million for the quarter ended September 30, 2012 to a gain of approximately \$2,123 for the same period of 2013.

Income before Income Taxes

Income before income taxes increased by approximately \$0.73 million, or 35%, to approximately \$2.84 million for the quarter ended September 30, 2013 from approximately \$2.10 million for the same period in 2012. The increase in income before income tax was mainly attributable to the decrease in cost of revenue.

Income Taxes

Our income taxes increased by approximately \$0.27 million or 60% to approximately \$0.72 million for the quarter ended September 30, 2013 from approximately \$0.45 million for the same period in 2012. The primary reason for the increase in income taxes was the increase in income before income tax as a result of decrease in cost of revenue.

The effective tax rate increased by 4% from 21% for the three months ended September 30, 2012 to 25% for the three months ended September 30, 2013. The increase in effective tax rate was mainly due to the decrease in fair value of unrealized gain of derivative instruments.

Net Income

Our net income increased by approximately \$0.46 million, or 28%, to approximately \$2.12 million for the quarter ended September 30, 2013 from approximately \$1.65 million for the same period in 2012 as a result of the factors described above. We expect to generate higher net profit in the remainder of 2013 as we continue to be eligible for value added tax instead of business tax.

Results of Operations for the Nine Months Ended September 30, 2013 and 2012

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 Nine Months Ended		September 30,		Amount	%			
	2013	2012	As	As					
			percentage	percentage	change	change			
Revenue	\$21,166,465	100	%	\$21,504,955	100	%	(338,490)	-2	%
Cost of revenue	12,045,782	57	%	15,305,121	71	%	(3,259,339)	-21	%
Gross profit	9,120,683	43	%	6,199,834	29	%	2,920,849	47	%
Operating Expenses									
General and administrative expenses	512,795	2	%	975,491	5	%	(462,696)	-47	%
Cafe relocation costs	-			762,602	4	%	(762,602)	-100	%
Total operating expenses	512,795	2	%	1,738,093	8	%	(1,225,298)	-70	%
Income from operations	8,607,888	41	%	4,461,741	21	%	4,146,147	93	%

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

Non-operating income (expenses)								
Change in fair value of derivative financial instrument - preferred stock	64,280	0	%	117,452	-		(53,172)	-45 %
Change in fair value of derivative financial instrument - warrants	310,173	1	%	(98,538)	-		408,711	-415 %
Interest income	13,630	0	%	14,158	0	%	(528)	-4 %
Interest expenses	(9,116)			(9,495)	0	%	379	-4 %
Other expenses	(232)	0	%	(14,450)			14,218	-98 %
Total non-operating income (expenses)	378,735	2	%	9,127	0	%	369,608	4050 %
Net income before income taxes	8,986,623	42	%	4,470,868	21	%	4,515,755	-101 %
Income taxes	2,207,690	10	%	1,260,470	6	%	947,220	75 %
Net income attributable to China Internet Cafe Holdings Group, Inc.	6,778,933	32	%	3,210,398	15	%	3,568,535	-111 %
Dividend on preferred stock	(113,836)	-1	%	(216,605)	-		102,769	-47 %
Net income attributable to China Internet Cafe Holdings Group, Inc. Common stockholders	\$6,665,097	31	%	\$2,993,793	14	%	3,671,304	123 %
Other comprehensive income								
Net income	\$6,778,933	32	%	3,210,398	15	%	3,568,535	111 %
Foreign currency translation	978,856	5	%	113,514	1	%	865,342	762 %
Net Comprehensive income	\$7,757,789	37	%	\$3,323,912	15	%	4,433,877	133 %

Comparison of Nine Months Ended September 30, 2013 and 2012

Revenue

Our revenue is primarily generated from utilization of stored value in the prepaid IC cards sold based on time usage of computers at the internet cafe. Sales revenue decreased approximately \$0.34 million, or 2%, from approximately \$21.50 million for the nine months ended September 30, 2012 to approximately \$21.17 million for the same period ended September 30, 2013. The slight decrease in revenue was mainly due to our normal business fluctuation. In 2012, our revenue and customer base stabilized and increased slightly after the successful relocation of 23 internet cafes to more desirable business districts where we were able to keep our existing loyal customers and attract new customers. In the future, we will continue to focus on growth within Shenzhen while simultaneously pursuing options for expansion through establishment and acquisition of internet cafes in other cities and provinces.

Cost of Revenue

Cost of revenue is primarily composed of depreciation and amortization, salary, rent, utility, business tax/value added tax and surcharge. Among the components of cost of revenue, depreciation and amortization, salary and rent are fixed costs while utility, business tax, value added tax and surcharge are variable costs, which change in proportion to the change in revenue. Our cost of revenue decreased by approximately \$3.26 million, or 21%, to approximately \$12.05 million for the nine months ended September 30, 2013 from approximately \$15.31 million for the same period in 2012. The decrease was mainly attributed to decrease in tax rate from 20% to 3% as a result of change in tax applicable to us from business tax to value added tax since the fourth quarter of 2012. We expect this trend of decrease in tax to continue in 2013 as we continue to be eligible to pay value added tax.

