CHINA EDUCATION ALLIANCE INC.
Form 10-Q
November 09, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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

For the transition period from ______________ to _____________

Commission file number: 001-34386

CHINA EDUCATION ALLIANCE, INC.
(Exact name of registrant as specified in its charter)

North Carolina (State or other jurisdiction of incorporation or organization)	56-2012361 (I.R.S. Employer Identification No.)
58 Heng Shan Road, Kun Lun Shopping Mall, Harbin, People's Republic of China (Address of principal executive offices)	150090 (Zip Code)

86-451-8233-5794
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o	Smaller reporting company	o

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

As of November 9, 2011 there were 10,582,503 shares of $0.001 par value common stock issued and outstanding.

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PART I –FINANCIAL INFORMATION

Item 1. Financial Statements

China Education Alliance, Inc. and Subsidiaries
Consolidated Balance Sheets

	September 30, 2011 (Unaudited)	December 31, 2010 (Audited)
ASSETS		
Current Assets		
Cash and cash equivalents	$ 73,738,147	$ 71,105,415
Accounts receivable	158,174	-
Other receivable	866,566	432,030
Prepaid expenses	2,127,893	2,834,976
Total current assets	76,890,779	74,372,421
Non-current Assets		
Note receivable	7,816,676	7,172,301
Property and equipment, net	8,420,669	9,946,729
Intangibles and capitalized software, net	12,671,056	1,515,381
Long-term investment	-	559,269
Deferred tax assets	363,580	-
Total non-current assets	29,271,980	19,193,680
Total Assets	$ 106,162,760	$ 93,566,101
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	$ 739,989	$ 686,102
Deferred revenues	997,561	1,072,373
Total current liabilities	1,737,551	1,758,475
Stockholders' Equity		
Common stock ($0.001 par value, 150,000,000 shares authorized, 10,582,503 and 10,420,637 issued at September 30, 2011 and December 31, 2010, respectively;and 137,512 shares held in treasury)	10,582	10,421
Additional paid-in capital	40,886,556	39,726,468
Statutory reserve	5,063,769	3,731,672
Retained earnings	48,407,580	44,591,566
Accumulated other comprehensive income	8,448,883	5,573,565
Less: Treasury stock	(977,072)	(977,072)
Stockholders' equity - China Education Alliance, Inc. and Subsidiaries	101,840,298	92,656,619
Noncontrolling interests in subsidiaries	2,584,911	(848,991)
Total stockholders' equity	104,425,209	91,807,627

Total Liabilities and stockholders's Equity	$ 106,162,760	$ 93,566,101

The accompanying notes are an integral part of these consolidated financial statements.

China Education Alliance, Inc. and Subsidiaries
Consolidated Statements of Operations
(Unaudited)

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Revenues				
Online education revenues	$ 5,330,692	$ 8,629,101	$ 14,458,244	$ 21,246,633
Training center revenues	4,147,879	5,223,860	11,618,155	11,013,279
Other Revenues	80,530	524,249	206,214	1,587,128
Total revenue	9,559,101	14,377,210	26,282,613	33,847,040
Cost of Goods Sold				
Online education costs	1,586,084	1,281,634	4,888,630	3,524,119
Training center costs	1,170,677	1,081,937	2,985,553	2,344,862
Other costs	10,603	36,776	28,986	114,613
Total cost of goods sold	2,767,364	2,400,347	7,903,170	5,983,594
Gross Profit				
Online education gross profit	3,744,607	7,347,467	9,569,614	17,722,514
Training center gross profit	2,977,203	4,141,923	8,632,602	8,668,417
Other gross profit	69,927	487,473	177,227	1,472,515
Total gross profit	6,791,737	11,976,863	18,379,443	27,863,446
Operating Expenses				
Selling expenses	2,199,187	5,182,765	7,743,091	10,902,529
Administrative	1,358,716	781,169	5,046,511	1,808,209
Depreciation and amortization	475,871	219,435	1,198,840	716,909
Total operating expenses	4,033,773	6,183,369	13,988,441	13,427,647
Income/(Loss) from operations	2,757,963	5,793,494	4,391,002	14,435,799
Other Income/ (Expense)				
Other income/(Expense)	(92,088)	631	(162,108)	21,769
Loss on disposal of fixed assets	(5,908)	-	(647,352)	-
Interest income	470,716	61,384	1,377,097	158,919
Investment loss	-	(526)	-	(8,132)
Total other income/(Expense)	372,721	61,489	567,638	172,556
Net Income Before Provision for Income Tax	3,130,684	5,854,983	4,958,639	14,608,355
Income taxes:				
Current	(54,622)	(638,216)	175,429	(1,531,361)
Deferred	(77,884)	-	14,042	-
Net Income	2,998,178	5,216,767	5,148,111	13,076,994
Net Income attributable to the noncontrolling interests	177,136	161,018	96,530	101,333
Net Income/(Loss) - attributable to CEU and Subsidiaries	$ 3,175,313	$ 5,377,785	$ 5,244,640	$ 13,178,327

Basic Earnings Per Share	$ 0.30	$ 0.52	$ 0.50	$ 1.25
Diluted Earnings Per Share	$ 0.30	$ 0.51	$ 0.50	$ 1.25
Basic Weighted Average Shares Outstanding	10,582,503	10,441,245	10,568,979	10,509,797
Diluted Weighted Average Shares Outstanding	10,582,503	10,454,418	10,568,979	10,544,575
The Components of Other Comprehensive Income				
Net income/(Loss)	$ 3,175,313	$ 5,377,785	$ 5,244,640	$ 13,178,327
Foreign currency translation adjustment	2,353,258	1,271,450	2,875,318	1,441,115
Comprehensive income	$ 5,528,571	$ 6,649,235	$ 8,119,958	$ 14,619,442

The accompanying notes are an integral part of these consolidated financial statements.

