Qingdao Footwear, Inc.
Form S-1/A
August 03, 2010

As filed with the Securities and Exchange Commission on August 2, 2010

Registration No. 333-167003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-1/A

Pre-Effective Amendment No.1

REGISTRATION STATEMENT
UNDER THE SECURITIES ACT OF 1933

Qingdao Footwear, Inc.

(formerly Datone, Inc.)
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	5661 (Primary Standard Industrial Classification Code Number)	16-1591157 (I.R.S. Employer Identification Number)

Qingdao Footwear, Inc. 269 First Huashan Road Jimo City, Qingdao, Shandong, PRC 86-0532-86595999 (Address, including zip code, and telephone number, including area code, of principal executive offices)	CT Corporation System 4701 Cox Road, Suite 301 Glen Allen, Virginia 23060 (804) 217-7255 (Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

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Approximate date of commencement of proposed sale to the public: As soon as practicable after this Registration Statement becomes effective.

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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

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

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

SUBJECT TO COMPLETION, DATED AUGUST 2, 2010

Qingdao Footwear, Inc.

Minimum Offering: 833,333 Shares of Common Stock
Maximum Offering: 1,000,000 Shares of Common Stock

We are offering a minimum of 833,333 and a maximum of 1,000,000 shares of the common stock of Qingdao Footwear, Inc. We expect that the offering price will be $6.00 per share. None of our officers, directors or affiliates may purchase shares in this offering.

We are a reporting company under Section 13 of the Securities Exchange Act of 1934, as amended. Our common stock is currently quoted on the OTC Bulletin Board under the symbol “QING” (previously “DATI”). We have applied for approval for quotation of our common stock on the NASDAQ Capital Market under the symbol “FOOT”. Although we have not yet been advised that our application has been approved, we will not complete this offering unless and until the NASDAQ Capital Market advises us that our common stock has been approved for listing upon the closing of this offering.

Investing in these shares of common stock involves significant risks. See “Risk Factors” beginning on page 12 of this prospectus.

	Per Share	Minimum Offering	Maximum Offering
Assumed public offering price	$ 6.00	$ 4,999,998	$ 6,000,000
Underwriting discount	$ 0.42	$ 350,000	$ 420,000
Proceeds to us, before expenses	$ 5.58	$ 4,649,998	$ 5,580,000

We expect our total cash expenses for this offering to be approximately $320,000, exclusive of the above commissions. In addition, we will pay the underwriter an accountable expense allowance of 1% of the amount of the offering, or $60,000 (maximum offering, exclusive of shares registered under Rule 462(b)) or $50,000 (minimum offering).

The offering will terminate upon the earlier of: (i) a date mutually acceptable to us and our underwriter after which the minimum offering is sold or (ii) December 31, 2010. The underwriter is required to use only its best efforts to sell the securities offered. The underwriter must sell the minimum number of securities offered (833,333 shares) if any are sold. Until we sell at least 833,333 shares, all investor funds will be held in an escrow account at SunTrust Bank, Richmond, Virginia. If we do not sell at least 833,333 shares by December 31, 2010, all funds will be promptly returned to investors (within one business day) without interest or deduction. If we complete this offering, net proceeds will be delivered to our company on the closing date. We will not be able to use such proceeds in China, however, until we complete certain remittance procedures in China. If we complete this offering, then on the closing date, we will issue shares of common stock to investors in the offering and underwriter warrants to our underwriter exercisable at a rate of one warrant per share to purchase up to 10% of the aggregate number of shares of common stock sold in this offering. We have registered these underwriter warrants and the shares of common stock underlying the underwriter warrants in connection with this offering.

These securities have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

Anderson & Strudwick,
Incorporated

Prospectus dated , 2010

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No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell only the shares offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date.

Except where the context otherwise requires and for purposes of this prospectus only:

- the terms “we,” “us,” “our company,” “our” and “Qingdao Footwear” refer to the combined business of Qingdao Footwear, In formerly Datone, Inc., and its wholly owned direct and indirect subsidiaries, (i) Glory Reach International Limited, or “Glory Reach,” a Hong Kong limited company; and (ii) Qingdao Hongguan Shoes Co., Ltd., a PRC limited company, or “QHS,” as the case may be.
- “shares” and “common stock” refer to our common stock, $0.001 par value per share;
- “China” and “PRC” refer to the People’s Republic of China, excluding, for the purposes of this prospectus only, Macau, Taiwan and Hong Kong; and
- all references to “RMB,” “Renminbi” and “¥” are to the legal currency of China and all references to “USD,” “U.S. dollars,” “dollars,” and “$” are to the legal currency of the United States.

For the sake of clarity, this prospectus follows English naming convention of first name followed by last name, regardless of whether an individual’s name is Chinese or English. For example, the name of our chief executive officer will be presented as “Tao Wang”, even though, in Chinese, Mr. Wang’s name would be presented as “Wang Tao.”

Unless otherwise indicated, all information in this prospectus assumes:

- no person will exercise any outstanding options;
- the sale of 1,000,000 shares of common stock, the maximum number of shares offered in this offering;
- an assumed public offering price of $6.00 per share; and
- the completion of the one-for-twenty-seven (1-for-27) reverse split of the outstanding shares of our common stock and the conversion of all outstanding shares of our Series A Convertible Preferred Stock into shares of common stock at a rate of 970 shares of common stock per share of preferred stock, which became effective on June 10, 2010.

