China Internet Cafe Holdings Group, Inc.
Form 10-K
April 19, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

FORM 10-K

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

For the fiscal year ended December 31, 2012

or

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

For the transition period from ______________________ to _______________________

Commission file number: 000-52832

CHINA INTERNET CAFÉ HOLDINGS GROUP, INC.

(Exact name of registrant as specified in its charter)

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

State of other jurisdiction of
incorporation or organization

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

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

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

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

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

Common Stock, $0.00001 par value
Title of Class

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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). x Yes ¨ No

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

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

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

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

¨ Yes x No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

Note. —If a determination as to whether a particular person or entity is an affiliate cannot be made without involving unreasonable effort and expense, the aggregate market value of the common stock held by non-affiliates may be calculated on the basis of assumptions reasonable under the circumstances, provided that the assumptions are set forth in this Form.

The aggregate market value of the voting and non-voting common stock of the issuer held by non-affiliates as of June 29, 2012 was approximately $2,682,356.84 (8,652,764 shares of common stock held by non-affiliates) based upon the closing price of $0.31 per share of common stock as quoted by OTC Bulletin Board on June 29, 2012.

APPLICABLE ONLY TO REGISTRANTS 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 Section 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 REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

As of April 18, 2013, there are 25,689,524 shares of common stock, par value $0.00001 issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980).

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PART I

Item 1. Business.

Overview

We operate a chain of 62 internet cafés in Shenzhen, Guangdong, the People's Republic of China ("PRC") that are generally open 24 hours a day, seven days a week. We provide internet café facilities to our customers and we believe we are the largest internet café chain in Shenzhen. We provide internet access at prices that we believe are affordable to both students and migrant workers. Although we sell snacks, drinks, and game access cards, over 95% of our revenue comes from selling access time to our computers. We sell internet café memberships to our customers. Members purchase prepaid IC cards (a pocket-sized card with embedded integrated circuits that can be used for identification, authentication, data storage and application processing), which include stored value that will be deducted based on time usage of a computer at the internet café. The cards are only sold at our cafés. We deduct the amount that reflects the access time used by a customer when the customer's IC card is inserted into the IC card slot on the computer.

Our History

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

Current PRC laws and regulations impose substantial restrictions on foreign ownership of the internet café business in the PRC. Therefore, our principal operations and sales and marketing activities in the PRC are conducted through Shenzhen Junlong Culture Communications Co., Ltd ("Junlong"), our variable interest entity ("VIE"), which holds the licenses and approvals for conducting the internet café business in the PRC.

Junlong was incorporated in the PRC in December 2003. It obtained its license to operate internet cafés in 2005. Our effective control over the VIE is contingent on a series of contractual arrangements. These contracts include a Management and Consulting Services Agreement, an Option Agreement, an Equity Pledge Agreement, and a Voting Rights Proxy Agreement. The Management and Consulting Services Agreement, dated June 11, 2010, is between our indirect, wholly owned subsidiary, Zhonghefangda, and our VIE. The rest of the agreements, also dated June 11, 2010, are among Zhonghefangda, our VIE and its shareholders. The terms of these agreements are summarized below. Please also refer to the full text of the contracts, which are filed as exhibits to this report.

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

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

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

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

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

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

Acquisition of Classic Bond

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

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

As a result of our acquisition of Classic Bond, we now own all of the issued and outstanding capital stock of Classic Bond. Classic Bond was incorporated in the British Virgin Islands on November 2, 2009 to serve as an investment holding company. Junlong was incorporated in the PRC in December 2003. It obtained its first licenses from the Ministry of Culture to operate an internet café chain in 2005 and opened its first internet café in April 2006.

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

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

On January 20, 2011, the Company filed with the Nevada Secretary of State a Certificate of Amendment to Articles of Incorporation to give effect to a name change from “China Unitech Group, Inc.” to “China Internet Cafe Holdings Group, Inc.” The Certificate of Amendment was approved by our Board of Directors on July 30, 2010 and was approved by a stockholder holding 59.45% of our outstanding common stock by written consent on July 30, 2010. In connection with the name change, on January 25, 2011, the Company filed an Issuer Company-Related Action Notification Form with FINRA requesting a name change from “China Unitech Group, Inc.” to “China Internet Cafe Holdings Group, Inc.” as well as an OTC voluntary symbol change from “CUIG” to “CICC.” These changes became effective on February 1, 2011. Our common stock began trading under the Company’s new name on the OTC Bulletin Boards on Tuesday, February 1, 2011 under our new trading symbol “CICC.”

On February 22, 2011, in connection with a security purchase agreement between the Company and certain investors (collectively, the “Investors”), we closed a private placement of approximately $6.4 million from offering a total of 474,967 units (the “Units”) at a purchase price of $13.50 per Unit, each consisting of:(i) nine shares of the Company’s 5% Series A Convertible Preferred Stock, par value $0.00001 per share (the “Preferred Shares”), convertible on a one to one basis into nine shares of the Company’s common stock; (ii) one share of common stock; (iii) two three-year Series A Warrants, each exercisable for the purchase of one share of common stock, at an exercise price of $2.00 per share; and (iv) two three-year Series B Warrants, each exercisable for the purchase of one share of common stock, to purchase one share of common stock, at an exercise price of $3.00 per share.

Our Industry

Background on Internet Cafés in the PRC

According to the Survey of China Internet Café Industry by the Ministry of Culture in 2005, the PRC had 110,000 internet cafés, with more than 1,000,000 employees and contributing RMB 18,500,000,000 to China's gross domestic product. According to an article entitled " *China Surpasses U.S. in Number of Internet Users"* written by David Barboza on the New York Times July 26, 2008 issue, the number of internet users in the PRC reached about 253 million in June 2008, thereby, putting China ahead of the United States as the world's biggest internet market. According to the research conducted by China Internet Network Information Center (CNNIC) in January 2012, the amount of internet users in China by the end of 2012 was 564 million, 126 million of which (22.4%) surf the internet via internet cafes.

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

Due to tightened regulations on the operations of internet cafés, there are currently around 81,000 internet cafés in the PRC (Source: "Internet café ban call draws Chinese hacker wrath". AFP 3 Mar, 2010. http://www.google.com/hostednews/afp/article/ALeqM5gJus4tWVAaeWI8IoS-n238PYpFjw). There are currently 10 chains which have licenses to operate nationally. They are CY Network Home Co., Ltd, Zhong Lu Shi Kong Co., Ltd, Digital Library of China Co., Ltd, Asia Telecommunication Network Co., Ltd, China Relic Information Consultation Center, Capital Net Co., Ltd, Great Wall Broadband Network Co., Ltd, China United Network Communications Group Co., Ltd, CECT-ChinaComm Communications Co., Ltd, and Read China Investment.

Computer Gaming Industry in China

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

2008 to $2.8 billion (source: http://www.zhongman.com/games/gamehot/20090429/15485138631.htm), rose 36% in 2009 to $3.97 billion (source http://tech.qq.com/a/20100111/000389.htm),rose 26% in 2010 to $4.8 billion, rose 21% in 2011 to $5.8 billion (source: http://games.sina.com.cn/y/n/2011-05-05/1111495419.shtml), and rose 41% in 2012 (source: http://games.sina.com.cn/y/n/2012-09-06/1016652450.shtml). Given the relatively low rate of computer ownership in the PRC as compared to western countries, management believes that Internet cafés are the primary distribution point for games in the PRC. A substantial number of game players access online games through internet cafés and these players are crucial for survival of internet cafés. (*see*: http://blog.sina.com.cn/s/blog_4aff94ef01007zei.html).

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

Given the popularity of Internet cafés in China, it has been management's experience that many online game companies have been making great efforts to support internet cafés to expand their customer base (*see*: http://blog.sina.com.cn/s/blog_4aff94ef01007zei.html) in the last few years. Many online game companies promote new products by allowing internet café customers to sample the new products in Internet cafes. In this way, online game operators are provided with an outlet to present their new products as well as receive feedback from those individuals who sample the products in the Internet cafes.

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

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

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

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

These promotions benefit the Company by increasing the number of customers who visit our Internet cafes. Currently, we have 62 direct outlets in Shenzhen City, and we believe that the Company name has strong brand recognition in Shenzhen. As a result, these promotions in our Internet cafés are likely to increase the customer base for new online gaming products.

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

Partnerships between Internet Cafés and Other Online Information Providers

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

Company	2012 Revenue Million US$	YOY	Net Profit	% Net	Market Cap
Tencent	$6,983	54 %	$2,034.0	25.0 %	$ 60,550
Shanda	$744.9	-11.4%	$177.2	-12.0%	$ 811
Netease	$1300	13.0 %	$583.9	12.4 %	$ 5,592
ChangYou	$623.4	29.0 %	$282.4	15.0 %	$ 1,393
Giant	$345.4	20.1 %	$159.5	12.9 %	$ 1,279
Perfect World	$444.7	-7.1 %	$86.8	-45.1%	$ 453
Total	$14,443		$3,324		$ 69,678

(Source: finance.yahoo.com, last accessed April 8, 2013)

Competitive Strengths

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

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

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Good Scale of Operation. We have a registered capital of RMB 10 million (approximately $1.47 million) with 62 cafés. The scale of operations allows us to control cost and standardize store management. It is our belief that our scale of operations will not be affected as we expand into additional provinces and obtain a national internet chain license as described in more detail below. The target companies that we intend to acquire in the future in provinces outside of Guangdong Province will be local companies with good scale of operations. We will identify target companies by conducting due diligence on each target company's corporate structure, management, financials, capitalization, and equity structure, and whether or not the target company has the proper approvals, permits, and certificates to legally operate an internet café in the PRC. We intend to buy 51% of the target's company, and keep the local management. However, we will relocate an account manager and an operation manager from our headquarters in Shenzhen to any newly acquired café to join the local management and assist in the process of the acquisition in order to make sure that the acquired café operates in the same manner as our existing Shenzhen-based cafes. As a result, we believe that the efficient and effective operation of the cafes will continue and the Company's scale of operations as a whole will not be negatively affected.