China Education Alliance, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities		
Net Income	$ 5,148,111	$ 13,076,994
Adjustments to reconcile net income to net cash provided by		
Operating activities		
Depreciation and amortization	1,198,840	1,244,677
Loss on disposal of fixed assets	641,444	-
Stock based compensation	1,161,211	169,710
Loss on equity investment	-	8,710
Deferred tax assets	(347,801)	-
Net change in assets and liabilities		
Account receivables	(155,739)	(632,276)
Prepaid expenses and other	948,608	655,210
Accounts payable and accrued liabilities	198,362	1,212,226
Other payable/receivable	(519,030)	-
Deferred revenue	(281,873)	1,174,971
Net cash provided by operating activities	7,992,133	16,910,222
Cash flows from investing activities		
Purchases of property and equipment	-	(760,273)
Proceeds from disposal of fixed assets	1,765,322	-
Deposit on fixed asset acquisition	-	(4,553,530)
Cash used for acquisitions	(7,860,157)	(884,938)
Net cash used in investing activities	(6,094,835)	(6,198,741)
Cash flows from financing activities		
Warrants exercised	-	298,749
Options exercised	-	38,657
Net cash provided by financing activities	-	337,406
Effect of exchange rate changes on cash	735,434	1,441,115
Net increase in cash	2,632,732	12,490,002
Cash and cash equivalents at beginning of period	71,105,415	65,035,332
Cash and cash equivalents at end of period	$ 73,738,147	$ 77,525,334
Supplemental disclosure of cash flow information		
Income taxes paid	$ 613,842	$ 1,428,684
Non-cash investing and financing activities		
Conversion of preferred stock to common	$ -	$ 1,867,644
Cancellation of WEI Acquisition	$ -	$ 932,000

The accompanying notes are an integral part of these consolidated financial statements.

China Education Alliance, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

1. Description of Business

Nature of organization - China Education Alliance, Inc. (the “Company” or “we”), formerly known as ABC Realty Co., was originally organized under the laws of the State of North Carolina on December 2, 1996. ABC Realty Co.’s primary purpose was to act as a broker or agent in residential real estate transactions. On September 15, 2004, ABC Realty Co. was reorganized pursuant to a plan of exchange (the “Plan of Exchange”) to acquire Harbin Zhong He Li Da Education Technology, Inc. (“ZHLD”), a corporation formed on August 9, 2004 in the City of Harbin in the Heilongjiang Province, People’s Republic of China (the “PRC”), with an authorized capital of $60,386 (RMB500,000).

On September 15, 2004, ABC Realty Co. executed a Plan of Exchange with ZHLD and Duane C. Bennett, the former Chairman of ABC Realty Co., pursuant to which the shareholders of ZHLD exchanged all of their registered capital of $60,386 for 18,333,334 shares of common stock of the Company, or approximately 95% of the Company’s common stock. On November 17, 2004, ABC Realty Co. changed its name to China Education Alliance, Inc. On December 13, 2004, China Education Alliance, Inc. consummated the Plan of Exchange with ZHLD and ZHLD’s shareholders. As a result of the Plan of Exchange, the transaction was treated for accounting purposes as a recapitalization of ZHLD.

ZHLD is a technology company engaged in the online education industry in the People’s Republic of China. Its mission is to promote online exam preparation services in the People’s Republic of China, to improve the efficiency and effectiveness of elementary education, secondary education, vocational education, skill education, continuing education, and professional training programs, and to integrate with the international education system.

ZHLD’s subsidiary, Heilongjiang Zhonghe Education Training Center (“ZHTC”) was registered in the PRC on July 8, 2005 with a registered capital of $60,386 and is accounted for as a wholly owned subsidiary of ZHLD. ZHLD owns 99% of ZHTC with 1% held in trust by Xiqun Yu, the Company’s CEO, for the benefit of China Education Alliance, Inc.

ZHLD also owns 70% of Beijing Hua Yu Hui Zhong Technology Development Co., Ltd. (“BHYHZ”). BHYHZ was formed on September 30, 2006 in the PRC. The remaining 30% interest was given to The Vocational Education Guidance Center of China (the “Guidance Center”) for no consideration. The 30% interest in BHYHZ that the Company transferred to the Guidance Center for no consideration was treated as an intangible asset. The minority ownership interest shares of operating losses of BHYHZ are being absorbed by the Company, as the minority interest holdings have no basis in their investment.

