China Internet Cafe Holdings Group, Inc.
Form 10-Q
May 20, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from to

COMMISSION FILE NUMBER: 000-52832

CHINA INTERNET CAFE HOLDINGS GROUP, INC.

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

Nevada	**98-0500738**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(Address of principal executive offices) (Zip Code)

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

N/A

(Former Address)

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

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

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

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

As of May 17, 2013, there are 25,689,524 shares of $0.00001 par value common stock (the "Common Stock") issued and outstanding.

FORM 10-Q

CHINA INTERNET CAFE HOLDINGS GROUP, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited).

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013

(UNAUDITED)

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$29,713,200	$25,818,041
Rental deposit	34,291	34,121
Equipment deposit	7,468	7,427
Inventory	64,399	49,681
Deferred tax assets	74,480	76,982
Total current assets	29,893,838	25,986,252
Property, plant and equipment, net	11,803,516	12,730,766
Intangible assets, net	115,377	124,274
Rental deposit-long-term portion	418,357	416,066
Total assets	$42,231,088	$39,257,358
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short term loan	$-	$158,702
Accounts payable	123,784	-
Registration penalties payable	641,200	641,200
Deferred revenue	1,620,750	1,505,699
Payroll and payroll related liabilities	318,266	350,277
Income and other taxes payable	898,997	754,709
Accrued expenses	711,587	396,878
Amount due to a shareholder	2,810,172	2,634,163
Dividend payable on preferred stock	186,565	72,729
Derivative financial instrument - preferred stock	-	64,280
Derivative financial instrument - warrants	52,203	329,254
Total current liabilities	7,363,524	6,907,891
Commitments and contingencies (Note 17)		
Converted Preferred stock ($0.00001 par value, 100,000,000 shares authorized, -0- and 4,274,703 shares issued and outstanding as of March 31, 2013 and December 31, 2012; preference in liquidation -$0 and $5,770,849, respectively)	-	3,682,473
Stockholders' Equity:		
Common stock ($0.00001 par value, 100,000,000 shares authorized, 25,689,524 and 21,414,821 shares issued and outstanding as of March 31, 2013 and December 31, 2012)	257	214
Additional paid in capital	5,732,759	2,050,329
Statutory surplus reserves	718,744	718,744
Retained earnings	26,641,574	24,320,169

Accumulated other comprehensive income	1,774,230	1,577,538
Total stockholders' equity	34,867,564	28,666,994
Total liabilities and stockholders' equity	$42,231,088	$39,257,358

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

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	For The Three Months Ended March 31, 2013	2012
Revenue	$ 7,198,307	$ 7,134,204
Cost of revenue	4,076,078	5,005,431
Gross profit	3,122,229	2,128,773
Operating Expenses		
General and administrative expenses	271,183	569,894
Total operating expenses	271,183	569,894
Income from operations	2,851,046	1,558,879
Non-operating income (expenses)		
Change in fair value of derivative financial instrument - preferred stock	64,280	(432,178)
Change in fair value of derivative financial instrument - warrants	277,051	(306,279)
Interest income	4,593	3,730
Interest expense	(5,240)	-
Other expenses	(145)	(143)
Total non-operating income (expenses)	340,539	(734,870)
Income before income taxes	3,191,585	824,009
Income taxes	756,344	495,450
Net income	2,435,241	328,559
Dividend on preferred stock	(113,836)	(71,938)
Net income attributable to China Internet Cafe Holdings Group, Inc. common stockholders	$ 2,321,405	$ 256,621
Other comprehensive income		
Net income	$ 2,435,241	$ 328,559
Foreign currency translation	196,692	180,058
Total comprehensive income	$ 2,631,933	$ 508,617
Earnings per share		
- Basic	$ 0.10	$ 0.01
- Diluted	$ 0.09	$ 0.01
Weighted average common stock outstanding		
- Basic	23,219,696	21,281,312

- Diluted	25,689,524	25,556,015

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE THREE MONTHS ENDED MARCH 31, 2013

	Common stock						
	Number of shares	Amount	Additional paid-in capital	Statutory reserves	Retained Earnings	Accumulated other comprehensive income	Total Stockholders' Equity
Balance at January 1, 2013	21,414,821	$ 214	$2,050,329	$718,744	$24,320,169	$ 1,577,538	$28,666,994
Converted preferred stock	4,274,703	43	3,682,430	-	-	-	3,682,473
Preferred stock dividend	-	-	-	-	(113,836)	-	(113,836)
Net income for the period	-	-	-	-	2,435,241	-	2,435,241
Foreign currency translation difference	-	-	-	-	-	196,692	196,692
Balance at March 31, 2013	25,689,524	$ 257	$5,732,759	$718,744	$26,641,574	$ 1,774,230	$34,867,564

CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE THREE MONTHS ENDED MARCH 31, 2012