We have relied on statistics provided by a variety of publicly-available sources and research reports regarding China’s expectations of growth, China’s demand for footwear and China’s footwear industry. We did not, directly or indirectly, sponsor or participate in the publication of such materials; however, we did purchase certain previously published research reports.

In particular, we have relied on a September 2009 Industry Profile titled “Footwear in China” from Datamonitor for information related to China’s footwear industry. We have also relied on a July 2007 research report from Gobi International titled “World Statistical Market Forecast: Footwear.” In addition, we have relied on the China Statistical Yearbook for a variety of statistics regarding China’s demographics and economy.

Prospectus Summary

This summary highlights information that we present more fully in the rest of this prospectus. This summary does not contain all of the information you should consider before buying shares in this offering. This summary contains forward-looking statements that involve risks and uncertainties, such as statements about our plans, objectives, expectations, assumptions or future events. In some cases, you can identify forward-looking statements by terminology such as “anticipate,” “estimate,” “plan,” “project,” “continuing,” “ongoing,” “expect,” “we believe,” “we intend,” “should,” “will,” “could,” and similar expressions denoting uncertainty or an action that may, will or is expected to occur in the future. These statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from any future results, performances or achievements expressed or implied by the forward-looking statements. You should read the entire prospectus carefully, including the “Risk Factors” section and the financial statements and the notes to those statements.

Our Company

We are a designer and retailer of branded footwear in Northern China. We were organized to service what we believe is an unmet and increasing demand for high quality formal and casual footwear throughout the PRC. As urbanization and individual purchasing power have increased in China, the demand for leather footwear has also grown.

Our principal business includes (1) designing and selecting designs for more than 200 unique styles of men’s and women’s leather shoe lines; (2) sourcing and purchasing contract-manufactured footwear; and (3) selling these lines of footwear under our proprietary brand, “Hongguan” (sometimes presented as “HonGung”). Our designs are on the whole targeted at consumers seeking business casual and formal leather shoes appropriate for an office setting. Approximately 60% of our revenues come from men’s footwear, with women’s footwear making up approximately 40% of our revenues. Similarly, approximately 60% of our revenues come from casual shoes, and approximately 40% of our revenues come from formal shoes.

We do not manufacture or assemble any shoes and instead outsource manufacturing to third parties. We operate a number of flagship stores throughout greater Qingdao. Our products are also brought to market through our extensive distribution network of authorized independent distributors as well as through third party retailers selected to operate exclusive Hongguan brand stores on our behalf. Our company headquarters and main sales office is located in Shandong province in northern China, in the city of Jimo, less than 25 miles from the major urban center of Qingdao.

Our company is incorporated in the State of Delaware, but all of our business operations are conducted through our Hong Kong subsidiary, Glory Reach, and our Chinese subsidiary, QHS.

Our Primary Geographic Market

Shandong Province

Shandong Province is China’s second largest province (after Guangdong), with a population of approximately 94 million people. The province is also China’s second most densely populated province (after Jiangsu), with 587 people per square kilometer, more than four times the average population density in China. Gross domestic product (“GDP”) attributable to Shandong ranks it second among China’s provinces, accounting for more than ten percent of China’s GDP in 2008. (“List of Administrative Divisions by Population Density,” en.wikipedia.org; “World Bank Supports Skills Development in Two Chinese Provinces,” go.worldbank.org)

Qingdao City

Qingdao is a sub-provincial city in China comprised of seven districts and five county-level cities. It is one of China's twenty largest cities and one of the two largest cities in Shandong province, with approximately 200,000 more people living in Jinan city than in Qingdao city but more than 1.7 million more people living in the greater Qingdao administrative area than in Jinan's administrative region. Qingdao has a population of approximately 8 million residents, of whom approximately 3.8 million live in the urban area.

Qingdao's per-capita GDP (approximately $7,616 in 2008) is above average in China (approximately $3,290 in 2008), in part due to the Chinese government's decision in 1984 to designate Qingdao as a special economic and technology development zone. For this reason, Qingdao's local economy features a variety of foreign investment, with South Korea and Japan investments being particularly prominent in the area. ("Qingdao," en.wikipedia.org)

Industry and Market Background

China is the largest producer of footwear in the world, with at least 25,000 enterprises employing more than 10 million employees who manufacture more than 10 billion pairs of shoes per annum. China's annual production accounts for nearly 70% of the 14.3 billion pairs of shoes produced worldwide. In 2008, roughly 75% of PRC production capacity was exported while the remaining 25% were consumed domestically. Chinese consumption of footwear reached 2.5 billion pairs in 2008. (Global Footwear, 2nd Edition, www.researchandmarkets.com) We anticipate stable growth in the domestic footwear market for the next several years. Beginning with the deterioration in the global economy in 2008 and the collapse of the Chinese textile and footwear export market, a material number of low margin manufacturers were forced out of business. Domestic consumption and retail sales within China, however, remained robust throughout the export downturn and global financial crisis. As we have intentionally avoided the manufacturing sector, we were able to capitalize on the economic conditions and maintain our profit margin and by capitalizing on overcapacity in our sourcing market and growing consumer demand.

China's footwear market generated total revenues of approximately $11.7 billion dollars in 2008. According to Datamonitor, from 2004 through 2008, revenues grew at a cumulative annual growth rate of approximately 10.7%. ("Footwear in China," www.datamonitor.com)

China's footwear market accounts for approximately 34% of the entire Asia-Pacific footwear market's value, and China is expected to continue to grow in future periods by over 8% per year through 2013. ("Footwear in China," www.datamonitor.com)

While Chinese per capita footwear consumption is lower than a number of other countries, China surpassed the United States in 2008 as the country that purchases the most pairs of footwear in the aggregate. Because the average Chinese consumer purchases an average of two pairs of shoes annually, far fewer than consumption levels in Korea, Japan or the West, shoe consumption are expected to approach levels of other nations with similar cultural consumption characteristics if China's consumer wealth continues to grow. ("Footwear in China," www.datamonitor.com) For this reason, we expect the market is likely to continue to grow for the foreseeable future.

Our Sales Channels

We sell our footwear in three ways. First, we have 12 flagship stores, which bear our Hongguan brand name and exclusively sell our Hongguan footwear. Second, we have 11 third-party-operated retail outlets that we do not control but that exclusively sell our Hongguan footwear and that are branded as Hongguan stores. Third, our footwear is sold at 192 outlets managed by distributors, at which outlets other companies' footwear may also be sold. In the year ended December 31, 2009, revenues from flagship stores, third-party retail outlets and distributor stores constituted approximately 16%, 10% and 74% of our revenues. In the year ended December 31, 2008, revenues from flagship stores, third-party retail outlets and distributor stores constituted approximately 15%, 13% and 72% of our revenues.

Our Growth Strategy

We believe that the market for affordable, high quality footwear in China provides us with attractive and sustainable growth opportunities. We intend to pursue the following strategies to achieve our goal:

(1) Continue our marketing and advertising campaigns in order to gain brand awareness.
(2) Expand distributor and third party operator stores in prime locations to maximize profits.
(3) Bring more self-owned stores online to increase higher margin sales.
(4) Continue to strive for excellence in quality, customer service and design in order to attract new and retain repeat customers.
(5) Leverage our growing purchasing power with manufacturers control costs.

The Offering

Shares Offered:	Minimum: 833,333 shares of common stock(1) Maximum: 1,000,000 shares of common stock(1)
Shares Outstanding Prior to Completion of Offering:	10,000,000 shares of common stock s
Shares to be Outstanding after Offering:	Minimum: 10,833,333 shares of common stock Maximum: 11,000,000 shares of common stock
Assumed Offering Price per Share:	$6.00
Gross Proceeds:	Minimum: $4,999,998 Maximum: $6,000,000
Proposed NASDAQ Capital Market Symbol:	"FOOT" (CUSIP No. 23816A103)
Corporate Information:	Our principal executive office is located at 269 First Huashan Road, Jimo City, Qingdao, Shandong, People's Republic of China. Our telephone number is (86) 0532-86595999. We do not maintain a corporate website at this time.
Transfer Agent:	Pacific Stock Transfer Company 4045 S. Spencer Street, Suite 403, Las Vegas, NV 89119
Risk Factors:	Investing in these securities involves a high degree of risk. As an investor, you should be able to bear a complete loss of your investment. You should carefully consider the information set forth in the "Risk Factors" section of this prospectus before deciding to invest in our shares of common stock.
Closing of Offering:	The offering contemplated by this prospectus will terminate upon the earlier of: (i) a date mutually acceptable to us and our underwriter after the minimum offering is sold or (ii) December 31, 2010. If we complete this offering, net proceeds will be delivered to our company on the closing date (such closing date being the above mutually acceptable date on or before December 31, 2010, provided the minimum offering has been sold). We will not complete this offering unless our application to list on the NASDAQ Capital Market is approved. We will not be able to use such proceeds in China, however, until we complete certain

remittance procedures in China. If we complete this offering, then on the closing date, we will issue shares to investors and underwriter warrants to our underwriter exercisable at a rate of one warrant per share to purchase up to 10% of the aggregate number of shares of common stock sold in this offering. We have registered these underwriter warrants and the shares of common stock underlying the underwriter warrants in connection with this offering.

Summary Financial Information

In the table below, we provide you with summary financial data of our company. This information is derived from our consolidated financial statements included elsewhere in this prospectus. Historical results are not necessarily indicative of the results that may be expected for any future period. When you read this historical selected financial data, it is important that you read it along with the historical statements and notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus.

	For the Fiscal Year ended December 31,		For the three months ended March 31, (Unaudited)	
	2009	2008	2010	2009
Gross profit	$ 7,701,113	$ 5,657,722	$ 2,109,057	$ 1,933,560
Income from Operations	$ 6,731,468	$ 4,842,892	$ 1,388,331	$ 1,701,880
Other Income (Expense)	$ 27,318	$ 4,704	$ (819)	$ 9,011
Income Taxes	$ 1,689,697	$ 1,211,899	$ 457,531	$ 427,723
Net Income	$ 5,069,089	$ 3,635,697	$ 929,981	$ 1,283,168
Other Comprehensive Income (loss)	$ 3,110	$ 232,047	$ 341	$ (6,705)
Comprehensive Income	$ 5,072,199	$ 3,867,744	$ 930,322	$ 1,276,463
Basic Earnings per Share (based on 10,000,000, 9,700,000, 9,700,000 and 9,700,000 shares outstanding, on March 31, 2010 and 2009, December 31, 2009 and 2008, respectively)(1)	$ 0.52	$ 0.37	$ 0.09	$ 0.13

	December 31,		March 31, (Unaudited)
	2009	2008	2010
Total Assets	$ 1,700,534	$ 5,559,520	$ 4,358,257
Total Liabilities	$ 1,208,445	$ 706,820	$ 2,871,440
Shareholders' Equity	$ 492,089	$ 4,852,700	$ 1,486,817
Total Liabilities and Shareholders' Equity	$ 1,700,534	$ 5,559,520	$ 4,358,257

(1) We have presented earnings per share after giving retroactive effect to the 1-for-27 reverse share split of our common stock and the conversion of all shares of our Series A Convertible Preferred Stock into shares of common stock at a rate of 970 shares of common stock per share of preferred stock that was completed on or about June 10 2010.

Risk Factors

Investment in our common stock involves a high degree of risk. You should carefully consider the risks described below together with all of the other information included in this prospectus before making an investment decision. The risks and uncertainties described below represent our known material risks to our business. If any of the following risks actually occurs, our business, financial condition or results of operations could suffer. In that case, you may lose all or part of your investment. You should not invest in this offering unless you can afford to lose your entire investment.

Risks Related to our Business

We have a short operating history.

We have only been in retail business since 2003. We may not succeed in implementing our business plan successfully because of competition from domestic and foreign market entrants, failure of the market to accept our products, or other reasons. Therefore, you should not place undue reliance on our past performance as they may not be indicative of our future results.

Some of our senior management lacks experience managing a public company and complying with laws applicable to operating as a U.S. public company.

Prior to the completion of this offering, Glory Reach and QHS completed a merger with Datone, Inc., the result of which was for Glory Reach and QHS to become wholly-owned subsidiaries of Datone, Inc., a U.S. public company. At the same time, however, the management of Datone resigned from its positions within Datone, Inc., and the management of Glory Reach became the management of our company. While the previous management of Datone, Inc. had experience in managing a U.S. publicly traded company, the management of Glory Reach did not. Prior to the completion of that merger, Glory Reach and QHS were operated as a private company located in China. While our chief financial officer has experience in working with U.S. public companies, some of our current senior management has experience managing a U.S. public company.

As a result of these transactions, our company will become subject to laws, regulations and obligations that did not previously apply to it, and our senior management currently has limited experience in complying with such laws, regulations and obligations. For example, we will need to comply with the Delaware laws applicable to companies that are domiciled in that state. By contrast, such senior management is currently experienced in operating the business of QHS in compliance with Chinese law. Similarly, by virtue of these transactions we will be required to file quarterly and annual reports and to comply with U.S. securities and other laws, which may not have applied to our company in the past. These obligations can be burdensome and complicated, and failure to comply with such obligations could have a material adverse effect on our company. In addition, we expect that the process of learning about such new obligations as a public company in the United States will require senior management to devote time and resources to such efforts that might otherwise be spent on the operation of the business of operating a footwear business.

While we have invited three independent directors (Troy Mao, Susan Woo and John Zhang) with experience in working with China-based companies listed in the United States to serve on our board and they have agreed to do so following the completion of this offering, these individuals do not currently serve on our board. Moreover, they will not join our board until the completion of this offering. These individuals will not review financial statements or otherwise exercise board oversight until they join our board of directors, so we will not benefit from their experience until after such completion.

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We face risks related to general domestic and global economic conditions and to the current credit crisis.

Our current operating cash flows provide us with stable funding capacity. However, the current uncertainty arising out of domestic and global economic conditions, including the recent disruption in credit markets, poses a risk to the PRC economy, and may impact our ability to manage normal relationships with our customers, suppliers and creditors. If the current situation deteriorates significantly, our business could be materially negatively impacted, as demand for our products and services may decrease from a slow-down in the general economy, or supplier or customer disruptions may result from tighter credit markets.

Our business is subject to the health of the PRC economy and our growth may be inhibited by the inability of potential customers to fund purchases of our products and services.

Our products are dependent on the disposable income of PRC citizens, which could be adversely affected by an economic downturn. Because much of our target consumer group consists of office workers who have benefitted from growth in the PRC economy, we believe that a weakening of the Chinese economy would disproportionately and materially affect our company. First, such a weakening could hurt consumer spending generally. Second, to the extent our products would be seen as a luxury by such consumers, we would expect that demand for our products would be further weakened.

We may be unable to compete effectively in China’s competitive footwear industry.

We face a variety of competitive challenges from other footwear retailers and wholesalers, including a number of competitors that have substantially greater financial and marketing resources than we do. We compete with other footwear retailers on the basis of:

- developing fashionable, high-quality merchandise in an assortment of sizes, colors and styles that appeals to our target consumers;
- anticipating and responding to changing consumer demands in a timely manner;
- ensuring product availability and optimizing supply chain effectiveness;
- the pricing of our merchandise;
- creating an acceptable value proposition for consumers;
- providing an inviting, customer-friendly shopping environment; and
- using our sales staff to provide attentive, product knowledgeable customer service at our flagship locations.

Competition in the retail footwear industry has increased. Accordingly, there is substantial pressure on us to maintain the value proposition of our footwear and the convenience of our store locations. In addition, it is possible that our competitors will increase their investment in their retail footwear operations, thereby achieving greater market penetration and placing additional competitive pressures on our business. If we are unable to respond effectively to these competitive pressures, our business, results of operations and financial condition could be adversely affected.

A majority of our operating expenses at our flagship stores are fixed costs that are not directly dependent upon our sales performance. As a result, declines in our operating performance may be magnified if we are unable to reduce expenses in response to a sales shortfall.

A majority of our operating expenses at our flagship stores are fixed costs that are not directly dependent on our sales performance, as opposed to variable costs, which increase as sales volume increases. These fixed costs include the leasing and operating costs associated with our flagship stores and, because flagship stores require minimum staffing levels, the majority of our labor expenses. If our sales were to decline, we may be unable to reduce or offset these fixed operating expenses in the short term. Accordingly, the effect of any sales decline is likely to be magnified because a larger percentage of our earnings are committed to paying these fixed costs. As a result, our net earnings and cash flow could be disproportionately negatively affected as a result of a decline in sales.

We may have insufficient liquidity and capital resources to meet our obligations as they become due.

As of March 31, 2010, we had cash and cash equivalents of $378,219. These cash and cash equivalents consist primarily of cash on hand and demand deposits. We require substantial cash flow in order to fund our operations, to purchase stock or choose, to pay our lease obligations and employment obligations. The amount of cash and cash equivalents on hand is insufficient to pay such obligations. In the event our cash flow decreased or our receivables were paid more slowly than we expect, we might be unable to pay our obligations as they become due.

We may have unseasonable weather where our stores are concentrated.

We increase our inventory levels to support the increased demand for our products, as well as to offer styles particularly suited for the relevant season. If the weather conditions for a particular season vary significantly from those typical for such season, such as an unusually cold early summer or an unusually warm winter, consumer demand for the seasonally appropriate merchandise that we have available in our stores could be adversely affected and negatively affect our net sales and margins. Lower demand for seasonally appropriate merchandise may leave us with an excess inventory of our seasonally appropriate products and/or basic products, forcing us to sell both types of products at significantly discounted prices and adversely affecting our net sales margins and operating cash flow. Conversely, if weather conditions permit us to sell our seasonal product early in the season, this may reduce inventory levels needed to meet our customers' needs later in that same season. Consequently, our results of operations are highly dependent on potentially unpredictable weather conditions.

We may be unable to adjust to constantly changing fashion trends.

Our success depends, in large part, upon our ability to gauge the evolving fashion tastes of our consumers and to provide merchandise that satisfies such fashion tastes in a timely manner. China's footwear retailing industry fluctuates according to changing fashion tastes and seasons, and merchandise usually must be ordered in advance of the season, frequently before consumer fashion tastes are evidenced by consumer purchases. In addition, the cyclical nature of China's footwear retailing industry also requires us to maintain substantial levels of inventory, especially prior to peak selling seasons when we build up our inventory levels. As a result, if we fail to properly gauge the fashion tastes of consumers, or to respond in a timely manner, this failure could adversely affect consumer acceptance of our merchandise and leave us with substantial unsold inventory. If that occurs, we may be forced to rely on markdowns or promotional sales to dispose of excess, slow-moving inventory, which would negatively impact financial results.

The results of our wholesale businesses are also affected by the buying plans of our customers, which include footwear retailers. No customer accounts for 10% or more of our wholesale business. Our wholesale customers may not inform us of changes in their buying plans until it is too late for us to make the necessary adjustments to our product lines and marketing strategies. While we believe that purchasing decisions in many cases are made independently by individual stores or chains, we are exposed to decisions by the controlling owner of a store chain that could decrease the amount of footwear products purchased from us. In addition, the retail industry periodically experiences consolidation. We face a risk that our wholesale customers may consolidate, restructure, reorganize or otherwise realign in ways that could decrease the number of stores that carry our products or the amount of shelf space devoted to our products. We also face a risk that our wholesale customers could develop in-house brands or utilize the private labeling of footwear products, which would negatively impact financial results.

We may be unsuccessful in opening new stores or relocating existing stores to new locations, adversely affecting our ability to grow.

Our growth, in part, is dependent upon our ability to expand our retail operations by opening and operating new stores, as well as relocating existing stores to new locations, on a profitable basis.

Our ability to open new stores and relocate existing stores to new locations on a timely and profitable basis is subject to various contingencies, some of which are beyond our control. These contingencies include our ability to:

- locate suitable store sites;
- negotiate acceptable lease terms;
- build-out or refurbish sites on a timely and cost effective basis;
- hire, train and retain qualified managers and personnel;
- identify long-term shopping patterns;
- obtain adequate capital resources; and
- successfully integrate new stores into our existing operations.

We may be unsuccessful in opening new stores or relocating existing stores for any of these reasons. In addition, we cannot assure you that, even if we are successful in opening new stores or relocating existing stores, those stores will achieve levels of sales and profitability comparable to our existing stores.

In order to grow at the pace expected by management, we will require additional capital to support our long-term growth strategies. If we are unable to obtain additional capital in future years, we may be unable to proceed with our plans and we may be forced to curtail our operations.

We will require additional working capital to support our long-term growth strategies, which includes identifying suitable points of market entry for expansion and growing the number of points of sale for our products, so as to enhance our product offerings and benefit from economies of scale. Our working capital requirements and the cash flow provided by future operating activities, if any, may vary greatly from quarter to quarter, depending on the volume of business during the period. We may not be able to obtain adequate levels of additional financing, whether through equity financing, debt financing or other sources. Additional financings could result in significant dilution to our earnings per share or the issuance of securities with rights superior to our current outstanding securities. In addition, we may grant registration rights to investors purchasing our equity or debt securities in the future. If we are unable to raise additional financing, we may be unable to implement our long-term growth strategies, develop or enhance our products and services, take advantage of future opportunities or respond to competitive pressures on a timely basis.

We rely on third parties to manufacture and distribute our products.