On April 18, 2008, ZHLD entered into an agreement and supplementary agreement with Harbin Daily Newspaper Group (“Newspaper Group”) to invest in a joint venture company, Harbin New Discovery Media Co., Ltd. (“New Discovery”). ZHLD contributed RMB 3,000 000 (approximately, $430,000) and Newspaper Group contributed RMB 3,120,000 (approximately, $445,000) towards the registered capital of New Discovery. In return for their respective contributions, ZHLD holds a 49.02% ownership interest and Newspaper Group holds a 50.98% ownership interest in New Discovery. The parties are prohibited, for the duration of the joint venture from retiring or transferring their ownership interests. This joint venture will create new educational material distribution channels in readable newspaper format in the future. The value of this investment as of September 30, 2011 and 2010 was $0 and 0, respectively.

On January 4, 2009, China Education Alliance's subsidiary, ZHLD entered into an agreement with Mr. Guang Li to jointly incorporate and invest in a joint venture company, Zhong He Li Da (Beijing) Management Consultant Co., Ltd. ("ZHLDBJ"). ZHLD contributed RMB 425,000 (approximately, $62,107), and Mr. Guang Li contributed RMB 75,000 (approximately, $10,960) towards the registered capital of ZHLDBJ, amounting to a total registered capital of 500,000 RMB (approximately, $73,067). In return for their respective contributions, ZHLD holds an 85% ownership interest, and Mr. Guang Li has a 15% ownership interest in ZHLDBJ. ZHLD has authorized Mr. Xiqun Yu, the Company CEO, to hold 20% of its ownership interest of ZHLDBJ on its behalf. ZHLDBJ will be involved in the vocational training business which includes IT engineering and accounting training, in particular, in running the "Million Managers Training Program", with the goal of improving participants' management skills and designing a complete solution for management, clients and suppliers.

On March 4, 2011, the Company entered into a management agreement (the “Management Agreement”) with Nanchang Institute of Technology (“NIT”), a vocational training institution based in Nanchang, People’s Republic of China. Pursuant to the Agreement, the Company will assist in managing the daily operations of NIT for ten years for an annual management fee of RMB 10 million (approximately $1,461,347). The management fee is payable on a quarterly basis and in the event of late payment, a late fee is imposed. Additionally, a liquidated damage of RMB 50 million (approximately $7,306,736) will be paid by the party that defaults on the agreement.

In connection with the Management Agreement, the Company entered in to a loan agreement (the “Loan Agreement”), pursuant to which the Company agreed to loan NIT RMB 50 million (approximately $7,306,736) to build training facilities and NIT will repay the RMB 50 million in ten years from the date NIT receives the principal. The Company loaned NIT approximately 47,000,000 RMB pursuant to this agreement in December 2010. The loan has an annual interest rate of 20% and the interest will be waived by the Company if NIT makes all payments under the Management Agreement in a timely manner. Currently, we receive 20 % annual interest income due each quarter; therefore, the management fee is waived. The loan is secured by the assets of certain guarantors.

On March 14, 2011 the Company entered into a Share Transfer Agreement with the shareholder of Harbin Tianlang Culture and Education School (“Tianlang”), a tutoring school with 5,000 current students, based in Harbin, People’s Republic of China. Pursuant to the Share Transfer Agreement, the Company agreed to purchase 60% of the equity interests of Tianlang for RMB 35 million (approximately $5.3 million). The shareholder and the Company also agreed to provide RMB 2 million (approximately $0.3 million) and RMB 3 million (approximately $0.5 million) as working capital for Tianlang, respectively. Tianlang had established a new board of directors with five directors, of which three directors were appointed by the Company and two directors were appointed by the shareholder.

The acquisition of Tianlang was not officially completed until April 2011. We are currently co-managing Tianlang with the previous majority owner. The approximately $5.3 million paid by the Company is included in intangible assets on the accompanying September 30, 2011 balance sheet.

On May 31, 2011, the Company entered into Share Transfer Agreements (the “Agreements”) with the shareholders (the “Shareholders”) of Changchun City Chaoyang District Nuoya Foreign Languages School (“Changchun Nuoya”) and Harbin City Nangang District Nuoya Foreign Languages School (“Harbin Nuoya”), two foreign language schools that have a total of 1,000 current students, based in the People’s Republic of China.

Pursuant to the Agreements, the Company agreed to purchase 100% of the two schools for RMB 8 million each (approximately $1.23 million). The purchase price shall be paid as follows: RMB 500,000 (approximately $76, 852) to be paid on the date when documents for the share transfer are accepted for processing by the government authorities and RMB 7,500,000 (approximately $1.15 million) to be paid within five business days after receipt of new licenses for operation. The Shareholders’ obligations under the Agreements are guaranteed by a guarantor who will be jointly and severally liable in the event of a breach by the Shareholders.

The acquisition of Changchun Nuoya and Harbin Nuoya was completed by the end of May 2011 and their financial statements have been consolidated with the Company’s financial statements since May 2011. The acquired net assets were identifiable intangible assets such as brand value, courses materials and student lists, and the economic useful life was amortized over 10 years. The approximately $2.5 million (RMB 16,000,000) paid by the Company is included in intangible assets in the accompanying September 30, 2011 balance sheet.