	Common stock						
	Number of shares	Amount	Additional paid-in capital	Statutory reserves	Retained Earnings	Accumulated other comprehensive income	Total Stockholders' Equity
Balance at January 1, 2012	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	53,870	-	72,729	-	(71,938)	-	791
Net income for the period	-	-	-	-	328,559	-	328,559
Foreign currency translation difference	-	-	-	-	-	180,058	180,058
Balance at March 31, 2012	21,308,247	$ 212	$ 1,906,455	$ 718,744	$ 20,016,910	$ 1,635,434	$ 24,277,755

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

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For The Three Months Ended March 31, 2013	2012 Restated
Cash flows from operating activities		
Net income	$ 2,435,241	$ 328,559
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in fair value of derivative financial instrument - preferred stock	(64,280)	432,178
Change in fair value of derivative financial instrument- warrants	(277,051)	306,279
Advisory fee	-	105,000
Depreciation	995,699	911,076
Amortization	9,566	9,535
Deferred tax assets	2,921	(1,481)
Changes in operating assets and liabilities:		
Inventory	(14,421)	97,757
Accounts payable	123,581	47,557
Deferred revenue	106,586	(39,832)
Payroll and payroll related liabilities	(33,884)	38,833
Income and other taxes payable	139,904	(283,416)
Accrued expenses and penalties payable	312,765	186,610
Amount due to a shareholder	168,287	101,281
Net cash provided by operating activities	3,904,914	2,239,936
Cash flows from financing activities		
Short term loan repayments	(159,314)	-
Net cash flows used in financing activities:	(159,314)	-
Effect of foreign currency translation on cash	149,559	119,123
Net increase in cash and cash equivalents	3,895,159	2,359,059
Cash and cash equivalents - beginning of period	25,818,041	19,629,680
Cash and cash equivalents - end of period	$ 29,713,200	$ 21,988,739
Cash paid during the year for:		
Interest paid	$ 5,240	$ -
Income taxes paid	$ 599,018	$ 600,199
Supplemental disclosures of non-cash transactions:		
Dividend payable on preferred stock	$ 186,565	$ 71,938
Advisory fee	$ -	$ 105,000

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

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CHINA INTERNET CAFE HOLDINGS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

1. Organization, Recapitalization and Nature of Business

China Internet Cafe Holdings Group, Inc. (“China Internet Cafe”)

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

Recapitalization of Classic Bond Development Limited

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

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

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

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

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

Classic Bond Development Limited ("Classic Bond")

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

On June 23, 2010, the Company further issued 1,950,000 shares of common stock to 42 individuals to raise fund of $84,093 (HK$651,721) for 651,721 shares and 1,308,954 shares associated with the reorganization of the Company at a value of $167,519 (HK$1,308,954) which is reflected as contributed capital by existing shareholders of Junlong and the total amount was $251,612. At March 31, 2013 and December 31, 2012, the issued and outstanding of Common Stock were 25,689,524 and 21,414,821 shares.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

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

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

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

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

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

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

Exclusive Management and Consulting Agreement

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

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

Junlong is a Chinese enterprise organized in the People's Republic of China ("PRC") on December 26, 2003 in accordance with the Laws of the People's Republic of China with the registered capital of $0.136 million (equivalent to RMB 1 million). In 2001, the Chinese government imposed higher capital (RMB10 million for regional internet café chain and RMB50 million for national internet café chain) and facility requirements for the establishment of internet cafes. On August 19, 2004, Junlong was granted approval from Shenzhen Municipal People's Government to increase its registered capital by $1,230,500 from $136,722 to $1,367,222 million (increased by RMB 9 million, from RMB 1 million to RMB 10 million) The capital verification process has been completed. In 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 March 31, 2013.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

2. Summary of Significant Accounting Policies

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

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

(c) Use of estimates
In preparing financial statements in conformity with accounting principles generally accepted in the United states of America, management makes estimates and assumptions that affect the reported amounts of assets and liabilities 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 11.

(d)Revenue recognition

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

The Company also records revenue from commission received from the sale of third parties on-line gaming cards, snacks and drinks. Commission revenue amounted to 20% of the value of the on-line gaming cards, snacks and drinks is recognized at the time the gaming cards, etc. are sold to customers. During the three months ended March 31, 2013 and 2012, the commission income was $113,611 and $71,963, respectively, less than 1% of total revenue.

(e)Cost of revenue

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

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CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

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

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

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

(i) Fair Value of Financial Instruments
The Company applies the provisions of accounting guidance, FASB Topic ASC 820 that requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value, and defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of March 31, 2013, the fair value of cash and cash equivalents, accounts payable, and accrued expenses approximated carrying value due to the short maturity of the instruments, or are based on quoted market prices or interest rates which fluctuate with market rates except for related party debt or receivables for which it is not practicable to estimate fair value.