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

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

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

Industry Risks

The principal risk the company faces is the risk associated with changes in government regulations regulating the Internet or Internet cafes. For example, in the year 2000, an arson killed twenty-four individuals and injured several more in an Internet café in Beijing. After this event, the government released new regulations governing the operation of internet cafes, did not issue any new internet café operating licenses, and forced all internet cafes to temporarily close for safety purposes (http://news.sina.com.cn/z/wangba/index.shtml). This type of action by the government could cause serious disruptions in our operations. Additionally, the possibility of passing regulations limiting access to the Internet could have a significant negative impact on our business. Please refer to our disclosure under the "Regulation" section on page 13 for more information on the current government regulations that may have an impact on the Internet, Internet café and online gaming industry. However, there are currently no government regulations that negatively impact our operations. On the contrary, current government regulations promote the expansion of our operations by encouraging the growth of large-scale chain internet cafes. Pursuant to the *Rules on Recognition and Management of Internet Café Chain Enterprises* promulgated by the Ministry of Culture, the PRC government encourages the internet café chain enterprises to merge, acquire or control individual internet cafés and provides simplified and convenient procedures for change of Internet Culture Operation Permit. Additionally, the PRC government requires counterparts of Ministry of Culture at all levels to give priority to the development of internet café chain enterprises when making the plan on the total number of internet cafés.

Our Growth Strategy

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

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

- *We will seek to grow by improving our company structure. To optimize our resources and operations, we plan to improve our company structure so that 20% of our internet cafés will be large stores, each with 300 or more computers mainly focusing on movies, high-end games and entertainment; 50% of cafés will be medium stores with 150 to 300 computers and a few movie suites focusing on high-end games; 10% of cafés will be small stores in the developed cities to spread our reputation with 100 to 150 computers. In order to penetrate the less developed cities, we want to open 20% of our stores in those cities. Our mission is to set up internet cafés all over the PRC to become a real national chain and the industry leader, and we will start to implement these plans in the second half of 2013.*

- *We will seek to grow by location selection. Running internet cafés is a retail business. Internet cafés are located in highly populated areas so as to attract customers. Junlong's internet cafés are located at busy and well attended areas such as industrial zones and business quarters. We kept conducting market research in Sichuan, Guizhou, and Yunan provinces and Chongqing municipalities in 2012. As a result of this market research, we have identified the university areas in Sichuan and Chongqing, the residential areas and business quarters in Yunan and Guizhou as prime areas for the establishment of internet cafés. As such, our future expansion in the south-western region will focus on the establishment of internet cafes in these locations.*

Use of Prepaid IC Cards

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

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

The basic membership comes with the IC card and costs RMB 10 (approximately $1.52) on top of the initial credits deposited. Members receive a discount (e.g. RMB 50 (approximately $7.94) deposit gets RMB 60 (approximately $9.52) credit in the IC card). There is no expiration date for IC cards, but money deposited into the IC cards is not refundable.

Software on the Computers

We have on average 250 computers in each location and a total of over 15,433 computers serving all 62 internet cafés. We install more than 1,000 online games on each of our computers. We also provide movies, music and online chatting software. We use Microsoft Word compatible software called "WPS," which is a freeware provided by Kingsoft, a Chinese software company, so that we do not pay for the higher priced Microsoft Office license.

Third Party Gaming Cards, Snacks and Drinks

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

New products or services

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

Our Customers

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

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

We estimate that at our internet café approximately 50% of computer time is spent on gaming, 30% for other entertainment (e.g. online chatting, online movies, or online music); and 20% for other purposes (e.g. work).

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

In the year of 2013 we plan to open internet cafés around university areas in the south-western provinces and cities including Sichuan and Chongqing. Students spend more time in internet cafés because their time is very flexible. We believe that major users of internet cafés in the future will be young game players.

Competition

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

Local Competitors in Shenzhen

- Shenzhen Weiwo Internet Café Chain Company. Weiwo was founded in 1997. Currently, Weiwo has 16 cafés. The company mainly operates a franchise model, with only 3 company owned cafés. The cafés are mainly located in Futian district, Shenzhen City. The company concentrates on mid-range market. Each café is relatively small with 100 to150 computers (for a total of around 1,600 computers). Its franchised stores are charged a franchising fee per month of approximately RMB 5,000 (approximately $774.67). Weiwo is the smallest internet café chain company in Shenzhen.

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

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

National Competitors

Currently there are ten national internet café chains:

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

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

Intellectual Property

Trademark

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

Domain Name

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

Software

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

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

Regulation

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

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

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

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

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

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

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

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

Our Employees

As of April 18, 2013, we had 656 full time employees. The following table sets forth the number of employees by function:

Function	**Number of Employees**
Senior Management	66
Accounting	6
Staff employees	584
Total	656

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

Item 1A. Risk Factors.

Not applicable.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

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

Junlong currently leases an office space of approximately 411.14 square meters for its headquarters located at #1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City, Longgang District, Shenzhen. The term of the lease is from March 15, 2012 to March 14, 2015.

Junlong also leases spaces from different entities or individuals for its 62 internet cafés. The rent we paid for leased spaces in the fiscal year ended December 31, 2012 was approximately $2.07 million in total.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

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

Market Information

Since March 20, 2013, our common stock is quoted on the OTCQB under the ticker symbol “CICC.” From March 10, 2011 through March 19, 2013, our common stock was quoted on the OTC Bulletin Board under the symbol CICC.OB. Prior to March 10, 2011, there was no active market for our common stock. The following table sets forth the high and low bid prices for our common stock for the periods indicated, as reported by the OTC Bulletin Board. The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

	High	Low
Year ended December 31, 2011		
1st Quarter	$2.00	$1.50
2nd Quarter	$1.50	$0.80

3rd Quarter	$1.01	$0.40
4th Quarter	$0.50	$0.15
Year ended December 31, 2012		
1st Quarter	$0.55	$0.36
2nd Quarter	$0.78	$0.26
3rd Quarter	$0.31	$0.26
4th Quarter	$0.50	$0.26

The last reported sales price of our common stock on the OTC Bulletin Board on December 31, 2012 was $0.50 and on April 18, 2013, the last reported sales price on the OTCQB was $0.29.

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

Approximate Number of Holders of Our Common Stock

As of April 18, 2013, there were approximately 228 stockholders of record of our common stock, as reported by our transfer agent. The number of record holders does not include persons who hold our common stock in nominee or "street name" accounts through brokers.

Dividends

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

Securities Authorized for Issuance under Equity Compensation Plans

As of April 18, 2013, we do not have in effect any compensation plans under which our equity securities are authorized for issuance and we do not have any outstanding stock options.

Recent Sales of Unregistered Securities

None.

Registrar and Stock Transfer Agent

Our independent stock transfer agent is VStock Transfer, LLC. Its mailing address is 77 Spruce Street, Suite 201, Cedarhurst, New York 11516. Its phone number is 212-828-8436.

Penny Stock Regulations

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

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

Repurchase of Equity Securities

None.

Item 6. Selected Financial Data.

Not Applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

Overview

Prior to the consummation of the share exchange transaction described below, we were a shell company with nominal operations and nominal assets. Currently, through our wholly-owned subsidiary, Junlong Culture Communication Co. Ltd. ("Junlong"), we operate 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 our fiscal year of 2012, we focused on increasing the number of our cafes in Shenzhen and relocating our existing cafes to the better business areas. 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 fiscal year ended December 31, 2012, our revenue was approximately $29.6 million and our net income was roughly $4.8 million, representing a decrease of 9% and 50%, respectively, from the revenue of roughly $32.6 million and net income of approximately $9.5 million for the fiscal year ended December 31, 2011.

The discussion below of our performance is based upon our audited financial statements for the fiscal year ended December 31, 2012 and 2011, 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

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	For The Years Ended December 31, 2012	As percentage	2011	As percentage	Amount change	% change
Revenue	$29,575,042	100 %	$32,597,144	100 %	(3,022,102)	-9 %
Cost of revenue	20,851,761	71 %	20,270,919	62 %	580,842	3 %
Gross profit	8,723,281	29 %	12,326,225	38 %	(3,602,944)	-29 %
Operating Expenses						
General and administrative expenses	1,199,510	4 %	2,274,760	7 %	(1,075,250)	-47 %
Cafe relocation costs	763,219	3 %	-	0 %	763,219	100 %
Total operating expenses	1,962,729	7 %	2,274,760	7 %	(312,031)	-14 %
Income from operations	6,760,552	23 %	10,051,465	31 %	(3,290,913)	-33 %
Non-operating income (expenses)						
Change in fair value of derivative financial instrument - preferred stock	83,424	0 %	1,457,090	-	(1,373,666)	-94 %
Change in fair value of derivative financial instrument - warrants	(199,758)	-1 %	783,290	-	(983,048)	-126 %
Interest income	18,624	0 %	12,439	0 %	6,185	50 %
Interest expenses	(14,501)		(9,303)	0 %	(5,198)	56 %
Other expenses	(14,515)	0 %	(563)		(13,952)	2478 %
Total non-operating income (expenses)	(126,726)	0 %	2,242,953	7 %	(2,369,679)	-106 %
Net income before income taxes	6,633,826	22 %	12,294,418	38 %	(5,660,592)	46 %
Income taxes	1,857,341	6 %	2,786,097	9 %	(928,756)	-33 %
Net income attributable to China Internet Cafe Holdings Group, Inc.	4,776,485	16 %	9,508,321	29 %	(4,731,836)	-50 %
Dividend on preferred stock	(216,605)	-1 %	(247,486)	-	30,881	-12 %
Net income attributable to China Internet Cafe Holdings Group, Inc. Common stockholders	$4,559,880	15 %	$9,260,835	28 %	(4,700,955)	-51 %
Other comprehensive income						
Net income	$4,776,485	16 %	9,508,321	29 %	(4,731,836)	-50 %
Foreign currency translation	122,162	0 %	843,432	3 %	(721,270)	-86 %
Net Comprehensive income	$4,898,647	17 %	$10,351,753	32 %	(5,453,106)	-53 %

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Comparison of Fiscal Years Ended December 31, 2012 and 2011

Revenue

Our revenue is primarily generated from sales of prepaid IC cards which include stored value that will be deducted based on time usage of computers at our internet cafes. Our revenue decreased approximately $3.0 million, or 9%, from approximately $32.6 million for the fiscal year ended December 31, 2011 to $29.6 million for the fiscal year ended December 31, 2012. The decrease in revenue was mainly attributable to decrease in time usage of our computers in the internet cafes in the second and third quarters of 2012 resulting from the relocation of our internet cafes. Starting from 2012, the Shenzhen local government has ordered certain factories to be relocated to new districts. In order to maintain our current customer base, we relocated 23 internet cafes to the districts where the factories are moved. As we have completed the relocation of internet cafés by the end of the third quarter of 2012, we expect our revenue will recover in 2013. 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 and business tax/value added tax and surcharge are variable costs, which change in proportion to the change in revenue. Our cost of sales increased approximately $0.6 million, or 3%, to approximately $20.9 million for the fiscal year ended December 31, 2012 from approximately $20.3 million for the same period in 2011. The increase for the year ended December 31, 2012 was mainly attributable to increase in depreciation, rent, utilities, and labor cost associated with five newly opened internet cafes, two of which were opened in the last quarter of 2011 and three were opened in 2012.