2 Basis of Preparation of Financial Statements

The accompanying consolidated financial statements differ from the financial statements used for statutory purposes in the PRC in that they have been prepared in compliance with U.S. generally accepted accounting principles ("GAAP") and reflect certain adjustments, recorded on the entities' books, which are appropriate to present the financial position, results of operations and cash flows in accordance with GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, and depreciation and valuation of property and equipment and intangible assets.

These consolidated financial statements for interim periods are unaudited. In the opinion of management, all adjustments, consisting of normal, recurring adjustments and disclosures necessary for a fair presentation of these interim statements have been included. The results reported in these consolidated interim financial statements are not necessarily indicative of the results that may be reported for the entire year. The accompanying consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and do not include all information and footnotes necessary for a complete presentation of financial statements in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed on April 15, 2011.

3. Summary of Significant Accounting Policies

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and wholly and its majority owned subsidiaries. All inter-company transactions and balances were eliminated.

Use of estimates - The preparation of these financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of net sales and expenses during the reported periods.

Significant estimates include values and lives assigned to acquired intangible assets, the useful lives and impairment of property and equipment. Actual results may differ from these estimates.

Cash and cash equivalents - The Company considers all highly liquid debt instruments purchased with a maturity period of three months or less to be cash or cash equivalents. The carrying amounts reported in the accompanying condensed consolidated balance sheets for cash and cash equivalents approximate their fair value. Substantially all of the Company's cash is held in bank accounts in the PRC and is not protected by FDIC insurance or any other similar insurance. The cash that the Company maintains in US banks are insured up to $250,000 at each bank as of September 30, 2011. The Company's cash at their US banks are in excess of statutorily insured limits at September 30, 2011 and December 31, 2010.

Property and equipment - Property and equipment is stated at the historical cost, less accumulated depreciation. Depreciation on property, plant and equipment is provided using the straight-line method over the estimated useful lives of the assets after taking into account a 5% residual value for both financial and income tax reporting purposes as follows:

Buildings	20 years
Communication Equipment	10 years
Motor vehicles	5 years
Furniture, Fixtures, and Equipment	5 years

Expenditures for renewals and betterments are capitalized while repairs and maintenance costs are normally charged to the statement of operations in the year in which they are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalized as an additional cost of the asset.

Upon sale or disposal of an asset, the historical cost and related accumulated depreciation or amortization of such asset is removed from their respective accounts and any gain or loss is recorded in the Statements of Operations.

The Company reviews the carrying value of property, plant, and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, the manner in which the property is used, and the effects of obsolescence, demand, competition, and other economic factors.

Intangibles - Intangibles consist of franchise rights on educational products, capitalized software and New Shifan’s expertise, magazine rights and contest operation rights. Most intangible assets are amortized over the lives of the rights agreements, or their respective operational useful lives.

The Company evaluates the carrying value of intangible assets during the fourth quarter of each year and between annual evaluations if events occur, or circumstances change, that would more likely than not reduce the fair value of the intangible asset below its carrying amount. There were no impairments recorded during the nine months ended September 30, 2011 and the year ended December 31, 2010.

In April 2011, the Company purchased 60% of Tianlang for RMB 35 million (Approximately $5.3 million) and 100% ownership of Changchun Nuoya and Harbin Nuoya. These three schools net assets were identifiable intangible assets such as brand name, cost of materials, student list, course materials and student lists. The economic useful life is amortized over 10 years.

Long-lived assets under certain circumstances are reported at the lower of carrying amount or fair value. Assets to be disposed of and assets not expected to provide any future service potential to the Company are recorded at the lower of carrying amount or fair value less cost to sell. To the extent carrying values exceed fair values; an impairment loss is recognized in operating results.

Foreign Currency - The Company’s principal country of operations is the PRC. The financial position and results of operations of the Company are recorded in Renminbi (“RMB”) as the functional currency. The results of operations denominated in foreign currency are translated at the average rate of exchange during the respective reporting period.

Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the market rate of exchange at that date. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of capital contribution. All translation adjustments resulting from the translation of the financial statements into the reporting currency (“U.S. Dollars”) are recorded in accumulated other comprehensive income, a separate component within shareholders’ equity. The accompanying consolidated financial statements are presented in United States dollars (“US$”). The functional currency of the Company is Renminbi (“RMB”). The consolidated financial statements are translated into United States dollars from RMB at year-end exchange rates as to assets and liabilities and average exchange rates as to revenues and expenses. Capital accounts are translated at their historical exchange rates when the capital transactions occurred. The resulting translation adjustments are recorded as a component of shareholders’ equity included in comprehensive income. Gains and losses from foreign currency transactions are included in net income. There were no gains and losses from foreign currency transactions for the nine months ended September 30, 2011 and 2010.