Gross Profit

Gross profit is the difference between sales revenue and cost of revenue. Our gross profit increased by approximately \$2.92 million, or 47%, to approximately \$9.12 million for the nine months ended September 30, 2013 from approximately \$6.20 million for the same period in 2012. Gross profit as a percentage of sales was 43% for the nine months ended September 30, 2013, as compared to 29% for the same period in 2012. The increase in our gross profit margin was mainly attributable to decrease in cost of revenue.

Operating Expenses

Operating expenses are composed of general and administrative expenses and café relocation costs. General and administrative expenses mainly consist of overheads of our headquarters in Shenzhen and fees paid to legal counsel, auditor, and consultants. Our operating expenses decreased by approximately \$1.22 million, or 70%, to approximately \$0.51 million for the nine months ended September 30, 2013 from approximately \$1.74 million for the same period in 2012. The decrease was primarily due to a decrease of approximately \$0.46 million in general and administrative expenses and a decrease of approximately \$0.76 million in café relocation expenses. The decrease in general and administrative expenses was a result of decrease in accrued registration penalty of approximately \$0.19 million, decrease in stock option expense of approximately \$0.11 million and decrease in administrative expenses in salaries, rent expenses, business entertainments, office expenses, and professional fees of approximately \$0.16 million.

Non-operating Income/Expenses

Our other income increased by approximately \$0.37 million, or 4,050%, to approximately \$0.38 million non-operating income for the nine months ended September 30, 2013 from approximately \$9,127 non-operating expense for the same period in 2012. The significant change was mainly due to the increase of approximately \$0.35 million in the fair value of derivative instruments from a gain of approximately \$0.02 million for the nine months ended September 30, 2012 to approximately \$0.36 million for the same period of 2013.

Income before Income Taxes

Income before income taxes increased by approximately \$4.52 million, or 101%, to approximately \$8.99 million for the nine months ended September 30, 2013 from approximately \$4.47 million for the same period in 2012. The increase in income before income tax was mainly attributable to the decrease in cost of revenue.

Income Taxes

Our income taxes increased by approximately \$0.95 million or 75% to approximately \$2.21 million for the nine months ended September 30, 2013 from approximately \$1.26 million for the same period in 2012. The primary reason for the increase in income taxes was the increase in income before income tax as a result of decrease in cost of revenue.

The effective tax rate decreased by 3% from 28% for the nine months ended September 30, 2012 to 25% for the nine months ended September 30, 2013. The decrease in effective tax rate was caused by decrease in the professional expenses associated with being a public company in the US which weren't deducted from the revenues of our PRC's subsidiaries.

Net Income

Our net income increased by approximately \$3.57 million, or 111%, to approximately \$6.79 million for the nine months ended September 30, 2013 from approximately \$3.21 million for the same period in 2012 as a result of the factors described above. We expect to generate higher net profit in the remainder of 2013 as we continue to be eligible for the value added tax instead of business tax.

Liquidity and Capital Resources

As of September 30, 2013, we had cash and cash equivalents of approximately \$37.38 million. The following table provides detailed information about our cash flow for each financial statement period presented in this report.

Edgar Filing: China Internet Cafe Holdings Group, Inc. - Form 10-Q

	Nine Months Ended	
	September 30,	
	2013	2012
Net cash provided by operating activities	\$ 10,843,065	\$ 6,426,043
Net cash used in investing activities	(72,056)	(2,141,885)
Net cash used in financing activities	-	158,516
Effect of foreign currency translation on cash and cash equivalents	791,421	63,598
Net cash flows	\$ 11,562,430	\$ 4,506,272

Operating Activities

Net cash provided by operating activities was approximately \$10.84 million for the nine months ended September 30, 2013, an increase of approximately \$4.42 million, or 69%, as compared to approximately \$6.43 million for the same period in 2012. The increase in cash provided by operating activities was mainly attributable to an increase in net income of approximately \$3.57 million in 2013 compared to the same period of 2012.

Investing Activities

Net cash used in investing activities was approximately \$0.07 million for the nine months ended September 30, 2013, as compared to approximately \$2.14 million for the same period in 2012. For the nine months ended September 30, 2013, we purchased Microsoft software for some cafes' computers for approximately \$0.07 million. For the same period ended September 30, 2012, we spent approximately \$3.14 million on acquisition of computers and equipment and lease hold improvements for one new cafe and the relocated 23 cafes.

Financing Activities

Net cash used in financing activities was approximately \$0 and \$0.16 million for the nine months ended September 30, 2013 and 2012, respectively. At the end of the first quarter of 2013, the Company paid off a short-term bank loan approximately \$0.16 million (RMB 1,000,000) from China Construction Bank. In June of 2013, the Company took out a new short-term loan of approximately \$0.16 million (RMB 1,000,000) from China Construction Bank.

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/value added tax and surcharges. Our internet surfing business tax or value added tax are 20% and 3% on gross revenue generated from our internet cafés, respectively. 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 or value added 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 \$2,101,891 and \$1,505,699 as at September 30, 2013 and December 31, 2012, 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 September 30, 2013.