Gross Profit

Gross profit is the difference between revenue and cost of revenue. Our gross profit decreased by approximately $3.6 million, or 29%, to approximately $8.7 million for the fiscal year ended December 31, 2012 from approximately $12.3 million for the same period in 2011. Gross profit as a percentage of sales was 29% for the fiscal year ended December 31, 2012, as compared to 38% for the fiscal year of 2011. The decrease in our gross profit margin was mainly attributable to (1) the increase in salary, depreciation, and other costs, (2) costs incurred from the opening and operations of five new internet cafes since the fourth quarter of 2011 and (3) decrease in revenue as a result of the relocation of our 23 cafes. Our management expects the gross profit margin to improve after the completion of the relocation.

Operating Expenses

Operating expenses are composed of general and administrative expenses and cafe 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 $0.3 million, or 14%, to approximately $2.0 million for the fiscal year ended December 31, 2012 from approximately $2.3 million for the same period in 2011. During the fiscal year of 2012, we incurred cafe relocation costs of approximately $0.8 million, which resulted from disposal of lease hold improvements due to the relocation of 23 cafes in the second and third quarters of 2012. We expect that our operating expenses will decrease in 2013 in view of the completion of relocation by the end of 2012.

Non-operating Income/Expenses

Our other income decreased by approximately $2.4 million, or 106%, to approximately $0.1 million non-operating expense for the fiscal year ended December 31, 2012 from approximately $2.2 million non-operating income for the same period in 2011. The significant decrease was due to the decrease of approximately $2.4 million in the fair value of derivative instruments from a gain of approximately $2.2 million for the fiscal year ended December 31, 2011 to a loss of approximately $0.2 million for the fiscal year of 2012.

Income before Income Taxes

Income before income taxes decreased by approximately $5.7 million, or 46%, to approximately $6.6 million for the fiscal year ended December 31, 2012 from approximately $12.3 million for the same period in 2011. The decrease in income before income tax was mainly attributable to the decrease in revenue, the increase in cost of revenue incurred from the newly opened internet cafes, the loss incurred from the disposal of fixed assets, and the decrease in fair value of our derivative instruments.

Income Taxes

Our income taxes decreased by approximately $0.9 million to approximately $1.9 million for the fiscal year ended December 31, 2012 from approximately $2.8 million for the same period in 2011. The primary reason for the decrease in income taxes was the decrease in income before income tax as a result of decrease in revenue and increase in cost of revenue.

Net Income

Our net income decreased by approximately \$4.7 million, or 50%, to approximately \$4.8 million for the fiscal year ended December 31, 2012 from approximately \$9.5 million for the same period in 2011 as a result of the factors described above. We expect to generate higher net profit in 2013 after the completion of the relocation of our internet cafes in 2012.

Liquidity and Capital Resources

As of December 31, 2012, we had cash and cash equivalents of approximately \$25.8 million. The following table provides detailed information about our cash flow for each financial statement period presented in this report.

Cash Flow

	Fiscal Year Ended December 31,	
	2012	2011
Net cash provided by operating activities	$8,464,920	$14,747,062
Net cash (used in) investing activities	(2,482,197)	(4,927,509)
Net cash provided by financing activities	158,645	5,520,681
Effect of foreign currency translation on cash and cash equivalents	46,993	452,622
Net cash flows	6,188,361	15,792,856

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Operating Activities

Net cash provided by operating activities was approximately $8.5 million for the fiscal year ended December 31, 2012, a decrease of approximately $6.3 million, or 43%, as compared to approximately $14.7 million of net cash provided by operating activities for the same period in 2011. The decrease in cash provided by operating activities was mainly attributable to (1) a decrease in net income of approximately $4.7 million and deferred revenue of approximately $2.1 million as compared to the same period in 2011 due to the relocation of 23 cafes; (2) a decrease in tax payable of approximately $0.9 million due to decrease in net income; and (3) a decrease in accrued expenses of approximately $0.5 million as a result of a penalty for delay in effectively registering securities sold in our private placement in February 2011.

Investing Activities

Net cash used in investing activities was approximately $2.5 million for the fiscal year ended December 31, 2012, a decrease of approximately $2.4 million, or 50%, as compared to approximately $4.9 million net cash used in investing activities for the same period in 2011. For the year ended December 31, 2012, we spent approximately $3.5 million on acquisition of computers and equipment and lease hold improvements for the new cafes and the relocated 23 cafes. Our deposits paid for property and equipment decreased by approximately $1.0 million. For the same period in 2011, we spent approximately $7.5 million on acquisition of computers and lease hold improvements for 15 cafes opened in 2011. In addition, we terminated an acquisition agreement in the same period of 2011 and the deposit in connection with the acquisition of approximately $2.5 million was returned to the Company.

Financing Activities

Net cash provided by financing activities was approximately $0.2 million for the fiscal year ended December 31, 2012, a decrease of approximately $5.4 million, or 97%, as compared to approximately $5.5 million for the same period in 2011. The Company conducted a securities offering in February 2011 and received the proceeds of approximately $5.9 million while in the year ended December 31, 2012, the Company took out a short-term loan of approximately $0.2 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 and surcharges. Our internet surfing business tax is 20% on gross revenue generated from our internet cafés. Our other surcharges are an education surcharge of 3%, city development surcharge of 1%, a culture development surcharge of 3%, and a snacks and drinks business tax of 5%. All surcharges are calculated on the basis of business tax amount.

Property, plant and equipment

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

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

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

Deferred Revenue

Deferred revenue represents unused balances of the prepaid amounts from the IC cards that are unused balance. The outstanding customer balances are $1,505,699 and $2,084,086 as at December 31, 2012 and 2011, respectively, and are included in deferred revenue on the balance sheets. Management has evaluated the deferred revenue balance and has determined any potential revenue from the unused balance to be immaterial as of the fiscal year ended December 31, 2012.

Comprehensive income

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

Income taxes

Income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Current tax is based on the profit or loss from ordinary activities adjusted for items that are non-assessable or disallowable for income tax purpose and is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date. Deferred income tax liabilities or assets are recorded to reflect the tax consequences in future differences between the tax basis of assets and liabilities and the financial reporting amounts at each year-end. A valuation allowance is recognized if it is more likely than not that some portion, or all, of a deferred tax asset will not be realized.

Foreign currency translation

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

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

	2012	2011
Year-end RMB : USD exchange rate	6.3011	6.3523
Average yearly RMB : USD exchange rate	6.3034	6.4544

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

Recently issued accounting pronouncements

Accounting Standards Codification

In October 2012, FASB issued ASU 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. In summary, the ASU requires post-acquisition date changes in the value of an indemnification asset to be accounted for on the same basis as the change in the underlying asset subject to the indemnification. Its adoption of ASU 2012-06 is not expected to have a material impact on its consolidated financial statements.

In October 2012, the FASB issued Accounting Standards Update (ASU) 2012-04, "Technical Corrections and Improvements" in Accounting Standards Update No. 2012-04. The amendments in this update cover a wide range of Topics in the Accounting Standards Codification. These amendments include technical corrections and improvements to the Accounting Standards Codification and conforming amendments related to fair value measurements. The amendments in this update will be effective for fiscal periods beginning after December 15, 2012. The adoption of

ASU 2012-04 is not expected to have a material impact on the Company’s financial position or results of operations.

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.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Not Applicable.

Item 8. Financial Statements and Supplementary Data.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

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

We have audited the accompanying consolidated balance sheets of China Internet Cafe Holdings Group, Inc. and Subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2012. China Internet Cafe Holdings Group, Inc. and Subsidiaries' management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Internet Cafe Holdings Group, Inc. and Subsidiaries as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

EFP Rotenberg, LLP

Rochester, New York

April 18, 2013

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2012	December 31, 2011 Restated
ASSETS		
Current assets:		
Cash and cash equivalents	$25,818,041	$19,629,680
Rental deposit	34,121	86,580
Equipment deposit	7,427	994,732
Inventory	49,681	212,607
Deferred tax assets	76,982	69,405
Total current assets	25,986,252	20,993,004
Property, plant and equipment, net	12,730,766	13,000,745
Intangible assets, net	124,274	161,083
Rental deposit-long-term portion	416,066	314,736
Total assets	$39,257,358	$34,469,568
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Short term loan	$158,702	$-
Accounts payable	-	100,480
Registration penalties payable	641,200	448,844
Deferred revenue	1,505,699	2,084,086
Payroll and payroll related liabilities	350,277	323,286
Income and other taxes payable	754,709	1,316,209
Accrued expenses	396,878	365,696
Amount due to a shareholder	2,634,163	2,135,218
Dividend payable on preferred stock	72,729	72,729
Derivative financial instrument - preferred stock	64,280	147,704
Derivative financial instrument - warrants	329,254	129,496
Total current liabilities	6,907,891	7,123,748
Commitments and contingencies (Note 17)		
Convertible preferred stock ($0.00001 par value, 100,000,000 shares authorized, 4,274,703 shares issued and outstanding as of December 31, 2012 and 2011; preference in liquidation - $5,770,849)	3,682,473	3,682,473
Stockholders' Equity:		
Common stock ($0.00001 par value, 100,000,000 shares authorized, 21,414,821 and 21,254,377 shares issued and outstanding as of December 31, 2012 and 2011)	214	212
Additional paid in capital	2,050,329	1,728,726
Statutory surplus reserves	718,744	718,744
Retained earnings	24,320,169	19,760,289

Accumulated other comprehensive income	1,577,538	1,455,376
Total stockholders' equity	28,666,994	23,663,347
Total liabilities and stockholders' equity	$39,257,358	$34,469,568

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	For The Years Ended December 31, 2012	2011 Restated
Revenue	$29,575,042	$32,597,144
Cost of revenue	20,851,761	20,270,919
Gross profit	8,723,281	12,326,225
Operating Expenses		
General and administrative expenses	1,199,510	2,274,760
Cafe relocation costs	763,219	-
Total operating expenses	1,962,729	2,274,760
Income from operations	6,760,552	10,051,465
Non-operating income (expenses)		
Change in fair value of derivative financial instrument - preferred stock	83,424	1,457,090
Change in fair value of derivative financial instrument - warrants	(199,758)	783,290
Interest income	18,624	12,439
Interest expenses	(14,501)	(9,303)
Other expenses	(14,515)	(563)
Total non-operating income (expenses)	(126,726)	2,242,953
Income before income taxes	6,633,826	12,294,418
Income taxes	1,857,341	2,786,097
Net income	4,776,485	9,508,321
Dividend on preferred stock	(216,605)	(247,486)
Net income attributable to China Internet Cafe Holdings Group, Inc. common stockholders	$4,559,880	$9,260,835
Other comprehensive income		
Net income	$4,776,485	$9,508,321
Foreign currency translation	122,162	843,432
Total comprehensive income	$4,898,647	$10,351,753
Earnings per share		
- Basic	$0.21	$0.44
- Diluted	$0.19	$0.39
Weighted average common stock outstanding		
- Basic	21,355,038	21,025,803
- Diluted	25,629,741	24,691,507

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	Common stock						
	Number of shares	Amount	Additional paid-in capital	Statutory reserves	Retained Earnings	Accumulated other comprehensive income	Total Stockholders' Equity
Balance at December 31, 2009	19,000,000	190	1,373,484	718,744	4,752,871	210,995	7,056,284
Contributed capital by existing shareholders	-	-	251,612	-	-	-	251,612
Reorganization for reverse merger	1,200,000	12	3,321	-	-	-	3,333
Net income for the year	-	-	-	-	5,746,583	-	5,746,583
Foreign currency translation difference	-	-	-	-	-	400,949	400,949
Balance at December 31, 2010	20,200,000	202	1,628,417	718,744	10,499,454	611,944	13,458,761
Issuance of common stock	924,967	10	100,309	-	-	-	100,319
Preferred stock dividend	129,410	-	-	-	(247,486)	-	(247,486)
Net income for the year	-	-	-	-	9,508,321	-	9,508,321
Foreign currency translation difference	-	-	-	-	-	843,432	843,432
Balance at December 31, 2011	21,254,377	$212	$1,728,726	$718,744	$19,760,289	$1,455,376	$23,663,347
Stock based compensation	-	-	105,000	-	-	-	105,000
Preferred stock dividend	160,444	2	216,603	-	(216,605)	-	-
Net income for the year	-	-	-	-	4,776,485	-	4,776,485
Foreign currency translation difference	-	-	-	-	-	122,162	122,162
Balance at December 31, 2012	21,414,821	$214	$2,050,329	$718,744	$24,320,169	$1,577,538	$28,666,994

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

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For The Years Ended December 31, 2012	2011 Restated
Cash flows from operating activities		
Net income	$4,776,485	$9,508,321
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Change in fair value of derivative financial instrument - preferred stock	(83,424)	(1,457,090)
Change in fair value of derivative financial instrument- warrants	199,758	(783,290)
Advisory fee	105,000	450,000
Depreciation	3,090,100	2,948,401
Amortization	38,103	37,212
Loss on disposal of fixed assets	762,602	-
Deferred tax assets	(7,011)	(68,307)
Changes in operating assets and liabilities:		
Rental deposit	(45,621)	(96,983)
Inventory	164,593	(24,259)
Accounts payable	(101,259)	29,718
Deferred revenue	(595,104)	1,457,156
Payroll and payroll related liabilities	24,356	113,758
Income and other taxes payable	(571,986)	284,120
Accrued expenses and penalties payable	221,122	704,897
Amount due to a shareholder	487,206	1,643,408
Net cash provided by operating activities	8,464,920	14,747,062
Cash flows from investing activities		
Increase of property, plant and equipment	(3,477,222)	(7,477,866)
Receipt of loan receivable due to termination of an investment agreement	-	2,478,929
Restricted cash	-	968,332
Deposits paid for property, plant and equipment	995,025	(896,904)
Net cash used in investing activities	(2,482,197)	(4,927,509)
Cash flows from financing activities		
Net proceeds from issuance of preferred stock and warrants	-	5,675,614
Increase/(Decrease) from short term loan	158,645	(154,933)
Net cash flows provided by financing activities:	158,645	5,520,681
Effect of foreign currency translation on cash	46,993	452,622
Net increase in cash and cash equivalents	6,188,361	15,792,856
Cash and cash equivalents - beginning of year	19,629,680	3,836,824

Cash and cash equivalents - end of year	$25,818,041	$19,629,680
Cash paid during the year for:		
Interest paid	$14,501	$9,303
Income taxes paid	$1,411,438	$2,775,996
Supplemental disclosures of non-cash transactions:		
Transfer of equipment deposits paid in property and equipment	$994,732	$1,250,275
Dividend payable on preferred stock	72,729	72,729
Registration penalties	$192,356	448,844
Advisory fee	$105,000	$450,000

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

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

1. Organization, Recapitalization and Nature of Business

<u>China Internet Cafe Holdings Group, Inc. (“China Internet Cafe</u>”)

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

<u>Recapitalization of Classic Bond Development Limited</u>

On July 2, 2010, the China Internet Cafe Holdings Group, Inc. (“China Internet Cafe”), entered into a share exchange transaction with Classic Bond Development Limited, a British Virgin Islands corporation (“Classic Bond”), and the shareholders of Classic Bond. Pursuant to the Share Exchange Agreement, China Internet Cafe acquired 100% of the issued and outstanding capital stock of Classic Bond in exchange for 19,000,000 newly issued shares of the Company’s common stock, which represented approximately 94% of the 20,200,000 issued and outstanding shares of common stock after the transaction and after the coincident cancellation of 4,973,600 shares of common stock held by the Company’s former majority stockholder which have a net effect of increase of 1,200,000 shares. The business, assets and liabilities did not change as a result of the reverse acquisition.

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

Accordingly, all references to common shares of Classic Bond's common stock have been restated to reflect the equivalent number of China Internet Cafe's common shares. In other words, the 2,000,000 Classic Bond shares outstanding are restated as 20,200,000 common shares, as of July 2, 2010. Each share of Classic Bond is restated to 10.10 shares of China Internet Cafe.

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

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

Classic Bond Development Limited ("Classic Bond")

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

On June 23, 2010, the Company further issued 1,950,000 shares of common stock to 42 individuals to raise fund of $84,093 (HK$651,721) for 651,721 shares and 1,308,954 shares associated with the reorganization of the Company at a value of $167,519 (HK$1,308,954) which is reflected as contributed capital by existing shareholders of Junlong and the total amount was $251,612. At December 31, 2011 and 20109, the issued and outstanding of Common Stock were 21,124,967 and 20,200,000 shares.

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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

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

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

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

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

Exclusive Management and Consulting Agreement

On June 11, 2010, Zhonghefangda signed exclusive management and consulting services agreement with Junlong. Pursuant to the agreement, Zhonghefangda agreed to provide management and consulting services to Junlong, upon request, in connection with the operation of the Business. The agreement provides that Junlong will compensate Zhonghefangda in consideration for its right to receive the aggregate net profit of Junlong for a period of twenty (20) years and for succeeding periods of the same duration until terminated by both parties under agreed conditions. Zhonghefangda will reimburse to Junlong the full amount of any net losses incurred by Junlong during the term of this agreement. As a result of entering into the exclusive management and consulting agreement, Zhonghefangda should be deemed to control Junlong as a Variable Interest Entity and should be consolidated in the accompanying financial statements.

Shenzhen Jun Long Culture Communication Co., Ltd. ("Junlong")

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

In 2005, Junlong obtained internet cafe licenses to operate an internet café chain from the Ministry of Culture, and opened the internet first cafe in April, 2006 and our members can access the internet at our venues. We started our internet cafes in 2006 and we opened 7 internet cafes in 2006, 5 internet cafes opened in 2007, 11 internet cafes opened in 2008, 5 internet cafes opened in 2009, 16 internet cafes opened in 2010, 15 internet cafes opened in 2011, and 3 internet cafes opened during the year of 2012. In total, we own 62 internet cafes within Shenzhen, Guangdong through December 31, 2012.

2. Summary of Significant Accounting Policies

(a) Basis of presentation

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

(b) Principle of consolidation

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

2. Summary of Significant Accounting Policies (Continued)

(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 an 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 vale recorded in other income (expense) in our statement of loss and comprehensive loss in each subsequent period. In general, warrants with anti-dilution provisions are measured using the binomial valuation model. The methodology based, in part, upon inputs for which there is little or no observable market 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 16.

(d) Revenue recognition

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

The Company also records revenue from commission received from the sale of third parties on-line gaming cards, snacks and drinks. Commission revenue amounted to 20% of the value of the on-line gaming cards, snacks and drinks is recognized at the time the gaming cards, etc. are sold to customers. During the years ended December 31, 2012 and 2011, the commission income was $373,285 and $249,430, less than 1% of total revenue.

(e) Cost of revenue

Cost of revenue consists primarily of depreciation of each internet café's computer equipment and hardware and overhead associated with the internet cafes including rental payments, utilities, business taxes, 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% on 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.

(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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

3. Summary of Significant Accounting Policies (Continued)

(i) Fair Value of Financial Instruments

The Company applies the provisions of accounting guidance, FASB Topic ASC 820 that requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value, and defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of December 31, 2012, the fair value of cash and cash equivalents, accounts payable, short-term loan, and accrued expenses approximated carrying value due to the short maturity of the instruments, or are based on quoted market prices or interest rates which fluctuate with market rates except for related party debt or receivables for which it is not practicable to estimate fair value.

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

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

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

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

The following are the major categories of assets and liabilities measured at fair value on a recurring basis during the year ended December 31, 2012, using quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3).

Description

	Level 1: Quoted Prices in Active Markets for Identical Assets	Level 2: Significant Other Observable Inputs	Level 3: Significant Unobservable Inputs	Total December 31,2012
Derivative Liability - Warrants	$ -	$ -	$ 329,254	$ 329,254
Derivative Liability – Preferred stock		-	64,280	64,280
Total	$ -	$ -	$ 393,535	$ 393,534

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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

2. Summary of Significant Accounting Policies (Continued)

(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 improvement	5 years
Cafe computer equipment and hardware	5 years
Cafe furniture and fixtures	5 years
Office furniture, fixtures and equipments	5 years
Motor vehicles	5 years

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

(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 are $1,505,699 and $2,084,086 as of December 31, 2012 and 2011, respectively, and are included in deferred revenue on the balance sheets. Management has evaluated the deferred revenue balance and has determined any potential revenue from the unused balance to be immaterial at the year ended December 31, 2012.

(o) Comprehensive income

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

(p) Income taxes

Income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Current tax is based on the profit or loss from ordinary activities adjusted for items that are non-assessable or disallowable for income tax purpose and is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date. 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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

2. Summary of Significant Accounting Policies (Continued)

(q) Consolidation of Variable Interest Entities

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

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

	December 31, 2012	December 31, 2011
Current assets and Long term rental deposit	$26,392,390	$21,256,846
Property, plant and equipment	12,730,766	13,000,745
Intangible assets	124,275	161,083
Total assets	39,247,431	34,418,674
Total liabilities	(10,129,831)	(11,064,894)
Net assets	$29,117,600	$23,353,780

(r) Foreign currency translation

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

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

	December 31, 2012	December 31, 2011
Year-end RMB : USD exchange rate	6.3011	6.3523
Average yearly RMB : USD exchange rate	6.3034	6.4544

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

(s) Post-retirement and post-employment benefits

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

(t) Earnings per share (EPS)

Earnings per share is calculated in accordance with ASC 260-10 which requires the Company to calculate net income (loss) per share based on basic and diluted net income (loss) per share, as defined. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted EPS is similar to basic EPS but presents the dilutive effect on a per share basis of potential common shares (e.g., convertible securities, preferred stock and warrants) as if they had been converted at the beginning of the periods presented, or issuance date, if later. Potential common shares that have an anti-dilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted EPS. See Note 13 for details.

(u) Retained earnings-appropriated

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

2. Summary of Significant Accounting Policies (Continued)

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

As of December 31, 2012 and 2011, the statutory surplus reserves of the subsidiary already reached 50% of the registered capital of the subsidiary and the Company did not have any further allocation on it.

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

(w) Reclassification
Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

(x) Recent Accounting Pronouncements
In October 2012, FASB issued ASU 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. In summary, the ASU requires post-acquisition date changes in the value of an indemnification asset to be accounted for on the same basis as the change in the underlying asset subject to the indemnification. Its adoption of ASU 2012-06 is not expected to have a material impact on its consolidated financial statements.

In October 2012, the FASB issued Accounting Standards Update (ASU) 2012-04, "Technical Corrections and Improvements" in Accounting Standards Update No. 2012-04. The amendments in this update cover a wide range of Topics in the Accounting Standards Codification. These amendments include technical corrections and improvements to the Accounting Standards Codification and conforming amendments related to fair value measurements. The amendments in this update will be effective for fiscal periods beginning after December 15, 2012. The adoption of ASU 2012-04 is not expected to have a material impact on the Company's financial position or results of operations.

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.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

3. Cash and cash equivalents

Cash and cash equivalents are summarized as follows:

	December 31, 2012	December 31, 2011
Cash and cash equivalents at bank	$25,800,930	$19,609,650
Cash in hand	17,111	20,030
	$25,818,041	$19,629,680

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents (Note 2). As of December 31, 2012 and 2011, $25,794,334 and $19,585,062 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 $1,951 and $44,618 of the Company's cash and cash equivalents were held by Chase bank and JP Morgan Chase bank in USA, respectively.

4. Equipment Deposits

Equipment deposits consist of:

December 31, 2012	December 31, 2011
$ 7,427	$994,732

As of December 31, 2011, equipment deposits for the purchase computers for three new internet cafes. One of them was opened in June 2012 and two of them were opened in July 2012. As of December 31, 2012, equipment deposits are for the purchase of an air-conditioner and fire protection systems for the new headquarters in Shenzhen.

5. Inventory

Inventory consists of:

	December 31, 2012	December 31, 2011
Purchased IC cards	$ 49,681	$ 212,607

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

6. Property, Plant and Equipment, net

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

	December 31, 2012	December 31, 2011
Leasehold improvement	$ 4,394,136	$ 4,535,898
Cafe computers equipment and hardware	16,939,215	14,130,446
Cafe furniture and fixtures	1,963,143	1,746,164
Office furniture, fixtures and equipment	303,271	303,318
Motor vehicles	471,973	468,169
	$ 24,071,738	$ 21,183,995
Less: Accumulated depreciation	(11,340,972)	(8,183,250)
Property, plant and equipment, net	$ 12,730,766	$ 13,000,745

During the year ended December 31, 2012, depreciation expenses amounted to $3,090,100, of which $2,985,548 and $104,552 were recorded as cost of sales and general and administrative expense, respectively.

During the year ended December 31, 2011, depreciation expenses amounted to $2,948,401, of which $2,860,808 and $87,593 were recorded as cost of sales and general and administrative expense, respectively.

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

7. Intangible Assets

Intangible assets are summarized as follows:

	December 31, 2012	December 31, 2011
Business License	$99,614	$99,000
Customer Lists	126,219	125,012
	225,833	224,012
Less: Accumulated Amortization	(101,559)	(62,929)
Total	$124,274	$161,083

During the years ended December 31, 2012 and 2011, amortization expenses amounted to $38,103 and $37,212 respectively which was recorded under cost of sales.

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

Year ending December 31,	
2013	$38,103
2014	38,103
2015	21,094
2016	9,158
2017	1,825
Thereafter	15,947
Total	$124,230

8. Short Term Loan

The short term loan due within one year as of December 31, 2012 and 2011 consist of the following:

Bank	Loan Period	Interest rate	December 31, 2012	December 31, 2011
China Construction Bank	April 1, 2012 to March 26, 2013	12.46 %	$ 158,702	-

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 director's guarantee. The annual interest rate is approximately 12.46% and is due on March 26, 2013.

9. Income and Other Taxes Payable

Income and other tax payables consist of the following:

	December 31, 2012	December 31, 2011
Business tax payable	$ -	$ 605,274
Value added taxes	78,013	-
Income tax	586,908	582,406
Withhold individual income tax payable	2,208	1,300
Other tax payable	87,580	127,229
Total	$ 754.709	$ 1,316,209

10. Due To A Shareholder

	December 31, 2012	December 31, 2011
Mr. Guo Di Shan, a shareholder of the Company	$ 2,634,163	$ 2,135,218

The amount due to Mr. Di Shan Guo is unsecured with no stated interest and is payable on demand. As of December 31, 2012, the total amounts of $2.6 million were accumulated amount since 2007 and used to pay daily operating expenses and professional fees.

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

11. Cost of Revenue

Cost of revenue consists of the following:

	For The Year Ended December 31,	
	2012	2011
Cost of revenue consists of		
Depreciation and amortization	$3,023,651	$2,898,020
Salary	3,250,516	2,446,447
Rent	2,326,337	1,886,295
Utility	2,221,137	2,143,416
Business tax and surcharge	6,138,096	7,841,367
Others	3,892,024	3,055,374
	$20,851,761	$20,270,919

12. Income Tax

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

	2012	2011
	US$	US$
Income (loss) subject to domestic income taxes only	(759,539)	685,681
Income (loss) subject to foreign income taxes only	7,429,365	11,608,737
	6,633,826	12,294,418

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

	2012 US$	2011 US$
Current:		
Federal	-	-
State	-	-
PRC	1,934,323	2,855,502
	1,934,323	2,855,502
Deferred:		
Federal	-	-
State	-	-
PRC	(76,982)	(69,405)
Total provision for income taxes	1,857,341	2,786,097

On March 16, 2007, the National People's Congress enacted a new enterprise income tax law (“New EIT Law”), which took effect on January 1, 2008. The New EIT Law applies a uniform 25% enterprise income tax rate to both foreign invested enterprises and domestic enterprises. While the New EIT Law equalizes the tax rates for foreign invested enterprises and domestic companies, preferential tax treatment would continue to be given to companies in certain encouraged economic sectors in PRC. Based on Circular 39—Circular on the Implementation of the Preferential Policies for Corporate Income Tax during the Transition Period, which was issued by the PRC State Council in 2007, enterprises that previously enjoyed a preferential tax rate, would transit to the statutory enterprise income tax rate of 25% over five years starting from January 1, 2008. During this transition period, for enterprises which previously enjoyed preferential tax rate of 15%, the applicable tax rate would increase to 18% for 2008, 20% for 2009, 22% for 2010, 24% for 2011 and 25% for 2012 and 2013.

Prior to 2008, Junlong enjoyed a preferential tax rate of 15% as a foreign invested enterprise because it was located in Shenzhen Special Economic Zone. Under the New EIT Law, Junlong was no longer entitled to 15% preferential tax rate but still enjoyed the reduced transitional tax rate at 24% for 2011. The aggregate dollar effect of preferential tax rate is as follows:

	2012	2011
Aggregate dollar effect of tax holiday	-	(116,087)
Per share effect—basic	$ -	$0.01
Per share effect—diluted	$ -	$-

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

12. Income Tax (Continued)

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

	2012 US$	2011 US$
Tax at federal statutory rate	1,658,456	3,073,604
Permanent differences	29,804	(560,095)
Loss not benefited	169,801	388,675
Prior year true ups	-	-
Tax holiday	-	(116,087)
	1,857,341	2,786,097

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

	2012 US$	2011 US$
DTA:		
Deferred assets - others	76,982	69,405
Deferred assets - NOL	865,401	666,516
Total Deferred assets	942,383	735,921
Total Gross DTA	942,383	735,921
Valuation allowance	(865,401)	(666,516)
Net deferred assets	76,982	69,405

The Company has recorded a valuation allowance against all of its US deferred tax assets at December 31, 2012 and 2011. In accordance with ASC 740 Accounting for Income Taxes, based on all available evidence, including the Company's historical results and the forecast of its future income, it is more likely than not that its US entity will not be able to realize its deferred tax assets, and that all of its PRC entities will be able to realize the deferred tax assets.

For U.S. federal income tax purposes, the Company has net operating loss, or NOL carry forwards of approximately $0.87 million and $0.67 million, at December 31, 2012 and 2011, respectively. The 2012 net operating loss carry forwards will expire after 20 years beginning 2030 and the 2011 net operating loss carry forwards will expire after 20 years beginning 2029, if not utilized. The Company has no net operating loss carry forwards for PRC enterprise income tax purposes, at December 31, 2012 and 2011, respectively.

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

Undistributed earnings of the Company’s PRC subsidiary amounted to approximately $26 million as of December 31, 2012. Those earnings are considered to be permanently reinvested and accordingly, no deferred tax expense is recorded for U.S. federal and state income tax or applicable withholding taxes. The PRC tax authorities have clarified that dividend distributions made out of pre-January 1, 2008 retained earnings will not be subject to withholding taxes.

The Company and its subsidiaries are subject to taxation in the U.S. and the PRC. Our U.S. federal and state income tax returns are generally not subject to examination by the tax authorities for tax years before 2007. The tax authorities in the PRC may examine the tax returns of the Company three years after its fiscal year ended.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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13. Earnings per Share

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

	For The Years Ended Dec 31,	
	2012	2011
BASIC		
Numerator for basic earnings per share attributable to the Company's common stockholders:		
Net income	$4,776,485	$9,508,321
Dividend on preferred stock	(216,605)	(247,486)
Net income used in computing basic earnings per share	$4,559,880	$9,260,835
Basic weighted average shares outstanding	21,355,038	21,025,803
Basic earnings per share	$0.21	$0.44

	For The Years Ended Dec 31,	
	2012	2011
DILUTED		
Numerator for diluted earnings per share attributable to the Company's common stockholders:		
Net income	$4,559,880	$9,260,835
Dividend on preferred stock	216,605	247,486
Net income used in computing diluted earnings per share	$4,776,485	$9,508,321
Weighted average outstanding shares of common stock	21,355,038	21,025,803
Weighted average preferred stock	4,274,703	3,665,704
Diluted weighted average shares outstanding	25,629,741	24,691,507

Diluted earnings per share	$0.19	$0.39
Potential common shares outstanding as of June 30:		
Series A preferred stock	4,274,703	4,274,703
Warrants	2,498,326	2,498,326
	6,773,029	6,773,029

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

14. Employee Benefits

The Company contributes to a state pension scheme organized by municipal and provincial governments in respect of its employees in PRC. The pension expense related to this plan, which is calculated at a range of 8% of the average monthly salary. The pension expense was $ 11,658 and $13,833 for the year ended December 31, 2012 and 2011, respectively.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

15. Stockholders' Equity

Common Stock

On July 2, 2010, the China Internet Cafe Holdings Group, Inc. ("China Internet Cafe"), entered into a share exchange transaction with Classic Bond Development Limited, a British Virgin Islands corporation ("Classic Bond"), and the shareholders of Classic Bond. Pursuant to the Share Exchange Agreement, China Internet Cafe acquired 100% of the issued and outstanding capital stock of Classic Bond in exchange for 19,000,000 newly issued shares of the Company's common stock, which represented approximately 94% of the 20,200,000 issued and outstanding shares of common stock after the transaction and after the coincident cancellation of 4,973,600 shares of common stock held by the Company's former majority stockholder which have a net effect of increase of 1,200,000 shares. The business, assets and liabilities did not change as a result of the reverse acquisition.

As of December 31, 2012 and 2011, there are 21,414,821 and 21,254,377 shares of Common Stock issued and outstanding respectively.

Series A Preferred Stock

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

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

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

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

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

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

15. Stockholders' Equity (Continued)

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

In addition to the holder's right to convert the Series A Preferred Stock at any time, provided that the Common Stock underlying the Series A Preferred Stock is registered under an effective registration statement or is available for resale under Rule 144, without limitation, all outstanding shares of the Series A Preferred Stock will automatically convert into shares of Common Stock (subject to a restriction that the holder may not convert if it would result in them holding in excess of 9.99% of the then issued and outstanding shares of Common Stock, unless they waive such restriction in writing at least 61 days prior) at the earlier to occur of (i) the 24 month anniversary of the Closing Date, or (ii) at such time that the volume-weighted average price of the Company's Common Stock is equal to or greater than $3.00 (as may be adjusted for any stock splits or combinations of the Common Stock) for a period of ten consecutive trading days and such Common Stock has an average daily trading volume, for ten consecutive trading days, equal to or greater than 50,000 shares.

As of December 31, 2012, there were 4,274,703 shares of Series A Preferred Stock outstanding, which were issued on February 22, 2011. No shares were outstanding at December 31, 2010.

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

<u>Securities Purchase Agreement</u>

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

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

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

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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

Warrants

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

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

The Company may call the Series A and Series B Warrants for redemption at a redemption price of $0.01 per Warrant share if the shares underlying the Warrants are registered for sale and the volume-weighted average price of the Company's Common Stock is equal to or greater than $6.00 per share or $9.00 per share, respectively, for a period of ten consecutive trading days and such Common Stock has an average daily trading volume, for ten consecutive trading days, equal to or greater than 75,000 shares per day.

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

Registration Rights Agreement

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

The required registration statement was filed by the required due date. However, the Company did not meet the deadline to render its S-1 registration statement effective. At December 31, 2012, the Company has accrued, $641,200 for the estimated liquidated damages it expects to pay.

Placement Agent Fees

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

In addition, the placement agents received warrants to purchase such number of securities equal to 9% of the aggregate number of shares of common stock issuable in connection with the Units (the “Placement Agent Warrants”). The Placement Agent Warrants expire after three years and are exercisable at the following prices: (i) 427,740 Warrants - $1.35 per share (ii) 85,494 Series A Warrants - $2.00 per share and (iii) 85,494 Series B Warrants - $3.00 per share. The terms of the Warrants, including anti-dilution protection for stock splits and similar events, are similar to the Warrants issued to the Investors, except that the 427,740 Warrants do not permit the Company to call the Warrants.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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

Securities Escrow Agreement

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

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

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

Lock-up Agreement

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

Accounting for Derivative Instruments

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

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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

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

Valuation of Derivative Instruments

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

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

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

At December 31, 2012, the Warrants, the Placement Agent Warrants and the embedded derivative instrument related to the Series A Preferred Stock were re-valued at $231,462, $97,792 and $64,280, respectively, using a binomial model, based on the quoted market price of $0.50, a term equal to the remaining life of the instruments, an expected dividend yield of 0%, risk-free interest rates of 0.03% to 0.17% based on constant maturity rates published by the U.S. Federal Reserve applicable to the remaining life of the instruments and estimated volatility of 149-173%. The aggregate change in the fair value of the derivative liabilities between December 31, 2011 and December 31, 2012 of

$116,334 has been debited 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 have a liquidation value of $5,770,849. Because the Series A Preferred Stock has conditions for its redemption that are outside our control, it is classified outside of Stockholders' Equity, in the mezzanine section of our balance sheet, in accordance with ASC 480-10-S99-3A. Because the Series A Preferred Stock is not currently redeemable and the Company currently believes that it is not probable that it will become redeemable, no adjustment of the carrying value of the Series A Preferred Stock has been recognized. If it becomes probable that the Series A Preferred Stock will be redeemed, it will be adjusted to its redemption value.

Placement Agent Fees

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

Advisory Fees

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

The Company also agreed to place in escrow for issuance to the affiliate a total of 400,000 shares of Common Stock, with 200,000 shares to be released following the completion of a Transaction, 100,000 shares to be released six months after the completion of a Transaction and 100,000 shares to be released 12 months after the completion of a Transaction. In accordance with ASC 505-50-25-7, the Company concluded that the value of the shares should be measured at the date the Transaction was completed because the shares are effectively fully vested as of that date and non-forfeitable and the agreement does not provide for any further specific performance criteria to be met. The Company valued the shares issued at $1.00 per share (based on the quoted market price), resulting in compensation expense for the services rendered and to be rendered of $400,000. The expense related to the services provided and to be provided was recognized over the period from November 22, 2010, the date from which services commenced under the agreement, to the one year anniversary, when the agreement expired. At December 31, 2011, the expense has been fully recognized.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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

In addition to the above fees, the Company issued 50,000 shares to its legal counsel, in consideration for their introducing the Company to the placement agent. The cost of these shares, which were valued at $1.00 per share (determined as described above) were expensed during the year ended December 31, 2011.

Fair Value Considerations

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

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

	Preferred – Embedded Derivative	Warrants	Total
Beginning balance, December 31, 2011	$ 147,704	$ 129,496	$ 277,200
Fair value adjustments	(83,424)	199,758	116,334
Ending balance, December 31, 2012	$ 64,280	$ 329,254	$ 393,534

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.

17. Commitments and Contingencies

Operating Leases

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

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

Fiscal year	
2013	$2,442,724
2014	2,414,951
2015	1,454,284
2016	367,237
2017	9,522
	$6,688,718

During the year ended December 31, 2012, rent expenses amounted to $2,396,870, of which $2,326,337 and $70,533 was recorded as cost of sales and general and administrative expense, respectively.

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

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

During the fiscal year ended December 31, 2012, the Company paid $7,427 (representing RMB 468,000) for setting up air-condition system and fire protection system in its new headquarter in Shenzhen. As of December 31, 2011, the Company paid $994,732 (representing RMB 6,318,839) was recorded in Equipment Deposits for those leasehold improvement and equipment not delivered yet.

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

17. Commitments and Contingencies (Continued)

Social Benefits Coverage

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

18. Concentrations

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

At December 31, 2012 and 2011, there was one supplier of consignment snacks and drinks with amount of $-0- and $100,480 respectively, which accounted for 100% and 100% of the Company’s account payable.

19. Operating Risk and Uncertainties

Interest rate risk

The interest rates and terms of repayment of bank and other borrowings are disclosed in Note 9. Other financial assets and liabilities do not have material interest rate risk.

Foreign currency risk

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

Company's operations are substantially in foreign countries

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

The Chinese government began tightening its regulation of internet cafes since 2001. In particular, a large number of unlicensed internet cafes have been closed. In addition, the Chinese government has imposed higher capital (RMB10,000,000 for regional internet café chain is required and RMB50,000,000 for national internet café chain) and facility requirements for the establishment of internet cafes. Furthermore, the Chinese government's policy, which encourages the development of a limited number of national and regional internet cafe chains and discourages the establishment of independent internet cafes, may slow down the growth of internet cafes. Recently, the Ministry of Culture, together with other government authorities, issued a joint notice suspending the issuance of new internet cafe chain licenses. Any intensified government regulation of internet cafes could restrict our ability to maintain and expand our internet cafes.

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

20. Segment Information

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

21. Additional Information - Condensed Financial Statements of the Company

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

As of December 31, 2012 and 2011, there were no material contingencies, significant provisions for long-term obligations, or guarantees of the Company, except for those which have been separately disclosed in the Consolidated Financial Statements, if any.

FINANCIAL INFORMATION OF CHINA INTERNET CAFE HOLDINGS GROUP, INC.

Condensed Balance Sheets

	December 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$1,951	$44,618
Rental deposit	3,333	3,333
Due from subsidiaries	6,332,030	5,959,933
Investment in subsidiaries	57,459,494	52,268,833
Total assets	$63,796,808	$58,276,717

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accrued expenses	$54,401	$54,401
Amount due to a shareholder	959,916	630,000
Registration penalties payable	641,200	448,844
Dividend payable on preferred stock	72,729	72,729
Derivative financial instrument - preferred stock	64,280	147,704
Derivative financial instrument - warrants	329,254	129,496
Total current liabilities	2,121,780	1,483,174
Convertible preferred stock ($0.00001 par value, 100,000,000 shares authorized, 4,274,703 shares issued and outstanding as of December 31, 2012 and 2011; preference in liquidation - $5,770,849)	3,682,473	3,682,473
Stockholders' Equity		
Common stock ($0.00001 par value, 100,000,000 shares authorized, 21,414,821 and 21,254,377 shares issued and outstanding as of December 31, 2012 and 2011)	214	212
Additional paid in capital	38,425,043	38,103,440
Retained earnings	19,567,298	15,007,418
Total stockholders' equity	57,992,555	53,111,070
Total liabilities and stockholders' equity	$63,796,808	$58,276,717

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

21. Additional Information - Condensed Financial Statements of the Company (Continued)

Condensed Statements of Income and Comprehensive Income

	December 31, 2012	December 31, 2011
Operating Expenses		
General and administrative expenses	$297,842	$899,927
Total operating expenses	297,842	899,927
Loss from operations	(297,842)	(899,927)
Non-operating income (expenses)		
Change in fair value of derivative financial instrument - preferred stock	83,424	1,457,090
Change in fair value of derivative financial instrument - warrants	(199,758)	783,290
Equity in earnings of unconsolidated subsidiaries	5,190,661	8,167,849
Interest income	-	18
Total non-operating expenses	5,074,327	10,408,248
Net loss before income taxes	4,776,485	9,508,321
Income taxes	-	-
Net income/(loss)	4,776,485	9,508,321
Dividend on preferred stock	(216,605)	(247,486)
Net income attributable to China Internet Cafe Holdings Group, Inc. common stockholders	4,559,880	9,260,835
Other comprehensive income		
Foreign currency translation adjustment	$122,162	843,432
Comprehensive income	$4,682,042	$10,104,267

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

21. Additional Information - Condensed Financial Statements of the Company (Continued)

Condensed Statements of Cash Flows

	December 31, 2012	December 31, 2011
Cash flows from operating activities		
Net income/(loss)	$4,776,485	$9,508,321
Adjustments to reconcile net income to net cash provided by operating activities		
Investment income from unconsolidated subsidiaries	(5,190,661)	(8,167,849)
Change on derivative financial instrument - preferred stock	(83,424)	(1,457,090)
Change on derivative financial instrument - warrants	199,758	(783,290)
Advisory fee	105,000	450,000
Changes in operating assets and liabilities:		
Due from subsidiaries	(372,097)	(5,959,932)
Accrued expenses	192,356	448,844
Amount due to a shareholder	329,916	330,000
Net cash used in operating activities	(42,667)	(5,630,996)
Cash flows from financing activities		
Net proceeds from issuance of preferred stock and warrants	-	5,675,614
Net cash provided by financing activities:	-	5,675,614
Effect of foreign currency translation on cash and cash equivalents		-
Net increase in cash	(42,667)	44,618
Cash - beginning of year	44,618	-
Cash - end of year	$1,951	$44,618

22. Subsequent Events

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

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

None.

Item 9A. Control and Procedures.

Evaluation of Disclosure Controls and Procedures

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

Pursuant to Rule 13a-15(b) under the Exchange Act, the Company carried out an evaluation with the participation of the Company’s management, including Dishan Guo, the Company’s chief executive officer, and chief financial officer, of the effectiveness of the Company’s disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the fiscal year ended December 31, 2012. Based upon that evaluation, the Company’s chief executive officer and chief financial officer concluded that the Company’s disclosure controls and procedures were not effective as of December 31, 2012 as a result of the material weaknesses identified in our internal control over financial reporting. These material weaknesses are discussed in “Management’s Report on Internal Control over Financial Reporting” below. Our management considers our internal control over financial reporting to be an integral part of our disclosure controls and procedures.

Management’s Report on Internal Control over Financial Reporting

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

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

The Company's management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*, including the following five framework components: i) control environment, ii) risk assessment, iii) control activities, iv) information and communications, and v) monitoring.

Based on management's evaluation, our chief executive officer and chief financial officer concluded that, as a result of the material weakness described below, as of December 31, 2012, our disclosure controls and procedures ("Disclosure Controls") are not designed at a reasonable assurance level and are ineffective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Specifically, our management identified certain matters involving internal control and our operations that it considered to be material weaknesses. As defined in the Exchange Act, a material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness identified by our management as of December 31, 2012, is described below:

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

As a result of the material weakness identified above, our internal control over financial reporting was not effective as of December 31, 2012.

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 by the end of fiscal year 2013 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 management's attention during the Company's last fiscal quarter that have materially affected, or are likely to materially affect, the Company's internal control over financial reporting.

Limitations on Controls

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

Item 9B. Other Information.

None.

Part III

Item 10. Directors, Executive Officers and Corporate Governance.

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

NAME	AGE	POSITION
Dishan Guo	48	Chairman, Chief Executive Officer and Chief Financial Officer
Zhenquan Guo	35	Director
Lei Li	48	Director
Wenbin An	73	Director
Lizong Wang	48	Director

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

Zhenquan Guo. Mr. Zhenquan Guo joined our board on August 23, 2010. Mr. Guo joined Junlong in 2003, working in a variety of roles. Since 2006, he has been the Operation Director. He is in charge of the daily operations of Junlong's wholly owned internet cafés. Over the past five years, he has taken part in all the internet cafe set up and license application tasks and gained extensive experience in the internet cafe industry. Mr. Guo graduated from Gannan Normal University in 2000, majoring in Mathematics and Applied Mathematics. He obtained his master's degree in marketing from Shenzhen University in 2008. Mr. Guo's foregoing experience, qualifications, attributes and skills led us to the conclusion that, in light of our business and structure, he should serve as a director of our company.

Lei Li. Mr. Lei Li joined our board on August 23, 2010. In 2009, Mr. Li is founded the Boardroom Advisors Company Limited, a Beijing-based financial advisory firm, and has been the managing director ever since. From August 2008 to June 23, 2012, Mr. Li was a director of Universal Travel Group, a travel services provider engaged in providing reservation, booking, and domestic and international travel and tourism services throughout China. From October 2007 to November 2009 he served as chief financial officer of Synutra International, Inc., a NASDAQ-listed company that focuses on selling premium infant formula products throughout China. From August 2004 to September 2007, Mr. Li was vice president and chief financial officer of Kasen International Holdings Limited, a public company listed on the Hong Kong Stock Exchange that manufactures upholstered furniture, furniture leather and automotive leather in China. Prior to that, from July 2001 through April 2004, Mr. Li served as chief financial officer at Eagle Brand Holdings Limited, a company listed on the Singapore Stock Exchange. Mr. Li's experience also includes serving as a financial controller at the Korean division of Exel Plc between January 1997 and July 2001, and serving as a senior auditor at Waste Management Inc.'s international department in London between February 1995 and December 1996. Mr. Li is a fellow member of the Association of Chartered Certified Accountants (ACCA) in the UK. He received a bachelor's degree in management and engineering from Beijing Institute of Technology in 1984, a master's degree in economics from Renmin University of China in 1987, and a master's degree in accounting and finance from the London School of Economics in 1992. Mr. Li's foregoing experience, qualifications, attributes and skills led us to the conclusion that, in light of our business and structure, he should serve as a director of our company.

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

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

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

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

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

Family Relationships

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

Involvement in Certain Legal Proceedings

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

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

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

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

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

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

Meetings of Our Board of Directors

During fiscal year ended December 31, 2012, our Board of Directors did not meet. We did not hold an annual meeting in 2012.

Board Committees

Audit Committee

Our Audit Committee is led by Lei Li as the chairperson. Lizong Wang, Wenbin An, Dishan Guo and Zhenquan Guo are also members of our audit committee. The audit committee is primarily responsible for reviewing the services performed by our independent auditors and evaluating our accounting policies and system of internal controls. Mr. Li is an independent director of the Company and is our audit committee financial expert.

Compensation Committee

Our compensation committee is led by Wenbin An as the chairperson. Lei Li, Lizong Wang, Dishan Guo and Zhenquan Guo are also members of our compensation committee. The compensation committee is primarily responsible for reviewing and approving our salary and benefits policies (including stock options) and other compensation of our executive officers.

Nominating Committee

Our nominating committee is led by Lizong Wang as the chairperson. Lei Li, Wenbin An, Dishan Guo and Zhenquan Guo are also members of our nominating committee. The nominating committee is primarily responsible for nominating directors and setting policies and procedures for the nomination of directors. The nominating committee is also responsible for overseeing the creation and implementation of our corporate governance policies and procedures.

A current copy of the audit committee charter, the compensation committee charter, and the nominating committee charter are available on the Company’s website, www.chinainternetcafe.com.

Material Changes to the Procedures by which Security Holders May Recommend Nominees to the Board of Directors

There have been no material changes to the procedures by which security holders may recommend nominees to the Board of Directors.

Code of Ethics

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

Director Independence

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

Board Leadership Structure and Role in Risk Oversight

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

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

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

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

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

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

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

Based solely on our review of the copies of such reports received by us and on written representations by our officers and directors regarding their compliance with the applicable reporting requirements under Section 16(a) of the Exchange Act, we believe that with respect to the fiscal year ended December 31, 2012, our directors, executive officers and 10% stockholders complied with all Section 16(a) filing requirements:

Item 11. Executive Compensation.

The following Summary Compensation Table sets forth, for the years indicated, all cash compensation paid, distributed or accrued for services, including salary and bonus amounts, rendered in all capacities by our chief executive officer and all other executive officers who received or are entitled to receive remuneration in excess of $100,000 during the stated periods.

Summary Compensation Table

Name and Principal Position	**Year**	Salary	Bonus	Stock Awards	Option Awards	Non-Equity Incentive Plan	Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
		(US$)	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)
Dishan Guo	2012	$47,611	0	0	0	0	0	0	$47,611
CEO /CFO(1)	2011	$46,480	0	0	0	0	0	0	$46,480

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

Employment Agreements

All of our employees, including Mr. Dishan Guo, our Chief Executive Officer, have executed our standard employment agreement. Our employment agreements with our executives provide the amount of each executive officer's salary and establish their eligibility to receive a bonus. Mr. Guo's employment agreement provides for an annual salary of RMB 300,000 (approximately $47,611).

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

Compensation Discussion and Analysis

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

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

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

Outstanding Equity Awards at Fiscal Year End

None of our executive officers received any equity awards, including, options, restricted stock or other equity incentives during the fiscal year ended December 31, 2012.

Compensation of Directors

The following table sets forth a summary of compensation paid to our directors who are not listed in the Summary Compensation Table during the fiscal year ended December 31, 2012:

Director Compensation

Name and Principal Position	Year	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)(5)	Non-Equity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings($)	All Other Compensation ($)	Total ($)
Dishan Guo(1)	2012	$-	-	-	-	-	-	-
Lei Li	2012	$19,044	-	-	-	-	-	19,044
Lizong Wang	2012	$19,044	-	-	-	-	-	19,044
Wenbin An	2012	$19,044	-	-	-	-	-	19,044
Zhenquan Guo(2)	2012	$	-	-	-	-	-	-

(1) Mr. Guo does not receive any additional compensation for his services as director of the Company.

(2) Mr. Zhenquan Guo received no compensation for serving as director of the Company for the fiscal year of 2012.

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

The following table sets forth information regarding beneficial ownership of our common stock as of April 18, 2013 (i) by each person who is known by us to beneficially own more than 5% of our common stock; (ii) by each of our officers and directors; and (iii) by all of our officers and directors as a group. Unless otherwise specified, the address of each of the persons set forth below is in care of Junlong, #1707, Block A, Genzon Times Square, Longcheng Blvd, Centre City, Longgang District, Shenzhen, Guangdong Province, People's Republic of China.

Name and Address of Beneficial Owner	Position	Title of Class	Amount and Nature of Beneficial Ownership (1)	Percent of Class (2)	
	Officers and Directors				
Dishan Guo	Chairman /CEO/CFO	Common stock, $0.00001 par value	12,008,750	46.75	%
Zhenquan Guo	Director	Common stock, $0.00001 par value	600,020	2.34	%
Lei Li	Director	Common stock, $0.00001 par value	—	—	
Wenbin An	Director	Common stock, $0.00001 par value	—	—	
Lizong Wang	Director	Common stock, $0.00001 par value	100,000	0.39	%
All officers and directors as a group (5 persons named above)		Common stock, $0.00001 par value	12,708,770	49.47	%
	5% Security Holders				
Dishan Guo		Common stock, $0.00001 par value	12,008,750	46.75	%

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

In determining beneficial ownership of our common stock as of a given date, the number of shares shown includes shares of common stock which may be acquired on exercise of warrants or options or conversion of convertible securities within 60 days of that date. In determining the number of shares of the class beneficially owned by such person or entity on April 18, 2013, (a) the numerator is the number of shares of the class beneficially owned by such person or entity, including shares which may be acquired within 60 days on exercise of warrants or options and conversion of convertible securities, and (b) the denominator is the sum of (i) the total number of shares of common stock outstanding on April 18, 2013, which is 25,689,524, and (ii) the total number of shares that the beneficial owner may acquire upon conversion of the preferred an on exercise of the warrants and options. Unless otherwise stated, each beneficial owner has sole power to vote and dispose of its shares.

(2) A total of 25,689,524 shares of our common stock are considered to be outstanding pursuant to SEC Rule 13d-3(d)(1) as of April 18, 2013.

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

The following includes a summary of transactions, or any currently proposed transaction, in which we were or are to be a participant and the amount involved exceeded or exceeds the lesser of $120,000, and in which any related person had or will have a direct or indirect material interest (other than compensation described under “Executive Compensation”). We believe the terms obtained or consideration that we paid or received, as applicable, in connection with the transactions described below were comparable to terms available or the amounts that would be paid or received, as applicable, in arm’s-length transactions.

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

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

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

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

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

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

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

- Before the Company opened a U.S. bank account in February 2011, various listing and other public company operating expenses were paid by the personal account of Dishan Guo, the Company's Chief Executive Officer. To date, Mr. Guo has lent the Company $2,135,218. This amount is considered to be a unsecured related party loan due to Mr. Guo Dishan with no stated interest and is payable on demand. This loan is not in writing and the Company keeps track of it through bank statements and intends to repay Mr. Guo in future.

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

As of December 31, 2012, we had $2,634,163 due to Mr. Di Shan Guo, our Chairman, Chief Executive Officer and Chief Financial Officer, which amount were accumulated since 2007 and used to pay daily operating expenses and professional fees. The amount due is unsecured with no stated interest and is payable on demand.

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

Director Independence

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

Item 14. Principal Accountant Fees and Services.

<u>Audit Fees</u>

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

2011	$85,000	EFP Rotenberg, LLP
2012	$93,000	EFP Rotenberg, LLP

Audit Related Fees

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

2011	$30,000	EFP Rotenberg, LLP
2012	$36,000	EFP Rotenberg, LLP

Tax Fees

For the Company’s fiscal years ended December 31, 2011 and 2010, we were not billed by our principal accountants for professional services rendered for tax compliance, tax advice, and tax planning.

All Other Fees

For the fiscal years ended December 31, 2012 and 2011, we did not incur any fees from our principal accountants for services other than the services covered under the “Audit Fees” and “Audit-Related Fees” for the fiscal year ended December 31, 2012 and 2011.

Preapproval Policy and Procedures

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

PART V

Item 15. Exhibits, Financial Statement Schedules.

Exhibit No.	Description
2.1(1)	Form of Share Exchange Agreement, dated July 2, 2010, among the Company, Classic Bond Development Limited and its shareholders.
3.1(6)	Amended and Restated Articles of Incorporation of China Internet Café Holdings Group, Inc.
3.2(2)	Bylaws of the Company
3.3(3)	Amended and Restated Bylaws, adopted on July 30, 2010
3.4(6)	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
10.1(1)	Management Consulting Service Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.2(1)	Equity Pledge Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.3(1)	Option Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.4(1)	Proxy Agreement, dated June 11, 2010, among Zhonghefangda, Junlong and Junlong's shareholders.
10.5(1)	

	English Translation of Form of Non-disclosure and Non-competition Agreement, dated March 11, 2010, between Junlong and its employees.
10.6(6)	Securities Purchase Agreement, dated February 22, 2011, by and among China Internet Café Holdings Group, Inc. and Investors identified therein
10.7(6)	Registration Rights Agreement, dated February 22, 2011
10.8(6)	Securities Escrow Agreement, dated February 22, 2011
10.9(6)	Lock-up Agreement, dated February 22, 2011
10.10(6)	Form of Series A Warrant
10.11(6)	Form of Series B Warrant
10.12	Lease Agreement, dated March 12, 2012, by and between Junlong and Shenzhen Jincheng Industrial Co., Ltd. [Unofficial Translation]*
14.1(4)	Code of Ethics
21(1)	Subsidiaries of the Company.
31.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document*
101.SCH	XBRL Schema Document*
101.CAL	XBRL Calculation Linkbase Document*
101.LAB	XBRL Label Linkbase Document *
101.PRE	XBRL Presentation Linkbase Document*
101.DEF	XBRL Definition Linkbase Document*

* Filed herewith

** Furnished herewith

(1) Incorporated by reference to our Current Report on Form 8-K filed with the SEC on July 9, 2010.

(2) Incorporated by reference to our Registration Statement on Form SB-2 filed on August 30, 2006.

(3) Incorporated by reference to our Current Report on Form 8-K filed with the SEC on August 3, 2010.

(4) Incorporated by reference to our Annual Report on Form 10-K filed with the SEC on June 30, 2008.

(5) Incorporated by reference to our Annual Report on Form 10-K filed with the SEC on September 28, 2010.

(6) Incorporated by reference to our Current Report on Form 8-K filed with the SEC on February 23, 2011

SIGNATURES

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

Date: April 19, 2013

CHINA INTERNET CAFÉ HOLDINGS GROUP, INC.

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

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

Name	Title	Date
/s/ Dishan Guo Dishan Guo	Chief Executive Officer, Chief Financial Officer, and Chairman of the Board (principal executive officer and principal financial officer)	April 19, 2013
/s/ Zhenquan Guo Zhenquan Guo	Director	April 19, 2013
/s/ Lei Li Lei Li	Director	April 19, 2013
/s/ Wenbin An Wenbin An	Director	April 19, 2013
/s/ Lizong Wang Lizong Wang	Director	April 19, 2013