	September 30, 2011	September 30, 2010
RMB: US$ exchange rate	6.38853	6.62270

	9 Months ended September 30, 2011	9 Months ended September 30, 2010
Average RMB: US$ exchange rate	6.48842	6.76950

Noncontrolling Interest - Noncontrolling interests in the Company's subsidiaries are recorded in accordance with the provisions of FASB Accounting Standards Codification 810 Consolidation ("ASC 810") and are reported as a component of equity, separate from the parent's equity. Purchase or sales of equity interests that do not result in a change of control are accounted for as equity transactions. Results of operations attributable to the noncontrolling interest are included in our consolidated results of operations and, upon loss of control, the interest sold, as well as interest retained, if any, will be reported at fair value with any gain or loss recognized in earnings.

Revenue recognition - Revenue is recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) the service has been rendered; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. The Company believes that these criteria are satisfied when customers download prepaid study materials.

Prepaid debit cards allow the Company's subscribers to purchase a predetermined monetary amount of download materials posted on its website. The Company tracks usage of the debit card and records revenue when the debit card is used.

At the time that the prepaid debit card is purchased, the receipt of cash is recorded as deferred revenue. Revenues are recognized in the month when card is used. Unused value relating to debit cards is recognized as revenues when the prepaid debit card expires.

Tuition from courses is recognized ratably over the period that fees are earned, typically the life of the course. The Company offers credits to students if they should withdraw, or be unable to complete their required courses. Historically the issuances of credits have not been high with regards to tuition fees. The Company offers cash refunds on a limited basis based on individual circumstances.

The Company engages an advertisement agency to manage its on-line advertisement revenue. Per the contract with this agency, upon posting of an on-line advertisement on the Company's website, the Company is entitled to share with the agency 50% of the amount charged to the on-line advertiser. The Company recognizes advertising revenue over the term of the advertisement. The agency is responsible for collection of all ad revenue from advertisers. The agency is required to make their remittance for on-line advertising six months after on-line ads are posted on their website.

Deferred revenue reflects the unearned portion of debit cards sold and tuition. Tuition is recognized as revenue ratably over the periods in which it is earned, generally the term of the program or as the debit card is used.

Accounts Receivables - Included in accounts receivables are receivables from advertising on the Company's websites and from the sale of prepaid debit cards to resellers. The sales of prepaid debit cards to resellers are recorded as deferred revenue until such time as the cards are used to download material from the Company's website. Total accounts receivables as of September 30, 2011 and December 31, 2010 was $158,174 and $0, respectively.

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The Company reviews its accounts receivables on a periodic basis and makes general and specific allowances when there is doubt as to the collectability of individual balances. In evaluating the collectability of individual receivable balances, the Company considers many factors, including the age of the balance, customer's historical payment history, its current credit-worthiness and current economic trends. Accounts are written off after exhaustive efforts at collection. If accounts receivable are to be provided for, or written off, they would be recognized in the consolidated statement of operations within operating expenses. At September 30, 2011 and December 31, 2010, the Company has not established an allowance for doubtful accounts, in addition the Company has not provided for, or written off, accounts receivable during the nine months ended September 30, 2011 and 2010.

Deferred Revenue - Deferred revenue reflects the unearned portion of debit cards sold and tuition payments received. Deferred revenue as of September 30, 2011 and December 31, 2010 was $997,561 and $1,072,373 respectively.

Advertising - The Company expenses advertising costs at the time they are published on the newspaper and for all other advertising the first time the respective advertising takes place. These costs are included in selling, general and administrative expenses. The total advertising expenses incurred for the three and nine months ended September 30, 2011 and 2010 were $155,086, $ 311,747 and $483,248 and $986,896, respectively.

Taxation - Taxation on profits earned in the PRC are calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the PRC after taking into effect the benefits from any special tax credits or "tax holidays" allowed in the PRC.

The Company does not accrue United States income tax on unremitted earnings from foreign operations, as it is the Company's intention to invest these earnings in foreign operations for the foreseeable future. All Company revenues are generated in the PRC. The Company's US operations provide corporate and administrative functions for the entire Company. The Company's tax provisions for the three and nine months periods ended September 30, 2011 and 2010 are related to the Company's PRC operations.

If the Company should have an uncertainty in accounting for income taxes, the Company evaluates a tax position in a two-step process. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation based on the technical merits of the position. The second step is to measure the tax position that meets the more-likely-than-not threshold to determine the amount of provision or benefit to be recognized in the financial statements. A tax position is measured at the largest amount of provision or benefit where there is a greater than 50% likelihood of being realized upon ultimate settlement.

Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent period in which the threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not criteria should be de-recognized in the first subsequent reporting period in which the threshold is no longer met.

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax provisions or benefits as of September 30, 2011, is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax provisions or benefits as of September 30, 2011, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax law and policy, that the unrecognized tax provisions or benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company's results of operations, financial condition or cash flows.