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:

	September 30, 2013	September 30, 2012
Nine months-end RMB : USD exchange rate	6.1364	-
Nine months average RMB : USD exchange rate	6.2132	6.3027
Three months average RMB : USD exchange rate	6.1613	6.3200
		December 31, 2012
Year-end RMB : USD exchange rate		6.3011

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 January 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. This ASU clarifies that ordinary trade receivables and receivables are not in the scope of ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. Specifically, ASU 2011-11 applies only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the FASB Accounting Standards Codification (Codification) or subject to a master netting arrangement or similar agreement. The FASB undertook this clarification project in response to concerns expressed by U.S. stakeholders about the standard's broad definition of financial instruments. After the standard was finalized, companies realized that many contracts have standard commercial provisions that would equate to a master netting arrangement, significantly increasing the cost of compliance at minimal value to financial statement users. An entity is required to apply the amendments in ASU 2013-01 for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The effective date is the same as the effective date of ASU 2011-11. The adoption of ASU 2013-01 is not expected to have a material impact on the Company's financial position or results of operations.

In February 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. This ASU improves the transparency of reporting these reclassifications. Other comprehensive income includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in this ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. All of the information that this ASU requires already is required to be disclosed elsewhere in the financial statements under U.S. GAAP.

The new amendments will require an organization to:

- Present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income - but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period.

- Cross-reference to other disclosures currently required under U.S. GAAP for other reclassification items (that are not required under U.S. GAAP) to be reclassified directly to net income in their entirety in the same reporting period. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is initially transferred to a balance sheet account (e.g., inventory for pension-related amounts) instead of directly to income or expense.

The amendments apply to all public and private companies that report items of other comprehensive income. Public companies are required to comply with these amendments for all reporting periods (interim and annual). A private company is required to meet the reporting requirements of the amended paragraphs about the roll forward of accumulated other comprehensive income for both interim and annual reporting periods. However, private companies are only required to provide the information about the effect of reclassifications on line items of net income for annual reporting periods, not for interim reporting periods. The amendments are effective for reporting periods beginning after December 15, 2012, for public companies. The adoption of ASU 2013-02 is not expected to have a material impact on the Company's financial position or results of operations.

In February 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. This ASU provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments in this ASU should be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU's scope that exist at the beginning of an entity's fiscal year of adoption. An entity may elect to use hindsight for the comparative periods (if it changed its accounting as a result of adopting the amendments in this ASU) and should disclose that fact. Early adoption is permitted. The adoption of ASU 2013-04 is not expected to have a material impact on the Company's financial position or results of operations.

In March 2013, FASB has issued Accounting Standards Update (ASU) No. 2013-05, Foreign Currency Matters (Topic 830). This ASU resolve the diversity in practice about whether Subtopic 810-10, Consolidation Overall, or Subtopic 830-30, Foreign Currency Matters Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity. In addition, the amendments in this Update resolve the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. This ASU is the final version of Proposed Accounting Standards Update EITF11Ar Foreign Currency Matters (Topic 830), which has been deleted. The amendments in this Update are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. The amendments should be applied prospectively to derecognition events occurring after the effective date. Prior periods should not be adjusted. Early adoption is permitted. If an entity elects to early adopt the amendments, it should apply them as of the beginning of the entity's fiscal year of adoption. The adoption of ASU 2013-05 is not expected to have a material impact on the Company's financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed by the Company in the reports filed under the Securities Exchange Act of 1934 as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls are also designed with the objective of ensuring that this information is accumulated and communicated to the Company's management, including the Company's chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(b) under the Exchange Act, the Company carried out an evaluation with the participation of the Company's management, including Dishan Guo, the Company's chief executive officer and chief financial officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of September 30, 2013. Based upon that evaluation, the Company's management concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2013 as a result of the material weakness identified in our internal control over financial reporting.

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

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

As a result of the material weakness identified above, our internal control over financial reporting was not effective as of September 30, 2013.

2013 Planned Remediation

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

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

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

Changes in Internal Control over Financial Reporting

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

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

Not applicable.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Copies of the following documents are included as exhibits to this report pursuant to Item 601 of Regulation S-K.

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(3)	Amended and Restated Bylaws, adopted on July 30, 2010
3.4(4)	Certificate of Designations Preferences and Rights of the 5% Series A Convertible Preferred Stock of China Internet Café Holdings Group, Inc.
4.1(1)	Form of Cancellation Agreement, dated July 2, 2010, among the Company and certain shareholders.

4.2(2)	Specimen Stock Certificate
31.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*

(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 Current Report on Form 8-K filed with the SEC on February 23, 2011.

*Filed herewith.

**Furnished herewith.

SIGNATURES

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

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

Date: November 14, 2013

/s/ Dishan Guo
Dishan Guo
Chief Executive Officer, President (Principal Executive
Officer) and Chief Financial Officer (Principal Financial
and Accounting Officer)