Qingdao Footwear, Inc.
Form 8-K/A
November 04, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K/A

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported): February 12, 2010

Qingdao Footwear, Inc.
(Formerly Datone, Inc.)
(Exact name of registrant as specified in its charter)

Delaware	000-53075	16-1591157
(State or other jurisdiction of incorporation or organization)	(Commission File Number)	(IRS Employer Identification No.)

Qingdao Footwear, Inc.
269 First Huashan Road
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Shandong, PRC

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Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a -12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d -2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e -4(c))

Explanatory Note:

The purpose of this second amendment to the Form 8-K filed February 12, 2010 and amended on August 3, 2010 is to include restated financial statements for the year ended December 31, 2009 and to update Mangement's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2009. In particular, the financial statements have been restated to reflect an understatement of tax liabilities for the period, as previously disclosed in a current report on Form 8-K filed on October 14, 2010.

Except as amended hereby, the Registrant is not amending the previously filed Form 8-K.

ITEM 2.01 COMPLETION OF ACQUISITION OR DISPOSITION OF ASSETS

Management's Discussion and Analysis of Financial Condition and Results of Operations

Disclaimer Regarding Forward-Looking Statements

Our discussion includes forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions. Actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth under the Risk Factors, Cautionary Notice Regarding Forward-Looking Statements and Business sections in this registration statement. We use terms such as "anticipate," "estimate," "plan," "project," "continuing," "ongoing," "expect," "believe," "intend," "may," "will," "should," "could," and similar expressions to identify forward-looking statements. The following discussion of the financial condition and results of operation of the Company for the fiscal years ended December 31, 2009 and 2008, should be read in conjunction with the selected financial data, the financial statements and the notes to those statements that are included elsewhere in this registration statement.

The discussion of the results of operations below are of Qingdao Footwear and its subsidiaries, Glory Reach and QHS, and have been derived from the financial statements that are included elsewhere in this prospectus. Glory Reach is deemed to be the accounting acquirer in the share exchange transaction consummated as of February 12, 2010, which is further described in the section, "Our Corporate Structure" in this prospectus. Since there is common control between Glory Reach and Qingdao Shoes, for accounting purposes, the acquisitions of Qingdao Shoes has been treated as a recapitalization with no adjustment to the historical basis of their assets and liabilities.

The restructuring has been accounted for using the "as if" pooling method of accounting and the operations were consolidated as if the restructuring had occurred as of the beginning of the earliest period presented in our consolidated financial statements and the current corporate structure had been in existence throughout the periods covered by our consolidated financial statements.

Overview

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. We are focused on providing footwear that rises to the style, quality and comfort demands of a high-end consumer at affordable prices within reach of middle market office employees. Our products can be divided into men's and women's casual and formal footwear. Along with the growth in urbanization and individual purchasing power in China, the demand for leather footwear has also grown. Since our organization in 2003, we have grown rapidly throughout Shandong province, a province that has approximately one-third the number of people of the United States.

Our principal business includes (1) designing and selecting designs for 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"). We do not manufacture or assemble any shoes. 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. We believe that the sale of our products through distributors and third parties has enabled us to grow by exploiting their local retail expertise and economies of scale while minimizing our expenditure on fixed asset and human resources. 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.

Principal Factors Affecting Our Financial and Operational Results

Our financial results of operations have been and will continue to be affected by a number of factors, including but not limited to the following factors:

Growth in the broader PRC economy

Our financial condition and results of operations have been driven by macro-economic conditions, increased disposable income and consumer spending in the PRC. Since our formation, we have derived 100% of our income from operations in China. Along with growth in the economy as a whole, Chinese domestic consumption has increased in line with rapid urbanization and increases in disposable income over the past 15 years. Per capita urban disposable income has increased by an annualized rate of 12.9% over the 5 years ending in 2008 and is anticipated to top $2,000 in 2012. The urban population as a percentage of the total population increased from 40.6% in 2003 to 46.6% at the end of 2009, and this trend is expected to continue into the future. (National Bureau of Statistics of China, www.stats.gov.cn) The United Nations estimates that China's population is likely to be evenly split between rural and urban areas by 2015. ("Urbanization in the People's Republic of China," www.wikipedia.org) We expect that financial performance will continue to be driven by the positive trends in retail consumption, urbanization and increased consumer spending in the future.