We depend on contract manufacturers to manufacture the merchandise that we sell. If these contract manufacturers are unable to secure sufficient supplies of raw materials, or maintain adequate manufacturing and shipping capacity, they may be unable to provide us with timely delivery of products of acceptable quality. In addition, if the prices charged by these contractors increase for reasons such as increases in the price of raw materials, increases in labor costs or currency fluctuations, our cost of manufacturing would increase, adversely affecting our results of operations. We also depend on third parties to transport and deliver our products. Due to the fact that we do not have any independent transportation or delivery capabilities of our own, if these third parties are unable to transport or deliver our products for any reason, or if they increase the price of their services, including as a result of increases in the cost of fuel, our operations and financial performance may be adversely affected.

We require our contract manufacturers to meet our standards in terms of working conditions and other matters before we are willing to contract with them to manufacture our merchandise. As a result, we may not be able to obtain the lowest possible manufacturing costs. In addition, any failure by our contract manufacturers to meet these standards, to adhere to labor or other laws or to diverge from our mandated labor practices, and the potential negative publicity relating to any of these events, could harm our business and reputation.

We do not have long-term agreements with any of our contract manufacturers, and any of these manufacturers may unilaterally terminate their relationship with us at any time. There is also substantial competition among footwear retailers for quality manufacturers. To the extent we are unable to secure or maintain relationships with quality manufacturers, our business could be harmed.

If we are unable to attract and retain senior management and qualified technical and sales personnel, our operations, financial condition and prospects will be materially adversely affected.

Our future success depends in part on the contributions of our management team and key technical and sales personnel and our ability to attract and retain qualified new personnel. In particular, our success depends on the continuing employment of our Chief Executive Officer, Mr. Tao Wang, our Chief Operating Officer, Shi Wenmao;

and our Chief Financial Officer, Mr. Joseph Meuse. There is significant competition in our industry for qualified managerial, technical and sales personnel and we cannot assure you that we will be able to retain our key senior managerial, technical and sales personnel or that we will be able to attract, integrate and retain other such personnel that we may require in the future. If we are unable to attract and retain key personnel in the future, our business, operations, financial condition, results of operations and prospects could be materially adversely affected.

We do not carry business interruption or other insurance, so we have to bear losses ourselves.

We are subject to risk inherent to our business, including equipment failure, theft, natural disasters, industrial accidents, labor disturbances, business interruptions, property damage, product liability, personal injury and death. We do not carry any business interruption insurance or third-party liability insurance or other insurance to cover risks associated with our business. As a result, if we suffer losses, damages or liabilities, including those caused by natural disasters or other events beyond our control and we are unable to make a claim again a third party, we will be required to bear all such losses from our own funds, which could have a material adverse effect on our business, financial condition and results of operations.

A major failure of our information systems could harm our business.

We depend on information systems to process transactions, manage inventory, purchase, sell and ship goods on a timely basis, and maintain cost-efficient operations. Any material disruption or slowdown of our systems could cause information to be lost or delayed, which could have a negative effect on our business. We may experience operational problems with our information systems as a result of system failures, viruses, computer “hackers” or other causes. We cannot be assured that our systems will be adequate to support future growth.

Our quarterly operating results are likely to fluctuate, which may affect our stock price.

Our quarterly revenues, expenses, operating results and gross profit margins vary from quarter to quarter. As a result, our operating results may fall below the expectations of securities analysts and investors in some quarters, which could result in a decrease in the market price of our common stock. The reasons our quarterly results may fluctuate include:

- variations in profit margins attributable to product mix;
- changes in the general competitive and economic conditions;
- delays in, or uneven timing in the delivery of, customer orders; and
- the introduction of new products by us or our competitors.

Period to period comparisons of our results should not be relied on as indications of future performance.

Our limited ability to protect our intellectual property, and the possibility that our technology could inadvertently infringe technology owned by others, may adversely affect our ability to compete.

We believe that our trademarks and other intellectual property are important to our business and are generally sufficient to permit us to carry on our business as presently conducted. We cannot, however, know whether we will be able to secure protection for our intellectual property in the future or whether that protection will be adequate for future products.

We rely on a combination of trade secret laws and confidentiality procedures to protect the patents, copyrights and technological know-how that comprise our intellectual property. We protect our technological know-how pursuant to non-disclosure and non-competition provisions contained in our employment agreements, and agreements with them to keep confidential all information relating to our customers, methods, business and trade secrets during and after their employment with us. Our employees are also required to acknowledge and recognize that all inventions, trade secrets, works of authorship, developments and other processes made by them during their employment are our property. We have been granted the use of brand name “Hongguan” (sometimes presented as “HonGung”).

A successful challenge to the ownership of our intellectual property could materially damage our business prospects. Our competitors may assert that our technologies or products infringe on their patents or proprietary rights. We may be required to obtain from others licenses that may not be available on commercially reasonable terms, if at all. Problems with intellectual property rights could increase the cost of our products or delay or preclude our new product development and commercialization. If infringement claims against us are deemed valid, we may not be able to obtain appropriate licenses on acceptable terms or at all. Litigation could be costly and time-consuming but may be necessary to protect our technology license positions or to defend against infringement claims.

Our business may be subject to seasonal and cyclical fluctuations in sales.

We may experience seasonal fluctuations in our revenue in some regions in the PRC, based on the seasonal changes in the weather and the tendency of customers to make purchases relating to their apparel suitable for the time of year. Any seasonality may cause significant pressure on us to monitor the development of materials accurately and to anticipate and satisfy these requirements. Our revenues are usually higher in the fourth and first quarters due seasonal purchases. This seasonality limits our ability to make accurate long-term predictions about our performance and makes it difficult to compare our revenues across quarters.

Risks Related to Doing Business in China

Changes in China's political or economic situation could harm us and our operating results.

Economic reforms adopted by the Chinese government have had a positive effect on the economic development of the country, but the government could change these economic reforms or any of the legal systems at any time. This could either benefit or damage our operations and profitability. Some of the things that could have this effect are:

- Level of government involvement in the economy;
- Control of foreign exchange;
- Methods of allocating resources;
- Balance of payments position;
- International trade restrictions; and
- International conflict.

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

Uncertainties with respect to the PRC legal system could limit the legal protections available to you and us.

We conduct substantially all of our business through our operating subsidiaries in the PRC and Hong Kong. Our principal operating subsidiary, QHS, is subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to foreign-invested enterprises. The PRC legal system is based on written statutes, and prior court decisions may be cited for reference but have limited precedential value. Since 1979, a series of new PRC laws and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, since the PRC legal system continues to evolve rapidly, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit legal protections available to you and us. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. In addition, all of our executive officers and all of our directors are residents of China and not of the United States, and substantially all the assets of these persons are located outside the United States. As a result, it could be difficult for investors to affect service of process in the United States or to enforce a judgment obtained in the United States against our Chinese operations and subsidiaries.

You may have difficulty enforcing judgments against us, as almost all of our assets and all of our officers and directors are located outside the United States.

We are a Delaware holding company, but Glory Reach is a Hong Kong company, and our principal operating subsidiary, QHS, is located in the PRC. Almost all of our assets are located outside the United States, and our current operations are conducted in the PRC. In addition, our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons is located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce in U.S. courts judgments predicated on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors, most of whom are not residents in the United States and the substantial majority of whose assets are located outside the United States. In addition, there is uncertainty as to whether the courts of the PRC would recognize or enforce judgments of U.S. courts. The recognition and enforcement of foreign judgments are provided for under the PRC Civil Procedures Law. Courts in China may recognize and enforce foreign judgments in accordance with the requirements of the PRC Civil Procedures Law based on treaties between China and the country where the judgment is made or on reciprocity between jurisdictions. China does not have any treaties or other arrangements that provide for the reciprocal recognition and enforcement of foreign judgments with the United States. In addition, according to the PRC Civil Procedures Law, courts in the PRC will not enforce a foreign judgment against us or our directors and officers if they decide that the judgment violates basic principles of PRC law or national sovereignty, security or the public interest. So it is uncertain whether a PRC court would enforce a judgment rendered by a court in the United States.

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

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

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

Future inflation in China may inhibit our ability to conduct business in China.

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

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

The majority of our revenues will be settled in RMB and U.S. dollars, and any future restrictions on currency exchanges may limit our ability to use revenue generated in RMB to fund any future business activities outside China or to make dividend or other payments in U.S. dollars. Although the Chinese government introduced regulations in 1996 to allow greater convertibility of the RMB for current account transactions, significant restrictions still remain, including primarily the restriction that foreign-invested enterprises may only buy, sell or remit foreign currencies after providing valid commercial documents, at those banks in China authorized to conduct foreign exchange business. In addition, conversion of RMB for capital account items, including direct investment and loans, is subject to governmental approval in China, and companies are required to open and maintain separate foreign exchange accounts for capital account items. We cannot be certain that the Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of the RMB.

Fluctuations in exchange rates could adversely affect our business and the value of our securities.

The value of our common stock will be indirectly affected by the foreign exchange rate between U.S. dollars and RMB and between those currencies and other currencies in which our sales may be denominated. Appreciation or depreciation in the value of the RMB relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business or results of operations. Fluctuations in the exchange rate will also affect the relative value of any dividend we issue that will be exchanged into U.S. dollars as well as earnings from, and the value of, any U.S. dollar-denominated investments we make in the future.

Since July 2005, the RMB is no longer pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the RMB may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future PRC authorities may lift restrictions on fluctuations in the RMB exchange rate and lessen intervention in the foreign exchange market.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions. While we may enter into hedging transactions in the future, the availability and effectiveness of these transactions may be limited, and we may not be able to successfully hedge our exposure at all. In addition, our foreign currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into foreign currencies.

Restrictions under PRC law on our PRC subsidiary's ability to make dividends and other distributions could materially and adversely affect our ability to grow, make investments or acquisitions that could benefit our business, pay dividends to you, and otherwise fund and conduct our businesses.

Substantially all of our revenues are earned by QHS, our PRC subsidiary. PRC regulations restrict the ability of our PRC subsidiary to make dividends and other payments to its offshore parent company. PRC legal restrictions permit payments of dividend by our PRC subsidiary only out of its accumulated after-tax profits, if any, determined in accordance with PRC accounting standards and regulations. Our PRC subsidiary is also required under PRC laws and regulations to allocate at least 10% of our annual after-tax profits determined in accordance with PRC GAAP to a statutory general reserve fund until the amounts in said fund reaches 50% of our registered capital status. Allocations to these statutory reserve funds can only be used for specific purposes and are not transferable to us in the form of loans, advances or cash dividends. Any limitations on the ability of our PRC subsidiary to transfer funds to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends and otherwise fund and conduct our business.

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

In October 2005, SAFE, issued the Notice on Relevant Issues in the Foreign Exchange Control over Financing and Return Investment Through Special Purpose Companies by Residents Inside China, generally referred to as Circular 75, which required PRC residents to register with the competent local SAFE branch before establishing or acquiring control over an offshore special purpose company, or SPV, for the purpose of engaging in an equity financing outside of China on the strength of domestic PRC assets originally held by those residents. Internal implementing guidelines issued by SAFE, which became public in June 2007 (known as Notice 106), expanded the reach of Circular 75 by (1) purporting to cover the establishment or acquisition of control by PRC residents of offshore entities which merely acquire "control" over domestic companies or assets, even in the absence of legal ownership; (2) adding requirements relating to the source of the PRC resident's funds used to establish or acquire the offshore entity; covering the use of existing offshore entities for offshore financings; (3) purporting to cover situations in which an offshore SPV establishes a new subsidiary in China or acquires an unrelated company or unrelated assets in China; and (4) making the domestic affiliate of the SPV responsible for the accuracy of certain documents which must be filed in connection with any such registration, notably, the business plan which describes the overseas financing and the use of proceeds. Amendments to registrations made under Circular 75 are required in connection with any increase or decrease of capital, transfer of shares, mergers and acquisitions, equity investment or creation of any security interest in any assets located in China to guarantee offshore obligations, and Notice 106 makes the offshore SPV jointly responsible for these filings. In the case of an SPV which was established, and which acquired a related domestic company or assets, before the implementation date of Circular 75, a retroactive SAFE registration was required to have been completed before March 31, 2006; this date was subsequently extended indefinitely by Notice 106, which also required that the registrant establish that all foreign exchange transactions undertaken by the SPV and its affiliates were in compliance with applicable laws and regulations. Failure to comply with the requirements of Circular 75, as applied by SAFE in accordance with Notice 106, may result in fines and other penalties under PRC laws for evasion of applicable foreign exchange restrictions. Any such failure could also result in the SPV's affiliates being impeded or prevented from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to the SPV, or from engaging in other transfers of funds into or out of China.

We have advised our shareholders who are PRC residents, as defined in Circular 75, to register with the relevant branch of SAFE, as currently required, in connection with their equity interests in us and our acquisitions of equity interests in our PRC subsidiaries. However, we cannot provide any assurances that their existing registrations have fully complied with, and they have made all necessary amendments to their registration to fully comply with, all applicable registrations or approvals required by Circular 75. Moreover, because of uncertainty over how Circular 75 will be interpreted and implemented, and how or whether SAFE will apply it to us, we cannot predict how it will affect our business operations or future strategies. For example, our present and prospective PRC subsidiaries' ability to conduct foreign exchange activities, such as the remittance of dividends and foreign currency-denominated borrowings, may be subject to compliance with Circular 75 by our PRC resident beneficial holders. In addition, such PRC residents may not always be able to complete the necessary registration procedures required by Circular 75. We also have little control over either our present or prospective direct or indirect shareholders or the outcome of such registration procedures. A failure by our PRC resident beneficial holders or future PRC resident shareholders to comply with Circular 75, if SAFE requires it, could subject these PRC resident beneficial holders to fines or legal sanctions, restrict our overseas or cross-border investment activities, limit our subsidiaries' ability to make distributions or pay dividends or affect our ownership structure, which could adversely affect our business and prospects.

Our business and financial performance may be materially adversely affected if the PRC regulatory authorities determine that our acquisition of QHS constitutes a Round-trip Investment without MOFCOM approval.

On August 8, 2006, six PRC regulatory agencies promulgated the Regulation on Mergers and Acquisitions of Domestic Companies by Foreign Investors, or the 2006 M&A Rule, which became effective on September 8, 2006. According to the 2006 M&A Rule, when a PRC business that is owned by PRC individual(s) is sold to a non-PRC entity that is established or controlled, directly or indirectly, by those same PRC individual(s) it must be approved by the Ministry of Commerce, or MOFCOM, and any indirect arrangement or series of arrangements which achieves the same end result without the approval of MOFCOM is a violation of PRC law.

The general manager of QHS, our chief executive officer, Mr. Tao Wang, as a PRC citizen, entered into a option agreement ("Incentive Option Agreement") and an entrustment agreement ("Entrustment Agreement") with Renhuan Shi, a Korean passport holder. Mr. Shi currently holds all of the equity of Swift Dynamic Limited ("Swift Dynamic"), the majority shareholder of Glory Reach. This equity is held by a non-Chinese citizen in order to comply with Chinese law. Shi is obligated under the terms of the Incentive Option Agreement to transfer the equity of Swift Dynamic to Mr. Wang in the event Mr. Wang exercises his option to purchase such equity after such option vests. Vesting will occur at a rate of 1/3 per year for the next three years so long as our company meets revenue targets of RMB95,200,000 in 2009 (approximately $13,965,907), RMB96,150,000 in 2010 (approximately $14,105,282) and RMB97,100,000 in 2011 (approximately $14,244,638) and Mr. Wang has been retained as our chief executive officer and a director of our company for at least three years. In connection with the Incentive Option Agreement, Mr. Shi may not transfer the equity of Swift Dynamic other than to Mr. Wang or Mr. Wang's designees. Under the terms of the Entrustment Agreement, Mr. Shi has granted to Mr. Wang the right to control the voting of Swift Dynamic. Because of the rights granted to Mr. Wang under these agreements, Mr. Wang is deemed the beneficial owner.

After Mr. Wang exercises this option, he will, through his ownership of Swift Dynamic, be our controlling stockholder. His acquisition of our equity interest, or the Acquisition, is required to be registered with the competent Administration of Industry and Commerce authorities, or AIC, in Beijing. Mr. Wang will also be required to make filings with the SAFE to register the Company and its non-PRC subsidiaries to qualify them as SPVs, pursuant to Circular 75 and Circular 106.

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