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Enterprise income tax

Under the Provisional Regulations of the PRC Concerning Income Tax on Enterprises promulgated by the State Council which came into effect on January 1, 1994, income tax is payable by Wholly Owned Foreign Enterprises (“WOFE’s”) at a rate of 15% of their taxable income. Preferential tax treatment may, however, be granted pursuant to any law or regulations from time to time promulgated by the State Council. ZHLD enjoyed a 100% exemption from enterprise income taxes during 2006 due to its classification as a WOFE. This exemption ended on December 31, 2006, at which time ZHLD qualified under the then current tax structure for a 50% reduction in the statutory enterprise income tax rates for the three years ended December 31, 2007, 2008 and 2009. For the years ended December 31, 2008 and 2007, ZHLD’s effective income tax rate was at 7.5%, based on having received a 50% exemption in the year ended December 31, 2007 when the prevailing effective tax rate was 30%, and an additional 50% exemption as ZHLD was a technology and software entity. During the year ended December 31, 2009, ZHLD obtained similar exemptions to those of the year ended December 31, 2008; however, the prevailing tax rate had a minimum threshold of 10% for the year ended December 31, 2009. In year 2011 ZHLD continues being qualified as a technology and software entity, and expects to receive a 15% statutory PRC enterprise income tax rate. The Company’s ZETC subsidiary is currently exempt from PRC taxation, as it operates a business enterprise engaged in educational opportunities. The Company’s other subsidiaries , BHYHZ, ZHLDBJ and New Shifan are taxed at the PRC statutory rate (25%), and have not accrued for taxes since inception, due to recurring losses or no income incurred since inception.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets, including tax loss and credit carry forwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company has deferred tax assets of $363,580 at September 30, 2011.

Value added tax

The Provisional Regulations of the People’s Republic of China Concerning Value Added Tax (VAT) promulgated by the State Council came into effect on January 1, 1994. Under these regulations and the Implementing Rules of the Provisional Regulations of the PRC Concerning Value Added Tax, VAT is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

VAT payable in the PRC is charged on an aggregated basis at a rate of 13% or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided, but excluding, in respect of both goods and services, any amount paid in respect of VAT included in the price or charges, less any deductible VAT already paid by the taxpayer on purchases of goods and services in the same financial year. The Company records all revenues net of VAT taxes.

Related party- A related party is a company, or individual, in which a director or an officer has beneficial interests in and in which the Company has significant influence.

As of September 30, 2011 and December 31, 2010 the Company has no related party transactions.

Stock based compensation - The Company records compensation expense associated with stock-based awards and other forms of equity compensation. Such compensation would include the recording of cost resulting from all stock-based payment transactions including shares issued under its stock option plans. The Company records expense over the vesting period in connection with stock options granted. The compensation expense for stock-based awards includes an estimate for forfeitures and is recognized over the expected term of the award on a straight-line basis.

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Fair value of financial instruments - The Company has adopted newly issued generally accepted accounting principles with regards to fair value measurement for assets and liabilities that establishes a common definition for fair value to be applied to existing generally accepted accounting principles that require the use of fair value measurements, establishes a framework for measuring fair value and expands disclosure about such fair value measurements. The adoption of these recently issued principles did not have an impact on the Company's financial position or operating results, but did expand certain disclosures.

Current fair value of financial instruments defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Additionally, current standards require the use of valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized below:

Level 1: Observable inputs such as quoted market prices in active markets for identical assets or liabilities

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data

Level 3: Unobservable inputs for which there is little or no market data, which require the use of the reporting entity's own assumptions.

The Company did not have any Level 2 or Level 3 assets or liabilities as of September 30, 2011.

Cash and cash equivalents of approximately $73,738,000 and $71,105,000 as of September 30, 2011 and December 31, 2010, include money market securities and commercial paper that are considered to be highly liquid and easily tradable as of September 30, 2011. These securities are valued using inputs observable in active markets for identical securities and are therefore classified as Level 1 within our fair value hierarchy.

In addition to fair value requirements noted above, recent standards expands opportunities for the use of fair value measurements in financial reporting and permits entities to choose to measure many financial instruments and certain other items at fair value. The Company did not elect the fair value options for any of its qualifying financial instruments.

Reverse Stock Split – On September 26, 2011 the Company effected a one-for-three reverse stock split of its issued and outstanding common stock. All common share based data in the financial statements has been retroactively restated to reflect this reverse stock split.

Reclassifications - Certain reclassifications have been made to the prior periods' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or the sum of retained earnings and statutory reserve.

Recent accounting pronouncements

A variety of proposed or otherwise potential accounting standards are currently under study by standard setting organizations and various regulatory agencies. Due to the tentative and preliminary nature of those proposed standards, management has not determined whether implementation of such proposed standards would be material to the consolidated statements.

4. Concentrations of Business and Credit Risk

The majority of the Company’s bank accounts in banks located in the PRC are not covered by any type of protection similar to that provided by the FDIC on funds held in U.S banks.

The Company is operating in the People’s Republic of China, which may give rise to significant foreign currency risks from fluctuations and the degree of volatility of foreign exchange rates between the U.S. dollar and the RMB.

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and trade receivables, the balances of which are stated on the balance sheet. The Company places its cash in high credit quality financial institutions; however, such funds are not insured in the PRC. As of September 30, 2011 and December 31, 2010, the Company maintains cash in the US, in a financial institution insured by the FDIC that has approximately $24,000 and $960,000, respectively, in funds in excess of FDIC insured amounts.

5. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	September 30, 2011	December 31, 2010
Cash on Hand -China	$ 45,920	$ 4,588
Bank Deposits-China	73,105,492	69,640,382
Bank Deposits-US	586,735	1,460,445
	$ 73,738,147	$ 71,105,415

As of September 30, 2011, approximately $770,000 on the books of Tianlang School was included in Chinese bank deposits. This amount is in a bank account that is nominally in the name of the schools non-controlling interest owner, the original shareholder of Tianlang School. However, the account is under joint control pursuant to a co-management agreement between the Company and the non-controlling interest owner.

6. Prepaid Expenses

Prepaid Expenses consist of the following:

	September 30, 2011	December 31, 2010
Prepaid rent	$ 374,645	$ 253,073
Prepaid teachers and online material	736,647	401,962
Prepaid services and professional fees	480,422	78,543
Prepaid advertising	275,496	712,700
Other prepaid expenses	261,683	1,388,698
	$ 2,127,893	$ 2,834,976

7. Note receivable

On March 4, 2011, the Company entered into a management agreement (the “Management Agreement”) with Nanchang Institute of Technology (“NIT”), a vocational training institution based in Nanchang, People’s Republic of China. Pursuant to the Agreement, the Company will manage the daily operations of NIT for ten years for an annual management fee of RMB 10 million. The management fee is payable on a quarterly basis and in the event of late payment, a late fee is imposed. Additionally, a liquidated damage of RMB 50 million will be paid by the party that defaults on the agreement.

In connection with the Management Agreement, the Company entered in to a loan agreement (the “Loan Agreement”), pursuant to which the Company will loan NIT RMB 50 million to build training facilities and NIT will repay the RMB 50 million in ten years from the date NIT receives the principal. The loan has an annual interest rate of 20% and the interest will be waived by the Company if NIT makes all payments under the Management Agreement in a timely manner. Currently, we receive 20 % annual interest income due quarterly; therefore, the management fee is waived. The loan is secured by the assets of certain guarantors.

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As of September 30, 2011, the amount of note receivable was $7,435,200.

8. Property and Equipment

Property and Equipment consist of the following:

	September 30, 2011	December 31, 2010
Buildings	$ 1,962,063	$ 4,593,799
Transportation vehicles	213,207	273,513
Communication equipment	7,724,450	5,968,091
Furniture and fixtures	3,668,273	3,653,441
	13,567,993	14,488,844
Less: Accumulated Depreciation	(5,147,324)	(4,542,115)
Property and equipment, net	$ 8,420,669	$ 9,946,729

For the three and nine months ended September 30, 2011 and 2010, depreciation expenses totaled $627,977 and $319,775, $1,039,522 and $981,300.

As of September 30, 2011 the Company did not have any land use rights agreements with the PRC for the office buildings owned by the Company.

In the PRC, land use rights, are the legal rights for an entity to use lands for a fixed period of time. The PRC adopted a dual land tenure system, under which, land ownership is independent of land use rights. The land is either owned by the state ("State Land") or by rural collective economic organization ("Collective Land").

9. Business Acquisitions

On March 14, 2011, the Company acquired a 60% controlling interest in Tianlang for a purchase price of RMB 35 million (approximately $5.3 million). The school is a tutoring school with approximately 5,000 enrolled students. The Company estimated the fair value of the 40% non-controlling interest at approximately$3.6 million, based on a reference to the fair value of the Company's controlling financial interest as determined by the price negotiated in the acquisition. The school had insignificant tangible assets or liabilities at the acquisition date. The entire estimated fair value of approximately $8.9 million has been allocated to amortizable intangible assets.

On May 31, 2011, the Company acquired a 100% ownership in Changchun City Chaoyang District Nuoya Foreign Languages School and Harbin City Nangang District Nuoya Foreign Languages School. These two schools are involved in the instruction of foreign languages, and have a combined enrollment of approximately 1,000 students. The aggregate purchase price for the two schools was RMB 16 million (approximately $2.5 million). The schools had insignificant tangible assets or liabilities at the acquisition date. The entire estimated fair value of approximately $2.5 million has been allocated to amortizable intangible assets.

The Company has not yet finalized the accounting for these acquisitions and is provisionally allocating the entire fair value of the acquired businesses to amortizable intangible assets, consisting of trade names, operating licenses, student lists and enrollment relationships, teachers' contracts, course curricula and educational processes. These intangible assets are provisionally being amortized over a ten year useful life. There is a possibility that the final accounting will result in changes to these provisional allocations, including the recording of residual values to be accounted for as goodwill.

10. Intangibles

Intangible assets consist of franchise rights, capitalized software, trade names, operating licenses, student lists and enrollment relationships, teachers' contracts, course curricula and educational processes.

For the three and nine months ended September 30, 2011 and 2010, amortization expenses totaled $297,203 and $41,248, $585,786 and $263,377, respectively.

11. Deferred revenue

Deferred revenue includes subscriber prepayments and education fee prepayments. Subscriber prepayments represent deferred revenue for the purchase of debit cards used to pay for the online downloading of education materials. The Company recognizes revenue when the card is used to download material. During the period between the purchase and use of debit cards, the unused portion of the debit card is treated as deferred revenue to the Company. Education fee prepayments represent payments for tuition for the Company's training schools, which are amortized over the term of the course. As of September 30, 2011 and December 31, 2010, the Company had deferred revenue of $997,561 and $1,072,373, respectively.