Increased consumer demand for leather footwear products in the PRC

Consumer demand for leather footwear products in the PRC is a key driver of our continued growth. The success of our enterprise depends in large part on the growth in the PRC consumer market, particularly consumer demand for high quality, affordable leather shoes. As average living standards in the PRC continue to improve and a larger percentage of employment opportunities become available in an urban office or service economy setting, we expect consumer demand in the PRC to shift increasingly towards footwear appropriate to such settings, such as fine leather footwear. 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, China's shoe consumption rate is 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 to continue to grow for the immediate future.

Management and Expansion of Our Distribution Network

The majority of our sales are derived through third party distributors. As such, management of our brand through and collection of receivables from these parties is paramount to our success and future growth. We manage our brand by controlling how our products are placed, selecting store locations and decoration, and other qualitative measures. We regularly visit and inspect third party stores in order to ensure they meet our high standards for appearance, quality and service.

In the past, we had managed receivables from our third parties by requiring full payment for goods within one month of delivery. Beginning with our sales fair in February 2010, we extended credit to certain distributors. These distributors were selected based on outstanding track records in both sales and timely payments. We extended this credit in order to enhance their ability to increase sales responsibly and reward them for past success and loyalty. The extension of credit allows these distributors to grow cost effectively in accordance with our goal of achieving greater penetration in the Shandong retail market. It also encourages them to purchase our new models of footwear. We monitor our receivables carefully and reserve the right to terminate contracts with any supplier whose payments are not timely. We have maintained strong and positive long term relationships with all the distributors that we extended credit periods to and have rarely encountered any difficulties on collection of accounts receivable and do not anticipate collection issues in the future. We encourage such timely repayment by maintaining regular communication with these distributors. Management believes that it has already taken adequate measures to ensure timely settlement by the distributors, and the extended credit period has not and will not materially adversely affected our liquidity or working capital.

Effective cost management and quality control in our supply chain

Our footwear is designed in house, but production of our footwear is entirely outsourced. To meet production requirements and to remain profitable, we must be able to count on our suppliers for quality product at reasonable prices delivered in a timely manner at commercially reasonable prices. Therefore, it is vital to our success that we are able to maintain control of our supply chain. We believe that we will be able to offset a portion of any such increased costs through improvement of production efficiency and use of economies of scale. Historically, we have been successful in containing cost of goods sold as a percentage of total cost of sales. For 2008 and 2009 our cost of goods sold accounted for 59% and 57% of total sales, respectively. We seek to capitalize on overcapacity in the footwear manufacturing industry in the PRC and leverage our purchasing power to continue to obtain favorable prices from our major suppliers. Should costs increase in the markets from which we currently source products, we are confident that we will be able to find alternative footwear providers throughout Southeast Asia. We actively work with our suppliers to maintain quality and reserve the right to return goods that do not meet our standards.

Competitive Pricing Points and Attractive Product Designs

We have been able to maintain strong gross profit margins through competitive pricing of our products and effective cost management. To increase sales volumes, our pricing policy is to offer a range of products set at different price points with the aim of targeting different segments within the mid-range market. In order to maintain our price competitiveness and sales volumes, we review our pricing strategy regularly to make adjustments based on various factors, including the market response to existing recommended retail prices, the level of sales, the expected product margin on individual products, the prices of our competitors' products and the anticipated market trends and expected demand from customers.

We pursue a variety of designs that offer a diversified product mix and provide a wide range of leather footwear styles to our customers, which we believe to be vital to attracting customers and to increasing our revenue. Our designers have historically produced more than 300 unique designs annually which vary by season and target demographic. We strive to find innovative styles and technologies to incorporate into our shoes and always meet the highest and most popular styles for our customers. In the coming years, we will monitor demand and adjust our products accordingly to maximize sales and profit.

Ability to maintain brand recognition and marketing success

We believe that brand recognition drives consumer product selection. We will continue to invest our efforts in brand building and establishing Hongguan as a quality affordable footwear brand rising to the highest fashion standards while remaining within reach of a smaller budget consumer. We place great emphasis on our brand and promote Hongguan products through advertisements in the media, sales fairs and various other promotional activities. We intend to increase our marketing budgets for promotional activities in the future in order to further strengthen our brand and market position.

Previous Organization and Reverse Acquisition

During fiscal year 2009, our company's corporate entity, Datone, Inc., was a provider of both privately owned and company owned payphones and stations in New York. Datone, Inc. received revenues from the collection of the payphone coinage, a portion of usage of service from each payphone and a percentage of long distance calls placed from each payphone from the telecommunications service providers. In addition, Datone, Inc. also received revenues from the service and repair of privately owned payphones and sales of payphone units.

On February 12, 2010, our company completed a reverse acquisition transaction through a share exchange with Glory Reach and the shareholders of Glory Reach (the "Glory Reach Shareholders"), whereby Qingdao Footwear (Datone, Inc. at the time) acquired 100% of the issued and outstanding capital stock of Glory Reach in exchange for 10,000 shares of Datone, Inc.'s Series A Preferred Stock. This preferred stock constituted 97% of our issued and outstanding capital stock on an as-converted to common stock basis as of and immediately after the consummation of the reverse acquisition. As a result of the reverse acquisition, Glory Reach became our wholly-owned subsidiary and the Glory Reach Shareholders became our beneficially controlling stockholders. The share exchange transaction with Glory Reach was treated as a reverse acquisition, with Glory Reach as the acquirer and Datone, Inc. as the acquired party. In connection with this acquisition, Datone, Inc. changed its name to "Qingdao Footwear, Inc." and changed its operations from serving as a provider of payphones and stations in New York to serving as a holding company for a designer and retailer of branded footwear in Northern China.

As a result of our acquisition of Glory Reach, we now own all of the issued and outstanding capital stock of Glory Reach, which in turn owns all of the outstanding capital stock of QHS.

Results of Operations

Comparison of Years Ended December 31, 2009 and December 31, 2008

The following table sets forth key components of our results of operations during the twelve months periods ended December 31, 2009 and 2008, both in dollars and as a percentage of our net sales. As the reverse acquisition of Glory Reach was entered into after December 31, 2009 and during the periods indicated QHS was the only entity in our combined business that had operations, the results of operations below refer only to that of QHS.

	Year Ended December 31, 2009		Year Ended December 31, 2008	
	Amount	% of Net Sales	Amount	% of Net Sales
Net Sales	$ 17,863,891	100%	$ 13,904,314	100%
Cost of sales	10,162,778	57%	8,246,592	59%
Gross profit	7,701,113	43%	5,657,722	41%
Selling, General and Administrative Expenses	969,645	5%	814,830	6%
Operating Income	6,731,468	38%	4,842,892	35%
Other income & interest expense	27,318	0%	4,704	0%
Income Before Income Taxes	6,758,786	38%	4,847,596	35%
Income taxes	1,689,697	9%	1,211,899	9%
Net income	$ 5,069,089	28%	$ 3,635,697	26%

Net Sales. Our net sales increased to $17,863,891 in the year ended December 31, 2009 from $13,904,314 in 2008, representing a 28% increase year-over-year. In 2009, due to increased competition in the shoe manufacturing industry, we were able to adopt discounted prices to expand our brand's penetration. The average selling price per pair was lowered by 11.1% to $16.00 in 2009, as opposed $17.99 in 2008. We consider the sales incentive to be successful as the volume of footwear sold increased 44.5% to 1.1 million pairs in 2009, up from 780 thousand pairs in 2008. We will continue to actively monitor the market and adjust our pricing policy according with our revenue and profit goals. We expect continued positive growth trends in PRC retail sales and the market as a whole will support our further growth.

Included in our net sales for fiscal 2009 were net sales of $15,071,745 attributable to our wholesale operations (including third party stores and distributor's stores) and net sales of $2,792,146 attributable to our retail operations. Net sales from our wholesale operations increased $3,216,960, or approximately 27.1%, to $15,071,745 in 2009 compared to sales of $11,854,785 in fiscal 2008. Net sales from our retail operations increased $742,617, or 36.2% to $2,792,146 in fiscal 2009, compared to sales of $2,049,529 in 2008. The average selling price per pair within our wholesale operations decreased to $15.07 per pair for 2009 from $16.91 in 2008, a decrease of 10.9% while the average selling price per pair within our retail operations decreased to $23.95 per pair for 2009 from $28.47 in 2008, a decrease of 15.9%.

Cost of Sales. For the year ended December 31, 2009, cost of sales grew 23.2% to $10,162,778 or approximately 56.9% of net revenues as compared to cost of sales of $8,246,592, approximately 59.3% of net revenues for the year ended December 31, 2008. The primary component of our cost of sales by dollar volume was the purchase of footwear. The increase in cost of sales was largely caused by more footwear purchases. The average unit cost per pair decreased to $9.10 per pair for 2009 from $10.67 in 2008, a decrease of 14.7%. Due to the impact of the global slowdown and subsequent slump in PRC footwear exports, the footwear manufacturing environment is extremely competitive. As a result, we believe we will be able to continue to source high quality products at low costs.

Gross Profit and Gross Margin. Our gross profit increased to $7,701,113 in the year ended December 31, 2009 from $5,657,722 in 2008. Gross profit as a percentage of net revenue was 43% and 41% for the year ended December 31, 2009 and 2008, respectively. The increase is mainly due to the changes described above. The sales in own stores contributed 15.6% of sales in 2009, up from 15% in 2008. The self owned-stores' gross profit margin is approximately 60%, compared with 40% for third party and distributor sales.

Selling, General and Administrative Expenses. Our selling, general and administration grew slightly to $969,645 in the year ended December 31, 2009 from $814,830 in year 2008. This increase was mainly due to our rapid growth as we increased sales volume.

Other Income. Other income increased to $27,318 in the year ended December 31, 2009 from $4,704 in 2008.

Income Before Income Taxes. Our income before income taxes increased to $6,758,786 in the year ended December 31, 2009 from $4,847,596 in 2008. This increase was due to the general expansion in our operational scope.

Income Taxes. Income tax increased to $1,689,697 in the year ended December 31, 2009 from $1,211,899 in 2008. The increase was due to an increase in income, as our income tax rate remained the same.

Net Income. In the year ended December 31, 2009, we generated a net income of $5,069,089, an increase from $3,635,697 in 2008. This increase was primarily due to successful scaling out of our business model.

Liquidity and Capital Resources

At December 31, 2009, we had cash and cash equivalents of $61,131, as compared to cash and cash equivalents of $118,534 at December 31, 2008, primarily consisting of cash on hand and demand deposits. The following table provides detailed information about our net cash flow for all financial statement periods presented in this report. To date, we have financed our operations primarily through cash flows from operations and equity contributions by our shareholders.

The following table sets forth a summary of our cash flows for the periods indicated:

Cash Flows
(all amounts in U.S. dollars)

	Year Ended December 31,	
	2009	2008
Net cash provided by operating activities	$ 9,846,859	$ 7,746,685
Net cash used in investing activities	(384,655)	(37,944)
Net cash used in financing activities	(9,522,757)	(7,660,033)
Effects of Exchange Rate Change on Cash	3,150	35,218
Net Increase (Decrease) in Cash	(57,403)	83,926
Cash at Beginning of the Year	118,534	34,608
Cash at End of the Year	61,131	118,534

Operating activities

Net cash provided from operating activities was $9,846,859 for the fiscal year ended December 31, 2009, as compared to $7,746,685 of net cash provided by operating activities for the fiscal year ended December 31, 2008, an increase of $2,100,174. Our primary cash flows from net income were realized through the sale of footwear. Net income after deducting non-cash items provided cash inflows of $5,069,089 for the fiscal year ended December 31, 2009 as compared to $3,635,697 for the fiscal year ended December 31, 2008, an increase of $1,433,392. Cash flows from accounts receivable decreased by $96,456 for the fiscal year ended December 31, 2009 as compared with the fiscal year ended December 31, 2008. The increase in accounts receivable was primarily due to growth in sales. The ending balance of accounts receivable as of December 31, 2009 was consistent with our normal practice. Additionally, we maintained higher inventory levels to ensure timely deliveries at the request of major distributors as of the end of the fiscal year ended December 31, 2009 compared with the fiscal year 2008. For fiscal year 2009, the operational net cash outflow included an increase in accounts receivable of $95,428 and inventories of 154,977 respectively; while offset by an increase in tax payable of $4,949,978, accounts payable of $15,180 and a decrease of $1,179 in prepaid expenses. Our other working capital remained stable throughout the period.

Investing activities

Net cash used in investing activities for the year ended December 31, 2009 was $384,655 as compared to $37,944 for the year ended December 31, 2008. The cash used for investing activities in 2009 represents cash advanced to our chief executive officer of $323 and purchase of property and equipment of $384,332. The cash used in investing activities of 2008 represents the cash used for purchase of property and equipment.

Financing activities

Net cash used in financing activities for the year ended December 31, 2009 was $9,522,757, as compared to $7,660,033 for the year ended December 31, 2008. The cash used in financing activities of 2009 resulted from the distribution to shareholders of $9,786,817, and the repayment of bank loans of $1,437,660 by netting off the proceeds from bank loan of $1,701,720. In the PRC, short term loans are a commonly-used means of financing. Short term loans may need to be renewed under new terms at maturity. Although we have not received any commitments from our lenders to renew our short term loans, we have no reason to believe that our short term financing would not be renewed upon maturity. The cash used in financing activities of 2008 represents the distribution to shareholders.

Bank loans

Our bank loans include short-term loans and long-term loans. In our industry, it is customary to obtain such loans to meet cash flow and inventory needs.

Capital resources

We believe that our cash on hand and cash flow from operations will meet part of our present cash needs and we will require additional cash resources, to meet our expected capital expenditure and working capital for the next 12 months. We may, however, in the future, require additional cash resources due to changed business conditions, implementation of our strategy to ramp up our marketing efforts and increase brand awareness, or acquisitions we may decide to pursue. If our own financial resources are insufficient to satisfy our capital requirements, we may seek to sell additional equity or debt securities or obtain additional credit facilities. The sale of additional equity securities could result in dilution to our stockholders. The incurrence of indebtedness would result in increased debt service obligations and could require us to agree to operating and financial covenants that would restrict our operations. Financing may not be available in amounts or on terms acceptable to us, if at all. Any failure by us to raise additional funds on terms favorable to us, or at all, could limit our ability to expand our business operations and could harm our overall business prospects.

Inflation

Inflation and changing prices have not had a material effect on our business and we do not expect that inflation or changing prices will materially affect our business in the foreseeable future. However, our management will closely monitor the price change in the industry and continually maintain effective cost control in operations.

Off Balance Sheet Arrangements

We do not have any off balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity or capital expenditures or capital resources that is material to an investor in our securities.

Seasonality

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 first and fourth quarters due to seasonal purchases.

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 operation. 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

We generate revenues from the retail and wholesale of shoes. Sales revenues are recognized when the following four revenue criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectability is reasonably assured. Sales are presented net of value added tax ("VAT"). No return allowance is made as product returns have been insignificant in all periods.

Retail sales are recognized at the point of sale to customers. Wholesales to our contracted customers are recognized as revenue at the time the product is shipped and title passes to the customer on an FOB shipping point basis. Wholesale prices are predetermined and fixed based on contractual agreements. We do not allow any discounts, credits, rebates or similar privileges.

We do not grant any inventory pricing protection or other inventory adjusting policies to our distributors. The distributors are responsible for their purchased products types and volumes, unless any quality problems arise. If quality issues arise with our products, the products will be fully replaced by our manufacturers in accordance with the purchase agreement. As a result, we recognize our sales on delivery of our products to our wholesalers. For the retail customers, we only allow returns due to quality problems. We do not permit returns based on any other reason, and we do not believe such liberal return policies are common in China. Should there be any quality defects; customers have the right to return the shoes to the stores from which they purchased them. The stores then return them to our company, and we negotiate an acceptable solution with the manufacturers, which tends to vary with the facts in each case. According to our historical data, such returns are at approximately 0.01% of total sales and are not material to our financial statements.

In light of the low level of revenue dilution, we do not generally assess returns of products, levels of inventory, expected introductions of new products or external sources.

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We have not experienced any purchases of products in excess of ordinary course of business levels as a result of any incentives. In our experience, customers merely purchase their seasonal footwear needs more quickly—but not in greater numbers—than they might otherwise purchase in the absence of such incentives. This result is not surprising in an industry like the footwear industry, which is marked by seasonal sales on, for example, sandals during summer and boots during winter. As a result of such seasonal fluctuations, our customers endeavor not to maintain excessive inventory but do try to purchase seasonally-specific shoes shortly before the season.