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

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

Level 2 – Inputs are unadjusted quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other 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 as of March 31, 2013, 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 March 31, 2013
Derivative Liability - Warrants	$ -	$ -	$ 186,565	$ 186,565
Derivative Liability – Preferred stock		-	-	-
Total	$ -	$ -	$ 186,565	$ 186,565

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CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

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

(j) Stock-Based Compensation

Our advisor assists the Company for ongoing corporate compliance and development are accounted for under ASC 505-50. ASC 505-50-30-11 (previously EITF 96-18) further provides that an issuer shall measure the fair value of the equity instruments in these transactions using the stock price and other measurement assumptions as of the earlier of the following dates, referred to as the measurement date:

i. The date at which a commitment for performance by the counterparty to earn the equity instruments is reached (a performance commitment); and

ii. The date at which the counterparty's performance is complete.

(k) Equipment deposits

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

(l) Property, plant and equipment

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

	Estimated Useful Lives
Leasehold 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 $1,620,750 and $1,505,699 as of March 31, 2013 and December 31, 2012, respectively, and are included in deferred revenue on the balance sheets. Management has evaluated the deferred revenue balance and has determined any potential revenue from the unused balance to be immaterial at the quarter ended March 31, 2013.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

2. Summary of Significant Accounting Policies (continued)

(o) Comprehensive income

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

(p) Income taxes

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

(q) Consolidation of Variable Interest Entities

According to the requirements of Statement of Financial Accounting Standards No. 810-10, "Variable interest Entities", the Company has evaluated the economic relationships of its wholly owned subsidiary, Shenzhen Zhonghefangda 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:

	March 31, 2013	December 31, 2012
Current assets and Long term rental deposit	$30,185,312	$26,392,390
Property, plant and equipment	11,803,518	12,730,766
Intangible assets	115,377	124,275
Total assets	42,104,207	39,247,431
Total liabilities	(10,533,543)	(10,129,831)
Net assets	$31,550,664	$29,117,600

(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:

	March 31, 2013	March 31, 2012
Quarter-end RMB : USD exchange rate	6.2666	-
Three months average RMB : USD exchange rate	6.2769	6.2976

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CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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2. Summary of Significant Accounting Policies (continued)

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

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

(s) Post-retirement and post-employment benefits

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

(t) Earnings per share (EPS)

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

(u) Retained earnings-appropriated

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

(v) Statutory surplus reserves

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

As of March 31, 2013 and December 31, 2012, the statutory surplus reserves of the subsidiary already reached 50% of the registered capital of the subsidiary and the Company did not have any further allocation 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) 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.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

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2. Summary of Significant Accounting Policies (continued)

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.

3. Cash and cash equivalents

Cash and cash equivalents are summarized as follows:

	March 31, 2013	December 31, 2012
Cash and cash equivalents at bank	$29,433,166	$25,800,930
Cash in hand	280,034	17,111
	$29,713,200	$25,818,041

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents. As of March 31, 2013 and December 31, 2012, $29,309,616 and $25,794,334 of the Company’s cash and cash equivalents were held by major banks located in the PRC, which management believes are of high credit quality, and $118,912 and $1,951 of the Company's cash and cash equivalents were held by Chase bank and JP Morgan Chase bank in USA, respectively.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

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4. Property, Plant and Equipment, net

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

	March 31, 2013	December 31, 2012
Leasehold improvement	$4,418,327	$4,394,136
Cafe computers equipment and hardware	16,862,903	16,770,575
Cafe furniture and fixtures	2,108,540	2,096,595
Office furniture, fixtures and equipment	339,920	338,059
Motor vehicles	474,571	471,973
	$24,204,261	$24,071,738
Less: Accumulated depreciation	(12,400,745)	(11,340,972)
Property, plant and equipment, net	$11,803,516	$12,730,766

During the quarter ended March 31, 2013, depreciation expenses amounted to $995,699, of which $972,244 and $23,455 were recorded as cost of sales and general and administrative expense, respectively.

5. Short Term Loan

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

Bank	Loan Period	Interest rate	March 31, 2013	December 31, 2012
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 was approximately 12.46% and was due on March 26, 2013. The loan has been paid in full on March 26, 2013.

6. Income and Other Taxes Payable

Income and other tax payables consist of the following:

	March 31, 2013	December 31, 2012
Value added taxes	$ 71,623	$ 78,013
Income tax	744,794	586,908
Withhold individual income tax payable	2,171	2,208
Other tax payable	80,409	87,580
Total	$ 898,997	$ 754,709

7. Due To a Shareholder

	March 31, 2013	December 31, 2012
Mr. Guo Di Shan, a shareholder of the Company	$2,810,172	$2,634,163

The amount due to Mr. Di Shan Guo is unsecured with no stated interest and is payable on demand. As of March 31, 2013, the total amounts of $2.8 million were accumulated amount since 2007 and used to pay daily operating expenses and professional fees.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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8. Income Tax

The Company is subject to U.S. federal income tax, and the Company’s subsidiaries incorporated in the People’s Republic of China (the “PRC”) are subject to enterprise income taxes in the PRC. The Company’s applicable enterprise income tax rate in PRC is 25% of its net income.

For the three months ended March 31, 2013 and 2012, the Company recorded uncertain tax benefits of approximately $0 and $0, respectively.

Aggregate undistributed earnings of approximately $29 million as of March 31, 2013 of the Group's PRC subsidiaries that are available for distribution to the Company are considered to be indefinitely reinvested, and, accordingly, no provision has been made for the Chinese dividend withholding taxes that would be payable upon distribution to the Company. Additionally, the Chinese tax authorities have clarified that distributions made out of pre-January 1, 2008 retained earnings would not be subject to the withholding tax.

The tax authorities may examine the tax returns of the Company three years after its fiscal year ended.

9. Employee Benefits

The Company contributes to a state pension scheme organized by municipal and provincial governments with respect to its employees in PRC. The pension expense related to this plan is calculated at a range of 8% of the average monthly salary. The pension expense was $2,600 and $3,452 for the three months ended March 31, 2013 and 2012, respectively.

10. Stockholders' Equity

Common Stock

On July 2, 2010, 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.. The business, assets and liabilities of China Internet Café did not change as a result of the reverse acquisition.

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

Series A Preferred Stock

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

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

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

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

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10. Stockholders' Equity (continued)

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

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

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

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

Securities Purchase Agreement

On February 22, 2011 (the "Closing Date"), the Company completed a private placement (the "Offering") of 474,967 units at a purchase price of $13.50 per unit, each unit consisting of:(i) nine shares of the Company's Series A Preferred Stock, convertible on a one to one basis into nine shares of the Company's common stock; (ii) one share of Common Stock; (iii) two three-year Series A Warrants (the "Series A Warrants"), each exercisable for the purchase of one share of Common Stock, at an exercise price of $2.00 per share; and (iv) two three-year Series B Warrants (the "Series B

Warrants"), each exercisable for the purchase of one share of Common Stock, at an exercise price of $3.00 per share. The Company received aggregate gross proceeds of $6,412,055. The Offering was conducted pursuant to a Securities Purchase Agreement (the "Agreement") between the Company and various accredited investors (the "Investors).

The Company reviewed the features of the Series A Preferred Stock, other than the conversion feature, and concluded that, on balance, the terms and features of the host contract should be considered to be more akin to a debt instrument.

The conversion price of the Series A Preferred Stock is subject to adjustment if the Company subsequently sells Common Stock at a lower price. Also, as described below for the Warrants, the conversion option is denominated in U.S. dollars, a currency other than the Company's functional currency. Accordingly, the embedded conversion option was not considered to be indexed only to the Company's common stock. In addition, the Company may be required to redeem the Series A Preferred Stock for cash if, on receipt of a conversion request, it is unable to issue shares registered for resale for any reason. In addition, the conversion price of the Series A Preferred Stock is subject to adjustment if the Company subsequently sells Common Stock at a lower price but there is no explicit limit on the number of shares that the Company may be required to issue. As a result of the foregoing, the exemption provided by ASC 815-10-15-74a was not available and the embedded conversion option was bifurcated and accounted for as a derivative liability. As noted above, on February 22, 2013, in accordance with its terms, all 4,274,703 shares of Series A Preferred Stock outstanding automatically converted into 4,274,703 shares of common stock. As a result of the conversion, the carrying value of the Series A Preferred Stock has been transferred to equity.

Warrants

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

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

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

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.

<u>Registration Rights Agreement</u>

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

The required registration statement was filed by the required due date. However, the Company did not meet the deadline to render its S-1 registration statement effective. At March 31, 2013, the Company has accrued $641,200 for the estimated liquidated damages it expects to pay.

Placement Agent Fees

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

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

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CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

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

Lock-up Agreement

On the Closing Date, the Company entered into a lock-up agreement (the "Lock-Up Agreement") with Mr. Dishan Guo (the "Stockholder"), the Company's chairman and principal stockholder, whereby the Stockholder is prohibited from selling our securities that they directly or indirectly own (the "Lock-Up Shares") until nine months after the Registration Statement is declared effective (the "Lock-Up Period"). The Registration Statement became effective on August 31, 2012 and the Lock-Up period ends on May 31, 2013. In addition, the Stockholder further agreed that during the 12 months immediately following the Lock-Up Period, the Stockholder will not offer, sell, contract to sell, assign or transfer more than 0.833% of the Lock-Up Shares during each calendar month following the Lock-Up Period, other than engaging in a transfer in a private sale of the Lock-Up Shares if the transferee agrees in writing to be bound by and subject to the terms of the Lock-Up Agreement.

Accounting for Derivative Instruments

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

The Series A Preferred Stock is a hybrid financial instrument that embodies the risks and rewards typically associated with both equity and debt instruments. Accordingly, we were required to evaluate the features of this contract to determine its nature as either an equity-type contract or a debt-type contract. We determined that the Series A Preferred Stock is generally more akin to a debt-type contract, principally due to its potential redemption requirements, its fixed rate quarterly dividend requirement and its lack of voting rights. We concluded that the exemption in FASB ASC 815-10-15-74 was not available and that the embedded conversion option, along with certain other features of the Series A Preferred Stock that have risks of equity, required bifurcation and classification in liabilities as a compound embedded derivative financial instrument.

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

Valuation of Derivative Instruments

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

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

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

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

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

At March 31, 2013, the Warrants, were re-valued at $52,203, using a binomial model, based on the quoted market price of $0.26, a term equal to the remaining life of the instruments, an expected dividend yield of 0%, risk-free interest rates of 0.13% based on constant maturity rates published by the U.S. Federal Reserve applicable to the remaining life of the instruments and estimated volatility of 141%. The aggregate change in the fair value of the derivative liabilities between December 31, 2012 and March 31, 2013 of $277,051 has been credited to income.

Accounting for Series A Preferred Stock

$3,682,473 of the proceeds received was allocated to the carrying value of the Series A Preferred Stock host contract. The 4,274,703 shares of Series A Preferred Stock had a liquidation value of $5,770,849. Because the Series A Preferred Stock had conditions for its redemption that are outside our control, it was classified outside of Stockholders' Equity, in the mezzanine section of our balance sheet, in accordance with ASC 480-10-S99-3A. All outstanding shares of Series A Preferred Stock were converted to common stock on February 22, 2013 and the carrying value of the Series A Preferred Stock was transferred to equity.

Placement Agent Fees

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

Consulting services and compensation

On January 1, 2012, the Company issued 300,000 common stock options exercisable at $0.64 per share vesting on January 1, 2012 to Potomac Investments, LLC for its service rendered. The options are exercisable until November 15, 2014. The company records the expense of the stock options over the related vesting period. The options were valued using the Binomial Model at the date of grant. The total fair market value at grant date is $108,000 based on the following assumptions: dividend yield: 0%; volatility: 164.33%, risk free rate: 0.36%, expected term: 3 years. All options remain outstanding at March 31, 2013.

Fair Value Considerations

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

The following represents a reconciliation of the changes in fair value of financial instruments measured at fair value using Level 3 inputs during the year ended March 31, 2013:

	Preferred – Embedded Derivative	Warrants	Total
Beginning balance, December 31, 2012	$ 64,280	$ 329,254	$ 393,534
Fair value adjustments	(64,280)	(277,051)	(341,331)
Ending balance, March 31, 2013	$ -	$ 52,203	$ 52,203

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.

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(UNAUDITED)

12. Commitments and Contingencies

Operating Leases

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

As of March 31, 2013, the Company was obligated under operating leases requiring minimum rentals as follows:

Fiscal year	
Remainder of 2013	$1,973,034
2014	2,609,257
2015	1,475,749
2016	319,569
2017	4,779
	$6,382,388

During the three months ended March 31, 2013 and 2012, rent expenses amounted to $853,718 and $556,099, respectively, of which $840,559 and $523,410 were recorded as cost of sales, respectively.

13. Concentrations

The Company did not have any customer constituting greater than 10% of net sales for the three months ended March 31, 2013 and 2012.

At March 31, 2013 and December 2012, there was one supplier of consignment snacks and drinks in the amount of $123,784 and $-0-, respectively, which accounted for 100% and 100% of the Company’s accounts payable.

14. Operating Risk and Uncertainties

Foreign currency risk

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

Company’s operations are substantially in a foreign country

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

The Chinese government began tightening its regulation of internet cafes in 2001. In particular, a large number of unlicensed internet cafes have been closed. In addition, the Chinese government has imposed higher capital and facility requirements for the establishment of internet cafes (RMB 10,000,000 for regional internet cafe chains and RMB 50,000,000 for national internet cafe chains). Furthermore, the Chinese government’s policy, which encourages the development of a limited number of national and regional internet cafe chains and discourages the establishment of independent internet cafes, may slow down the growth of internet cafes. Recently, the Ministry of Culture, together with other government authorities, issued a joint notice suspending the issuance of new internet cafe chain licenses. Any intensified government regulation of internet cafes could restrict our ability to maintain and expand our operations.

CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

14. Operating Risk and Uncertainties (continued)

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.

15. Earnings per Share

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

	For The Three Months Ended March 31,	
	2013	2012
BASIC		
Numerator for basic earnings per share attributable to the Company's common stockholders:		
Net income	$ 2,435,241	$ 328,559
Dividend on preferred stock	(113,836)	(71,938)
Net income used in computing basic earnings per share	$ 2,321,405	$ 256,621
Basic weighted average shares outstanding	23,219,696	21,281,312
Basic earnings per share	$ 0.10	$ 0.01

	For The Three Months Ended March 31,	
	2013	2012

DILUTED		
Numerator for diluted earnings per share attributable to the Company's common stockholders:		
Net income used in computing basic earnings per share	$ 2,321,405	$ 256,621
Dividend on preferred stock	113,836	71,938
Net income used in computing diluted earnings per share	$ 2,435,241	$ 328,559
Weighted average outstanding shares of common stock	23,219,696	21,281,312
Weighted average preferred stock	2,469,828	4,274,703
Diluted weighted average shares outstanding	25,689,524	25,556,015
Diluted earnings per share	$ 0.09	$ 0.01
Potential common shares outstanding as of March 31:		
Series A preferred stock	-	4,274,703
Warrants	2,498,326	2,498,326
	2,498,326	6,773,029

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CHINA INTERNET CAFÉ HOLDINGS, GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 AND DECEMBER 31, 2012

(UNAUDITED)

15. Earnings per Share (continued)

During the three months ended March 31, 2013 and 2012, the average market price of the common stock during the period was less than the exercise price of the Warrants. Accordingly, the Warrants were anti-dilutive and have not been included in the calculation of diluted earnings per share.

16 Segment Information

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

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

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

Overview

Prior to the consummation of the share exchange transaction described below, we were a shell company with nominal operations and nominal assets. Currently, through our 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 the first quarter of 2013, we focused on integrating our existing cafes. We expect our future growth to be driven by a number of factors and trends including:

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

For the quarter ended March 31, 2013, our revenue was approximately $7.20 million and our net profit was approximately $2.44 million, representing an increase of 1% and 641%, respectively, from the revenue of approximately $7.13 million and net profit of approximately $0.33 million for the quarter ended March 31, 2012. As of March 31, 2013, we had 583 employees.

The discussion below of our performance is based upon our unaudited financial statements for the quarter ended March 31, 2013 and 2012, which are included in this report.

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

- **Improved Disposable Income**. We believe as the Shenzhen municipal government increases the minimum wage, migrant workers, who are our major customers, will have more disposable income. We are expecting the inflow of migrant workers to continue to contribute to our revenue growth.

- **Continued Internet Café Use.** Our business may be adversely affected by increased home computer and home game console ownership. We believe, however, the home computer and game console penetration rate is relatively low in the PRC as compared to that of the United States and Europe. In addition, young people in the PRC prefer internet cafes to home computers since it is a social place for them. We expect the preference will continue and provide sustainable business.

- **Customer Loyalty.** As we continue to expand our operations, developing and maintaining customer loyalty will be critical to continued revenue growth.

- **Expansion into South Western Provinces**. The Company currently holds an internet café chain license. In order to meet the basic requirements of a national internet chain license, the Company's primary objective is to acquire and open at least 20 internet cafes in two provinces other than Guangdong province. The Company has conducted research in the south-western provinces and cities including Chongqing, Sichuan, Guizhou, and Yunnan and is targeting internet cafes these areas for acquisition purposes. The Company believes a national license is imperative for the development of a national market.

Recent Developments and Reorganizations

On July 2, 2010, we completed a reverse acquisition transaction ("Reverse Acquisition") through a share exchange with Classic Bond Development Limited, a BVI company, ("Classic Bond") and its shareholders, whereby we acquired 100% of the issued and outstanding capital stock of Classic Bond, in exchange for 19,000,000 shares of our common stock, $0.00001 par value, which constituted 94% of our issued and outstanding shares on a fully-diluted basis as of and immediately after the consummation of the Reverse Acquisition. As a result of the Reverse Acquisition, Classic Bond became our wholly-owned subsidiary and the former shareholders of Classic Bond became our controlling stockholders.

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

On January 20, 2011, we filed with the Nevada Secretary of a Certificate of Amendment to Articles of Incorporation to give effect to a name change from "China Unitech Group, Inc." to "China Internet Café Holdings Group, Inc."

On February 22, 2011, in connection with a security purchase agreement between the Company and certain investors (the "Investors"), we closed a private placement (the "Offering") of approximately $6.4 million from offering a total of 474,967 units at a purchase price of $13.50 per unit. As a condition to the Offering, we agreed to grant certain registration rights to the Investors pursuant to a Registration Rights Agreement dated February 22, 2011.

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

Results of Operations

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

For The Three Months Ended March 31,			
2013	2012	Amount	%

		As percentage		As percentage	change	change
Revenue	$7,198,307	100 %	$7,134,204	100 %	64,103	1 %
Cost of revenue	4,076,078	57 %	5,005,431	70 %	(929,353)	-19 %
Gross profit	3,122,229	43 %	2,128,773	30 %	993,456	47 %
Operating Expenses						
General and administrative expenses	271,183	4 %	569,894	8 %	(298,711)	-52 %
Cafe relocation costs	0	0 %	-	0 %	0	100 %
Total operating expenses	271,183	4 %	569,894	8 %	(298,711)	-52 %
Income from operations	2,851,046	40 %	1,558,879	22 %	1,292,167	83 %
Non-operating income (expenses)						
Change in fair value of derivative financial instrument - preferred stock	64,280	1 %	(432,178)	-	496,458	-115 %
Change in fair value of derivative financial instrument - warrants	277,051	4 %	(306,279)	-	583,330	-190 %
Interest income	4,593	0 %	3,730	0 %	863	23 %
Interest expenses	(5,240)		-	0 %	(5,240)	100 %
Other expenses	(145)	0 %	(143)		(2)	1 %
Total non-operating income (expenses)	340,539	5 %	(734,870)	-10 %	1,075,409	-146 %
Net income before income taxes	3,191,585	44 %	824,009	12 %	2,367,576	287 %
Income taxes	756,344	11 %	495,450	7 %	260,894	53 %
Net income attributable to China Internet Cafe Holdings Group, Inc.	2,435,241	34 %	328,559	5 %	2,106,682	641 %
Dividend on preferred stock	(113,836)	-2 %	(71,938)	-	(41,898)	58 %
Net income attributable to China Internet Cafe Holdings Group, Inc. Common stockholders	$2,321,405	32 %	$256,621	4 %	2,064,784	805 %
Other comprehensive income						
Net income	$2,435,241	34 %	328,559	5 %	2,106,682	641 %
Foreign currency translation	196,692	3 %	180,058	3 %	16,634	9 %
Net Comprehensive income	$2,631,933	37 %	$508,617	7 %	2,123,316	417 %

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Comparison of Fiscal Quarter Ended March 31, 2013 and 2012

Revenue

Our revenue is primarily generated from sales of prepaid IC cards which include stored value that will be deducted based on time usage of computers at the internet cafe. Sales revenue increased approximately $0.07 million, or 1%, from $7.13 million for the quarter ended March 31, 2012 to $7.20 million for the quarter ended March 31, 2013. The slight increase in revenue was mainly contributed to our successful strategy of cafe relocation. In 2012, we relocated 23 internet cafes to the districts where the factories were moved so that we could keep our existing loyal customers and attract new customers in the desirable business districts. 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 decreased by approximately $0.93 million, or 19%, to approximately $4.08 million for the quarter ended March 31, 2013 from approximately $5.01 million for the same period in 2012. The decrease was mainly attributed to decrease in tax rate from 20% to 3% as a result of change in tax applicable to us from business tax to value added tax since the fourth quarter of 2012. We expect this trend of decrease in tax to continue in 2013 as we continue to be eligible to pay value added tax.

Gross Profit

Gross profit is the difference between sales revenue and cost of revenue. Our gross profit increased by approximately $0.99 million, or 47%, to approximately $3.12 million for the quarter ended March 31, 2013 from approximately $2.13 million for the same period in 2012. Gross profit as a percentage of sales was 43% for the quarter ended March 31, 2013, as compared to 30% for the same period in 2012. The increase in our gross profit margin was mainly attributable to increase in revenue and decrease in cost of revenue.

Operating Expenses

Operating expenses are composed of general and administrative expenses. General and administrative expenses mainly consist of overheads of our headquarters in Shenzhen and fees paid to legal counsel, auditor, and consultants. Our administrative expenses decreased by approximately $0.30 million, or 52%, to approximately $0.27 million for the quarter ended March 31, 2013 from approximately $0.57 million for the same period in 2012. During the first quarter of 2012, we incurred a stock option expense of $0.11 million as we granted stock options to Potomac Investment LLC in consideration of their service rendered in 2011 and accrued registration penalty $0.19 million as a result. We expect that our operating expenses will remain relatively stable in the future.

Non-operating Income/Expenses

Our other income increased by approximately $1.08 million, or 146%, to $0.34 million non-operating income for the quarter ended March 31, 2013 from approximately $0.73 million non-operating expense for the same period in 2012. The significant change was mainly due to the increase of approximately $1.08 million in the fair value of derivative instruments from a loss of approximately $0.74 million for the quarter ended March 31, 2012 to a gain of approximately $0.34 million for the same period of 2013.

Income before Income Taxes

Income before income taxes increased by approximately $2.37 million, or 287%, to approximately $3.19 million for the quarter ended March 31, 2013 from approximately $0.82 million for the same period in 2012. The increase in income before income tax was mainly attributable to the decrease in cost of revenue.

Income Taxes

Our income taxes increased by approximately $0.26 million or 53% to approximately $0.76 million for the quarter ended March 31, 2013 from approximately $0.50 million for the same period in 2012. The primary reason for the increase in income taxes was the increase in income before income tax as a result of decrease in cost of revenue.

The effective tax rate decreased by 37% from 60% for the three months ended March 31, 2012 to 23% for the three months ended March 31, 2013. The significant decrease in effective tax rate was mainly due to the significant increase in fair value of unrealized loss of derivative instruments.

Net Income

Our net income increased by approximately $2.11 million, or 641%, to approximately $2.44 million for the quarter ended March 31, 2013 from approximately $0.33 million for the same period in 2012 as a result of the factors described above. We expect to generate higher net profit in 2013 as we continue to be eligible for the value added tax instead of business tax.

Liquidity and Capital Resources

As of March 31, 2013, we had cash and cash equivalents of approximately $29.71 million. The following table provides detailed information about our cash flow for each financial statement period presented in this report.

Cash Flow

	Three Months Ended March 31, 2013	2012
Net cash provided by operating activities	$3,904,914	$2,239,936
Net cash used in financing activities	(159,314)	-
Effect of foreign currency translation on cash and cash equivalents	149,559	119,123
Net cash flows	$3,895,159	$2,359,059

Operating Activities

Net cash provided by operating activities was approximately $3.90 million for the quarter ended March 31, 2013, an increase of approximately $1.66 million, or 74%, as compared to approximately $2.24 million for the same period in 2012. The increase in cash provided by operating activities was mainly attributable to an increase in net income of approximately $2.1 million.

Financing Activities

Net cash used in financing activities was approximately $0.16 million for the quarter ended March 31, 2013, an increase of approximately $0.16 million, or 100%, as compared to $0 for the same period in 2012. The Company paid off a short-term loan of approximately $0.16 million (RMB 1,000,000) from China Construction Bank in the first quarter of 2013.

Critical Accounting Policies

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

Revenue recognition

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

The Company also records revenue from commission received from the sale of third parties on-line gaming cards, snacks and drinks. Commission revenue amounting to 20% of the value of the on-line gaming cards, snacks and drinks is recognized at the time the items are sold to customers.

Cost of goods sold

Cost of goods sold consists primarily of depreciation of each internet café's computer equipment and hardware and overhead associated with the internet cafés including rental payments, utilities, business taxes/value added tax and surcharges. Our internet surfing business tax or value added tax are 20% and 3% on gross revenue generated from our internet cafés, respectively. Our other surcharges are an education surcharge of 3%, city development surcharge of 1%, a culture development surcharge of 3%, and a snacks and drinks business tax of 5%. All surcharges are calculated on the basis of business tax amount or value added tax amount.

Property, plant and equipment

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

	Estimated Useful Lives
Leasehold improvement	5 years
Café computer equipment and hardware	5 years
Café furniture and fixtures	5 years
Office furniture, fixtures and 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 $1,620,750 and $1,505,699 as at March 31, 2013 and December 31, 2012, respectively, and are included in deferred revenue on the balance sheets. Management has evaluated the deferred revenue balance and has determined any potential revenue from the unused balance to be immaterial as of the quarter ended March 31, 2013.

Comprehensive income

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

Income taxes

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

Foreign currency translation

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

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

	March 31, 2013	March 31, 2012
Quarter-end RMB : USD exchange rate	6.2666	-
Three months average RMB : USD exchange rate	6.2769	6.2976

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

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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 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed by the Company in the reports filed under the Securities Exchange Act, 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) for the quarter ended March 31, 2013. Based upon that evaluation, the Company’s management concluded that the Company’s disclosure controls and procedures were not effective for the quarter ended March 31, 2013 as a result of the material weaknesses identified in our internal control over financial reporting.

Specifically, our management identified certain matters involving internal control and our operations that it considered to be material weaknesses. As defined in the Exchange Act, a material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness identified by our management for the quarter ended March 31, 2013 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 for the quarter ended March 31, 2013.

2013 Planned Remediation

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

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

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

Changes in Internal Control over Financial Reporting

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

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

Not applicable.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

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

Exhibit No.	Description
2.1(1)	Form of Share Exchange Agreement, dated July 2, 2010, among the Company, Classic Bond Development Limited and its shareholders.
3.1(2)	Articles of Incorporation of the Company
3.2(2)	Bylaws of the Company
3.3(3)	Amended and Restated Bylaws, adopted on July 30, 2010
3.4(4)	Certificate of Designations Preferences and Rights of the 5% Series A Convertible Preferred Stock of China Internet Café Holdings Group, Inc.
4.1(1)	Form of Cancellation Agreement, dated July 2, 2010, among the Company and certain shareholders.
4.2(2)	Specimen Stock Certificate
31.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document**
101.SCH	XBRL Taxonomy Extension Schema Document**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document**

101.LAB XBRL Taxonomy Extension Label Linkbase Document**

101.DEF XBRL Taxonomy Extension Definition Linkbase Document**

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

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

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

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

*Filed herewith.

**Furnished herewith.

SIGNATURES

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

CHINA INTERNET CAFE HOLDINGS GROUP, INC.

Date: May 20, 2013

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

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