12. Stockholders' Equity

The Company recorded the following equity transactions during the nine months ended September 30, 2011.

On May 6, 2011, our director, Yizhao Zhang was granted 6,667 shares of Common Stock pursuant to the Company's 2011 Incentive Stock Plan.

On January 19, 2011, the Company issued 155,113 shares of common stock valued at market closed price at $7.17 to the employees pursuant to the Company's 2009 Incentive Stock Plan.

The Company recorded the following equity transactions during the year ended December 31, 2010.

- Warrants for the acquisition of 33,195 shares of common stock were exercised, resulting in the issuance of 33,195 share of common stock. Total cash received from exercised warrants was $298,749. There were no warrants outstanding, subsequent to these warrants being exercised, as of December 31, 2010.

- Options for the acquisition of 6,887 shares of common stock were exercised at the price of $8.7, resulting in the issuance of 6,887 share of common stock. Total cash received from exercised options were $59,901.

- A total of 4,502,143 Series A Preferred Shares were converted into 500,238 shares of common stock.

- The Company has repurchased our own stock totaling 137,512 shares for the amount of $977,072.

- The cancellation of WEI's 133,334 shares.

13. Warrants and Options

All the number of shares below is reflected after a one-for-three reverse stock split.

Warrants

For nine months ended September 30, 2011 and the year ended December 31, 2010, the Company did not grant any warrants.

As of September 30, 2011, all the Company’s previously issued warrants have been exercised and the Company did not have any warrants outstanding.

Stock Options:

During the quarter ended June 30, 2011, Mr. Yizhao Zhang was granted another option to purchase 20,000 shares of Common Stock of the Company at the exercise price of $3.78 per share pursuant to the 2011 Incentive Stock Plan. This option vests on the date of the option and may be exercised till three years from the date of grant, provided Mr. Zhang is still a director of or otherwise engaged by the Company at the date of exercising. The total stock based compensation was $22,208 related to the vesting of previously granted options.

During the quarter ended June 30, 2011, a number of our employees were granted options to purchase an aggregate of 32,667 shares of our common stock at the exercise price of $3.78 per share pursuant to the 2011 Incentive Stock Plan. These options are valid for three years from the date of grant and become exercisable during the term of Optionee's employment in three equal annual installments. The total stock based compensation was $ 2,246.

During the year ended December 31, 2010. The options to purchase a total of 6,887 shares of common stocks were exercised for the amount of $59,921.

During the year ended December 31, 2010, the total stock based compensation was $180,909.

During the six months ended June 30, 2010, the Company did not grant any stock options. Options for the purchasing of 4,444 shares of common stock were exercised at the price of $8.70, resulting in the issuance of 4,444 share of common stock.

During the year ended December 31, 2009 the Company established the 2009 Incentive Stock Plan, with 333,334 authorized shares to be issued or granted in stock options.

During the quarter ended June 30, 2011, the Company established the 2011 Incentive Stock Plan, with 333,334 authorized shares to be issued or granted.

The Company measures the intrinsic value of options at the end of each reporting period until options are exercised, cancelled or expire unexercised. As of September 30, 2011 there are 194,447 options with a weighted average exercise price of $9.12 and a weighted average remaining life of 1.25 years, which remain outstanding and continue to be remeasured at the intrinsic value over their remaining vesting period ranging from 9 months to 2.75 years. Compensation expense in any given period is calculated as the difference between total earned compensation at the end of the period, less total earned compensation at the beginning of the period. Compensation earned is calculated on a straight line basis over the requisite service period for any given option award. A total of approximately $23,493 in compensation expense remains unearned as of September 30, 2011. The intrinsic value for exercisable options as of September 30, 2010 is $0 due to the market price is lower than exercise price.

Stock option activity for the quarter ended September 30, 2011 is summarized as follows:

	Shares underlying options	Weighted average Exercise Price
Outstanding as of January 1, 2010	152,000	$ 9.99
Granted		
Exercised	(6,887)	-
Expired / cancelled / forfeited	(3,333)	-
Outstanding as of December 31, 2010	141,780	$ 9.99
Granted	52,667	3.78
Exercised	-	-
Expired / cancelled / forfeited	-	-
Outstanding as of September 30, 2011	194,447	$ 9.12

The following table summarizes the Company's stock options outstanding at September 30, 2011.

Exercise Price	Outstanding September 30, 2011	Weighted Average Remaining Life in Years	Number exercisable
$ 9.57	100,000	0.75	66,667
$ 16.77	10,000	0.75	6,667
$ 8.70	31,780	0.75	22,667
$ 3.78	52,667	2.11	45,115
	194,447		141,116

14. Earnings Per Share

Per GAAP the Company reconciles the numerator and denominator of the basic and diluted earnings per share (EPS) computations.

For the three months and nine months ended September 30, 2011 and 2010, dilutive shares include shares attributable to exercisable options only if such inclusion would be dilutive.

The following reconciles the components of the EPS computation: