

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)

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

For the quarterly period ended September 30, 2011

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  No

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



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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)
<b>ASSETS</b>		
<b>Current Assets</b>		
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
<b>Non-current Assets</b>		
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
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
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
<b>Stockholders' Equity</b>		
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
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The accompanying notes are an integral part of these consolidated financial statements.

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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
<b>Revenues</b>				
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
<b>Total revenue</b>	<b>9,559,101</b>	<b>14,377,210</b>	<b>26,282,613</b>	<b>33,847,040</b>
<b>Cost of Goods Sold</b>				
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
<b>Total cost of goods sold</b>	<b>2,767,364</b>	<b>2,400,347</b>	<b>7,903,170</b>	<b>5,983,594</b>
<b>Gross Profit</b>				
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
<b>Total gross profit</b>	<b>6,791,737</b>	<b>11,976,863</b>	<b>18,379,443</b>	<b>27,863,446</b>
<b>Operating Expenses</b>				
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
<b>Total operating expenses</b>	<b>4,033,773</b>	<b>6,183,369</b>	<b>13,988,441</b>	<b>13,427,647</b>
<b>Income/(Loss) from operations</b>	<b>2,757,963</b>	<b>5,793,494</b>	<b>4,391,002</b>	<b>14,435,799</b>
<b>Other Income/ (Expense)</b>				
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 )
<b>Total other income/(Expense)</b>	<b>372,721</b>	<b>61,489</b>	<b>567,638</b>	<b>172,556</b>
<b>Net Income Before Provision for Income Tax</b>	<b>3,130,684</b>	<b>5,854,983</b>	<b>4,958,639</b>	<b>14,608,355</b>
<b>Income taxes:</b>				
Current	(54,622 )	(638,216 )	175,429	(1,531,361 )
Deferred	(77,884 )	-	14,042	-
<b>Net Income</b>	<b>2,998,178</b>	<b>5,216,767</b>	<b>5,148,111</b>	<b>13,076,994</b>
Net Income attributable to the noncontrolling interests	177,136	161,018	96,530	101,333
<b>Net Income/(Loss) - attributable to CEU and Subsidiaries</b>	<b>\$ 3,175,313</b>	<b>\$ 5,377,785</b>	<b>\$ 5,244,640</b>	<b>\$ 13,178,327</b>

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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
<b>Cash flows from operating activities</b>		
Net Income	\$ 5,148,111	\$ 13,076,994
<b>Adjustments to reconcile net income to net cash provided by</b>		
<b>Operating activities</b>		
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 )	-
<b>Net change in assets and liabilities</b>		
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
<b>Cash flows from investing activities</b>		
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 )
<b>Cash flows from financing activities</b>		
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
<b>Supplemental disclosure of cash flow information</b>		
Income taxes paid	\$ 613,842	\$ 1,428,684
<b>Non-cash investing and financing activities</b>		
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. (“ZHL D”), 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 ZHL D and Duane C. Bennett, the former Chairman of ABC Realty Co., pursuant to which the shareholders of ZHL D 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 ZHL D and ZHL D’s shareholders. As a result of the Plan of Exchange, the transaction was treated for accounting purposes as a recapitalization of ZHL D.

ZHL D 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.

ZHL D’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 ZHL D. ZHL D owns 99% of ZHTC with 1% held in trust by Xiqun Yu, the Company’s CEO, for the benefit of China Education Alliance, Inc.

ZHL D 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, ZHL D 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”). ZHL D 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, ZHL D 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.

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## 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	2010
RMB: US\$ exchange rate	6.38853	6.62270
	9 Months ended	
	September 30,	
Average RMB: US\$ exchange rate	2011	2010
	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.



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.



#### 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.

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.



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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income- attributable to CEU and subsidiaries	\$3,175,313	\$5,377,785	\$5,244,640	\$13,178,327
Weighted average shares outstanding -basic effective of dilutive securities	10,582,503	10,441,245	10,568,979	10,509,797
Effect of dilutive securities	-	13,173	-	34,778
Weighted average shares outstanding -basic effective of dilutive securities	10,582,503	10,454,418	10,568,979	10,544,575
Earnings per share - basic	\$0.30	\$0.52	\$0.50	\$1.25
Earnings per share - diluted	\$0.30	\$0.51	\$0.50	\$1.25

#### 15. Commitments and Contingencies

We are presently involved in two putative class action lawsuits filed in the U.S. District Court for the Central District of California. The first action, *Apicella v. China Education Alliance, Inc., et al.*, No. 10-cv-09239 (CAS)(JCx), was filed on December 2, 2010; the second action, *Clemens v. China Education Alliance, Inc., et al.*, No. 10-cv-09987 (JFW)(AGRx), was filed on December 28, 2010. On March 2, 2011, both actions were consolidated in *In re China Education Alliance, Inc. Securities Litigation*, No. 10-cv-09239 (CAS) (JCx)(C.D. Cal.). The Consolidated Amended Complaint alleges that we and the other defendants are liable under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 for allegedly false and misleading statements and omissions in our public filings between 2008 and 2010 and in an investor conference call in December 2010. The Consolidated Amended Complaint also asserts claims under Section 20(a) of the Securities Exchange Act of 1934 against the individual defendants. The Court denied the company's motion to dismiss the Consolidated Amended Complaint on October 11, 2011. In addition, on October 28, 2011, a derivative lawsuit was filed on behalf of the company in the U.S. District Court for the Central District of California against the individuals named as defendants in the securities class action lawsuit for alleged breaches of fiduciary duties based on similar facts as alleged in the class action. The derivative lawsuit is *Padnos v. Yu, et al.*, No. 11-cv-8973 (C.D. Cal.). If we were to be subsequently involved in more litigation proceedings, and/or we are unable to settle these lawsuits or any other similar lawsuits on terms favorable to us and/or if adverse judgments were to be levied against us, our profitability could be severely impacted. Also, these lawsuits could result in substantial costs, potential liabilities and the diversion of management's attention and resources and result in a material adverse effect on our financial condition and results of operations.

The Company and its subsidiaries are self-insured, and they do not carry any property insurance, general liability insurance, or any other insurance that covers the risks of their business operations. As a result any material loss or damage to its properties or other assets, or personal injuries arising from its business operations would have a material adverse effect on the Company's financial condition and operations.

If a loss should occur, or if management deems that a loss is probable, relating to our Company's product or performance of our services, an accrual for such loss or losses would be recognized at such time of occurrence or determination. The Company has not accrued any losses as of September 30, 2011.

16. Operating Risk

(a) Country risk

Currently, the Company's revenue is mainly derived from sale of educational products and services in the People's Republic of China. The Company hopes to expand its operations in the People's Republic of China, however, there are no assurances that the Company will be able to achieve such an expansion successfully. Therefore, a downturn or stagnation in the economic environment of the PRC could have a material adverse effect on the Company's financial condition.

(b) Products risk

The Company competes with larger companies, who have greater funds available for expansion, marketing, research and development and the ability to attract more qualified personnel. There can be no assurance that the Company will remain competitive with larger competitors.

(c) Exchange risk

The Company cannot guarantee that the current exchange rate will remain steady, therefore there is a possibility that the Company could post the same amount of profit for two comparable periods and because of a fluctuating exchange rate actually post higher or lower profit depending on exchange rate of Chinese Renminbi (RMB) converted to U.S. dollars on that date. The exchange rate could fluctuate depending on changes in the political and economic environments without notice.

(d) Political risk

Currently, the People's Republic of China is in a period of growth and is openly promoting business development in order to bring more business into the People's Republic of China. Additionally, the People's Republic of China allows a Chinese corporation to be owned by a United States corporation. If the PRC government changes the laws or regulations, the Company's ability to operate in the People's Republic of China could be affected.

(e) Key personnel risk

The Company's future success depends on the continued services of executive management in the People's Republic of China. The loss of any of their services would be detrimental to the Company and could have an adverse effect on business development. The Company does not currently maintain key-man insurance on their lives. Future success is also dependent on the ability to identify, hire, train and retain other qualified managerial and other employees. Competition for these individuals is intense and increasing.

(f) Non-compliance with financing requirements

The Company might need to obtain future financing that require timely filing of registration statements, and have declared effective those registration statements, to register the shares being offered by the selling stockholders in future financing. The Company might be subject to liquidated damages and other penalties if they continue to obtain future financing requiring registration statements, and not having those registration statements filed and declared

effective in a prompt manner.

17.

Subsequent Events

In accordance with ASC 855, "Subsequent Events" the Company evaluates subsequent events after the balance sheet date up through the date that the financial statements are issued.

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18.

Restatement

On November 4, 2011, in the process of preparing its quarterly report on Form 10-Q for the quarter ended September 30, 2011, management became aware that the Company's quarterly reports for the quarters ended March 31, 2011 and June 30, 2011 erroneously did not include interest income of \$381,476 for the quarter ended March 31, 2011 and \$381,745 for the quarter ended June 30, 2011, related to the loan made to Nanchang Institute of Technology and the tax effect of \$57,222 for the quarter ended March 31, 2011 and \$57,262 for the quarter ended June 30, 2011.

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

The following discussion of the results of our operations and financial condition should be read in conjunction with our unaudited consolidated financial statements and the related notes thereto, which appear elsewhere in this report.

Except for the historical information contained herein, the following discussion, as well as other information in this report, contain "forward-looking statements," within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the "safe harbor" created by those sections. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may, and are likely to, differ materially from what is expressed or forecasted in the forward-looking statements due to numerous factors, including those discussed from time to time in this report, as well as and any risks described in the "risk factors" section of our annual report on Form 10-K for the year ended December 31, 2010, filed with the SEC on April 15, 2011 and any other filings we make with the SEC. In addition, such statements could be affected by risks and uncertainties related to the ability to conduct business in the People's Republic of China, demand, including demand for our products resulting from change in the educational curriculum or in educational policies, our ability to raise any financing which we may require for our operations, competition, government regulations and requirements, pricing and development difficulties, our ability to make acquisitions and successfully integrate those acquisitions with our business, as well as general industry and market conditions and growth rates, and general economic conditions. Any forward-looking statements speak only as of the date on which they are made, should not be relied upon as representing our views as of any subsequent date and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this report.

Our discussion and analysis of our financial condition and results of operations are based upon our unaudited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. On an on-going basis, we evaluate these estimates, including those related to useful lives of real estate assets, cost reimbursement income, bad debts, impairment, net lease intangibles, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

#### Overview

We are a provider of quality educational resources in the People's Republic of China ("PRC"). Our main line of business is providing online and offline educational materials to students from grades K-12, and to provide vocational skills training to individuals over 18 years of age. Our website, [www.edu-chn.com](http://www.edu-chn.com), has a large database of education preparation materials, test counseling materials, and high-quality educational resources for students in grades K-12, including 500,000 sets of questions that have been collected over the years as well as teaching lesson plans and teaching courseware.

With over 20 learning centers in Beijing, Harbin and Nanchang, we have enough classroom space to meet the needs of nearly 10,000 students. Our educational materials consist of materials provided by elite teachers and schools throughout the nation as well as courses developed by us. Because the PRC education system is localized, and features multiple categories, we plan to expand our products and services in line with the country's national

development plan. We plan to set up another 30 or more education centers providing various education resources by the end of the year 2011 in order to become a large-scale provider of high quality educational resources in the PRC.

We generate revenue through our website by selling prepaid debit cards to our subscribers. These debit cards permit the subscriber to download materials from our website over a specified period, usually one year. We recognize revenue from the debit cards when the students use the debit cards to purchase our products. To the extent that the debit cards expire unused, we recognize the remaining balance of the debit card at that time. We also recognize revenue from our other online education business including the sale of advertising on our website. We recognize revenue from our training center's classes ratably over the term of the course, and we recognize revenue from face-to-face tutorials with students who attend our training center and face-to-face information technology training courses.

The laws of the PRC provide the government broad power to fix and adjust prices. Although the sale of educational material over the Internet is not presently subject to price controls, we cannot give you any assurance that they will not be subject to controls in the future. To the extent that we are subject to price control, our revenue, gross profit, gross margin and net income will be affected since the revenue we derive from our services will be limited and we may face no limitation on our costs. Further, if price controls affect both our revenue and our costs, our ability to be profitable and the extent of our profitability will be effectively subject to determination by the applicable PRC regulatory authorities.

Because students who purchase our on-line programs purchase debit cards for the programs that they use, and students who enroll in our training classes pay their tuition before starting classes, we do not have significant accounts receivable. As of September 30, 2011, we had \$158,174 of accounts receivable, which is comprised of on-line advertising.

Our prepaid expenses are \$2,127,893 and account for 2.8% of current assets as of September 30, 2011. Prepaid expenses primarily consist of prepaid rent, advance payments made for services to teachers, online materials and video, prepaid advertising and prepaid other expense. As of September 30, 2011, prepayment of rent totaled \$374,645. Prepayments to teachers and online materials totaled \$736,647. They included \$309,884 for course development materials and \$425,763 for data storage software. Prepayments for advertising totaled \$275,496. Prepaid services and professional fees totaled \$480,422, comprising prepaid attorney and financial consulting fees of \$76,834, and technician service fees of \$403,588. Other prepaid expenses totaled \$261,683, consisting of remodeling fees of \$202,057 and property management and certification fees of \$59,626. We amortize the prepayments to teachers for course development materials over six months, which is the estimated life of the testing materials. The prepaid rent related to our Beijing office and dormitory rental for our training center and the prepayment to teachers decreases as the materials are delivered and the prepaid rent decreases ratably during the terms of the leases.

In our on-line education business segment, the principal component of cost of sales is the cost of obtaining new material to offer students as well as depreciation related to computer equipment and software and direct labor cost. Our on-line education business generated a gross margin of 66.2% for the nine months ended September 30, 2011. The gross margin is affected by the payments we have to make to the teachers for the materials. In our training center business, the principal components of cost of sales are costs of the faculty and the amortization of intangible assets. This business generates a gross margin, which was 74.3% for the nine months ended September 30, 2011.

In December 2006, we acquired, for approximately \$1.0 million, all of the fixed assets and franchise rights of Harbin Nangang Compass Computer Training School ("Compass Training School"), which was engaged in the business of providing on-line education resources to computer vocational training school students. As a result of this acquisition, we became the exclusive partner of Beida Qingniao APTEC Software Engineering within Heilongjiang Province for vocational training. The acquisition included materials and resources to provide on-site education classes and patented course materials. Compass Training School currently has two principal education programs focused on network engineering and ACCP software engineering with nine on-site classrooms and nine multimedia/computer classrooms at two centers. The partnership with Beida Qingniao expired last year, and we are currently operating a popular IT



training course developed through our own system to meet strong market demand.

We own 70% of Beijing Hua Yu Hui Zhong Technology Development Co., Ltd, which was formed on September 30, 2006. At the time of its organization, we transferred a 30% interest in this subsidiary to the National Vocational Education Association of China, a non-profit, quasi-government entity, for no consideration, in order to enable us to work in cooperation with the Guidance Center's network to expand our business. This cooperation will be of great help in achieving our goal of nationwide promotion of high-quality professional education resources.

We are in the process of introducing new services aimed at students who want to attend vocational school. These students include high school students who do not continue their education at universities and university graduates who are not able to find employment. The core business for our vocation education will be in three main areas: vocation training, vocational certification, and career development for college graduates. We have collaborated with the National Vocational Education Association of China in setting up [www.360ve.com](http://www.360ve.com), which provides information regarding vocation training schools and vocation training both on-line and on-site.

On April 18, 2008, our wholly owned subsidiary, Harbin Zhong He Li Da Education Technology, Inc ("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. Media Co., Ltd. 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 Harbin New Discovery Media Co., Ltd. In return for their respective contributions, ZHLD holds a 49.02% ownership interest and Newspaper Group holds a 50.98% ownership interest in Harbin New Discovery Media Co., Ltd. The parties are prohibited, for the duration of the joint venture from retiring or transferring their ownership interests. This joint venture has created new educational material distribution channels in readable newspaper format. The value of this investment as of September 30, 2011 is \$437,498.

Pursuant to the terms of the supplementary agreement, Newspaper Group assigned all their rights in the "Scientific Discovery," a scientific information newspaper with a focus on education to introduce scientific knowledge to elementary and secondary students exclusively, to the joint venture company, Harbin New Discovery Media Co., Ltd. In the event that the rights to "Scientific Discovery" expire because of reason other than a change in government policies and an inability to defend against or resist such changes, Newspaper Group is liable to ZHLD for twice the latter's registered contribution in the joint venture in liquidated damages. The transaction closed on July 7, 2008 and as a result, Harbin New Discovery Media Co., Ltd. is now a 49.02% owned equity investment of ZHLD, referred to as a noncontrolling interest in subsidiaries in the accompanying balance sheet.

On January 4, 2009, 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 holds 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 the management, clients and suppliers.

On February 3, 2010, we announced that through our wholly owned subsidiary, ZHLD, we have incorporated a new company in the PRC, Beijing New Shifan Education & Technology ("New Shifan"), with a registered capital of RMB 1.95 million. New Shifan was created to continue the operations of Beijing Shifan Culture Communication Co., Ltd. ("Beijing Shifan"). The focus of New Shifan is on the advancement of science and mathematics education, the publishing of the "Senior High School Students Mathematic, Physics, and Chemistry" magazine, which has been endorsed by the PRC Ministry of Education. Beijing Shifan was the sponsor and organizer of a nationwide contest for

middle school and high school students, and New Shifan continues to sponsor and organize the contest. This national competition tests the students' academic abilities in mathematics, physics and chemistry. There are over 100,000 students participating in the contest from 23 provinces in the PRC. Because winners of the contest qualify for enrollment in some of the top universities in the People's Republic of PRC, New Shifan has a significant impact on the secondary education market in the PRC. New Shifan annually organizes three to five large scale contests and generates its revenue from students' registration fees for the contests.

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, PRC. Pursuant to the Management Agreement, the Company will manage 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 Management Agreement.

In connection with the Management Agreement, we entered into a loan agreement (the “Loan Agreement”), pursuant to which we will lend NIT RMB 50 million (approximately \$7,306,736) to build training facilities and NIT will repay the loan 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. In the event it prepays the principal and interests that are not due, NIT is subject to a prepayment penalty in the amount of 25% of the loan principal. The assets of certain guarantors secure the loan. As of September 30, 2011, we loaned NIT \$7,435,200 and NIT paid us \$782,653 in interest and 0 in principal. Currently, we receive 20 % annual interest income due quarterly; therefore, the management fee is waived.

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, PRC. Pursuant to the Share Transfer Agreement, the Company agreed to purchase 60% of the 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. After the execution of the Share Transfer Agreement, Tianlang has established a new board of directors with five directors, of which three directors are appointed by the Company and two directors are appointed by the shareholder.

The acquisition of Tianlang was officially completed in April 2011. We are currently co-managing Tianlang with the previous majority owner.

On March 21, 2011, the Company entered into an additional agreement with NIT. Pursuant to the agreement, the Company and NIT will jointly establish Nanchang Institute of Technology College of Vocational Training and Certification (the “College”). NIT will provide facilities for free and the Company will provide teachers, curriculums and certificates of trainings and pay all the expenses incurred in the teaching process. In return, NIT and the Company will receive 20% and 80% of the total revenue of the College, respectively. The Company is responsible for the College’s operation which began on March 21, 2011.

On May 31, 2011, we entered into share transfer agreements with 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 PRC. Pursuant to the share transfer agreements, we agreed to purchase 100% ownership of each of the two schools for RMB 8 million (approximately \$1.23 million).

On September 26, 2011, we effected a one-for-three reverse stock split of our issued and outstanding common stock. As a result, all common share based data in our discussion of results of operation and financial condition has been retroactively restated to reflect this reverse stock split.

### Significant Accounting Estimates and Policies

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with generally accepted accounting principles (“GAAP”). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities. On an on-going basis, we evaluate our estimates including the allowance for doubtful accounts, the salability and recoverability of our products, income taxes and contingencies. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Property and equipment are evaluated for impairment whenever indicators of impairment exist. Accounting standards require that if an impairment indicator is present, we must assess whether the carrying amount of the asset is unrecoverable by estimating the sum of the future cash flows expected to result from the asset, undiscounted and without interest charges. If the recoverable amount is less than the carrying amount, an impairment charge must be recognized based on the fair value of the asset.

Intangible assets and capitalized software, which we acquired from third parties, are amortized over the lives of the rights agreements, which is two to five years. We evaluate the carrying value of the franchise rights and other intangibles 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 quarters ended September 30, 2011 and 2010.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes. This process involves estimating our current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. Our deferred tax asset is from our US corporate parent and has been fully resolved. Our US parent provides corporate and administrative functions for the entire consolidated Company. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent that we establish a valuation allowance or increase this allowance in a period, we must include a tax provision or reduce our tax benefit in the statements of operations. We use our judgment to determine our provision or benefit for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We believe, based on a number of factors including historical operating losses that we will not realize the future benefits of a significant portion of our net deferred tax assets and we have accordingly provided a full valuation allowance against our deferred tax assets. However, various factors may cause those assumptions to change in the near term.

We cannot predict what future laws and regulations might be passed that could have a material effect on our results of operations. We assess the impact of significant changes in laws and regulations on a regular basis and update the assumptions and estimates used to prepare our financial statements when we deem it necessary.

We have determined the significant principles by considering accounting policies that involve the most complex or subjective decisions or assessments. Our most significant accounting policies are those related to revenue recognition and deferred revenue.

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. We believe that these criteria are satisfied upon customers’ download of prepaid study materials. Prepaid debit cards allow our subscribers to purchase a predetermined monetary amount of download materials posted

on our website. Prepaid service contracts are amortized to income on a straight-line basis over the length of the service contract. These service contracts allow the user to obtain materials for a designed period of time. At the time that the prepaid debit card is purchased, the receipt of cash is recorded as deferred revenue. Revenue is recognized in the month when services are actually rendered. Unused value relating to debit cards is recognized as revenue when the prepaid debit card has expired. Revenue from advertising on our website is recognized when the advertisement is run. Since advertising customers are billed monthly, there is no unearned advertising revenue.

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 revenue upon posting of an advertisement on their web site. 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.

Prepaid expenses are primarily comprised of advance payments made for services to teachers, online materials and video, prepaid advertising and prepaid rent.

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, including testing booklets, supplemental materials, and teaching material. We value the sales based on the actual occurrence of customer download. Therefore, the spare time between the purchase of debit cards and actual download is recorded under advances on accounts as deferred or unearned revenues. Once the download takes place, the amount is then transferred from advances on accounts to sales. Education fee prepayments represent tuition payments and payments for service contracts, which are amortized over their respective terms.

#### Recent Accounting Pronouncements

Recent accounting pronouncements applicable to the Company are summarized below.

- In October 2009, the FASB issued ASU No. 2009-13, "Multiple-Deliverable Revenue Arrangements." This ASU establishes the accounting and reporting guidance for arrangements including multiple revenue-generating activities. This ASU provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this ASU also establish a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms, significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this ASU are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. The adoption of this ASU is expected to have minimal to no impact on our consolidated financial statements.
- In October 2009, the FASB issued ASU No. 2009-14, "Certain Revenue Arrangements That Include Software Elements." This ASU changes the accounting model for revenue arrangements that include both tangible products and software elements that are "essential to the functionality," and scopes these products out of current software revenue guidance. The new guidance will include factors to help companies determine what software elements are considered "essential to the functionality." The amendments will now subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple-deliverables. The amendments in this ASU are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. The Company is currently evaluating this new ASU.

• In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.

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.

## Results of Operations

### Three Months Ended September 30, 2011 and 2010

The following table sets forth information from our statements of operations for the three months ended September 30, 2011 and 2010:

	(Dollars)					
	Three Months Ended September 30 2011			2010		
Revenue	\$9,559,101	100.0	%	\$14,377,210	100.0	%
Cost of sales	2,767,364	29.0	%	2,400,347	16.7	%
Gross Profit	6,791,737	71.0	%	11,976,863	83.3	%
Income from operations	2,757,963	28.9	%	5,793,494	40.3	%
Other income/(Expense)	372,721	3.9	%	61,489	0.4	%
Income before income taxes	3,130,684	32.8	%	5,854,983	40.7	%
Provision for income taxes	(132,506 )	-1.38	%	(638,216 )	-4.4	%
Net income	2,998,178	31.4	%	5,216,767	36.3	%
Less: Net loss attributable to the noncontrolling interest	177,136	1.9	%	161,018	1.1	%
Net income-attributable to CEU and Subsidiaries	3,175,313	33.2	%	5,377,785	37.4	%

We operate three revenue generating areas of online education, education training centers and on-line advertising. The following table sets forth information as to the gross margin for our three revenue generating segments for the three months ended September 30, 2011 and 2010:





	(Dollars)			
	Three Months Ended September			
	2011		2010	
	30			
<b>Online Education</b>				
Revenue	\$	5,330,692	\$	8,629,101
Cost of sales		1,586,084		1,281,634
Gross profit		3,744,607		7,347,467
Gross margin		70.2	%	85.1
				%
<b>Training Center</b>				
Revenue		4,147,879		5,223,860
Cost of sales		1,170,677		1,081,937
Gross profit		2,977,203		4,141,923
Gross margin		71.8	%	79.3
				%
<b>Other</b>				
Revenue		80,530		524,249
Cost of sales		10,603		36,776
Gross profit		69,927		487,473
Gross margin		86.8	%	93.0
				%

#### Revenue

At the end of 2010, there were allegations that we failed to disclose material adverse facts about our business, operations, and prospects (the “Allegations”) which were cited by major websites and other media. The reason for the decrease was the result of the Company's name brand and imagine still in the process of slowly recovering. Some parents and students have been reluctant to use our services. As a result, there was a decrease in the number of students seeking our services both online and on-site. In addition, the morale of our employees and teachers was adversely affected, which led to unfavorable conditions in our daily operation.

As a result, revenue for the three months ended September 30, 2011 (the “September 30, 2011 Quarter”) decreased by \$4,818,109, or 33.5%, to \$9,559,101 from \$14,377,210 for the three months ended September 30, 2010 (the “September 30, 2010 Quarter”).

Revenue generated by the online education division decreased by \$3, 298,409, or 38.2%, to \$5,330,692 during the September 30, 2011 Quarter from \$8,629,101 during the September 30, 2010 Quarter. This decrease was a result of loss of business directly attributable to the Allegations cited above.

Revenue generated by the training center division decreased by \$1,075,981, or 20.6% to \$4,147,879 during the September 30, 2011 Quarter from \$5,223,860 during the September 30, 2010 Quarter. The revenue from the training division is comprised of revenue from technology training classes, language training classes, vocational training classes etc. The decrease was mainly attributable to a decrease in revenue relating to technology training classes of approximately \$996,000 and a decrease in revenue from other tutorial classes of \$80,000, resulting from the adverse impact of the Allegations. Lately the employment rate for new graduates has been very low and an increasing number of new graduates seek vocational training to enhance their chances of employment. Therefore, we predict that in the

future, revenue from our training center division will increase due to higher demand for such training classes.

Other revenue includes revenue generated from online advertising. Other revenue decreased by \$443,719, or 84.6% during the September 30, 2011 Quarter compared to the September 30, 2010 Quarter. The decrease was mainly attributable to decrease in advertising income related to online education. In the future we will continue to focus on our main business lines: examination preparation, vocational training and language training.

We anticipate that the negative impact of such Allegations will continue to have an impact on our business. To negate the adverse impact, we have conducted extensive marketing activities during the first quarter of fiscal year 2011 and acquired three schools during the second quarter. We also set up direct training centers in Beijing and other provinces in the PRC. We are hopeful that with time, we will demonstrate the falsehood of such Allegations and that our business will improve.

Deferred revenue reflects the unearned portion of debit cards sold in the online division and unearned tuition from training centers. The deferred revenue is not necessarily in direct proportion to our revenue. Usually the Company's deferred revenue remains at a relatively low level in relation to revenue from debit cards, as most students consume their debit cards in a short period and most tuition is expensed monthly. A change in deferred revenue is not necessarily related to students' enrollment, and also has no impact in subsequent quarters. During the September 30, 2011 Quarter, deferred revenue decreased by approximately \$1,661,304 or 62.5% to \$997,561 during the September 30, 2011 Quarter from \$2,658,865 during the June 30, 2011 quarter. The decrease was mainly due to a decrease in sales of debit cards to students resulting from the summer break when the students do not use the debit cards for downloading materials as much as during the school term.

Our current operations are primarily conducted in the northeastern region of the PRC. PRC has about 150 million students aged 6 to 18, who are the target of our education services. There are about 10 million students in the 6 to 18 age group in the northeastern region of the PRC. Because we serve approximately 500,000 to 600,000 students in the age group, only 5% of the students in the current market, we believe that we have great potential to grow. Our growth will depend on how we penetrate and expand into the market. Our expansion may take the form of organic growth and/or acquisitions and the key to our growth will be increased student enrollment.

#### Cost of Sales

Our overall cost of sales increased by \$367,017 or 15.3% to \$2,767,364 in the September 30, 2011 Quarter, as compared to \$2,400,347 in the September 30, 2010 Quarter.

The cost of sales for our online education division increased by \$304,450 or 23.8% compared to the same period in 2010. This increase was mainly attributable to the rental of new servers for online education. The gross margin for online education service decreased to 70.2% in the September 30, 2011 Quarter from 85.1% in the September 30, 2010 Quarter due to the decrease in revenues from online education and increased cost of sales.

The cost of sales for our training center division increased \$88,740 or 8.2% during the September 30, 2011 Quarter as compared to the September 30, 2010 Quarter. The increase in the cost of sales was mainly attributable to amortization of prepaid course materials. The gross margin of our training service decreased to 71.8% in the September 30, 2011 Quarter from 79.3% in the September 30, 2010 Quarter due to the continuous amortization of prepaid class materials, which accounted for approximately \$401,000.

The cost of sales for other revenue decreased by \$26,173 or 71.2%. This decrease was mainly attributable to the decrease in other revenue. The gross margin for our other revenues decreased from 93.0% in the September 30, 2010 Quarter to 86.8% in the September 30, 2011 Quarter. In the future we expect the cost of sales of our other revenue to increase as our other revenue increases.



## Expenses

Selling expenses decreased by \$2,983,578 or 57.6% to \$2,199,187 in the September 30, 2011 Quarter, from \$5,182,765 in the September 30, 2010 Quarter. Selling expenses were 23.0% of total sales for the September 30, 2011 Quarter compared with 36.0% for the September 30, 2010 Quarter. Our selling expenses include media advertising, outdoor advertising agent fees, commissions associated with sales of our exam preparation debit cards and enrollment of onsite training centers. The decrease in selling expenses was a result of the decrease in revenue and the decrease in marketing and advertising expenses.

Administrative expenses increased by \$577,547 or 73.9%, to \$1,358,716 in the September 30, 2011 Quarter, as compared to \$718,169 in the September 30, 2010 Quarter. This increase was mainly due to the increase of expenses relating to amortization of intangible assets from acquisition of three schools: TianLang, Harbin Nuoya and Changchun Nuoya.

Depreciation and amortization expenses increased by \$256,436, or 116.9% to \$475,871, in the September 30, 2011 Quarter, as compared to \$219,435 in the September 30, 2010 Quarter. Depreciation and amortization expenses are expected to increase for our training center division because of the amortization of intangible assets of Harbin Nuoya, Changchun Nuoya and Tianlang.

We realized an income tax benefit under the PRC Enterprise Income Tax Law of \$273,188 from the deduction of 15% of advertising and promotion expenses that were accrued during the year 2010 but were previously non-deductible.

For the September 30, 2011 Quarter, interest income increased by \$409,332 primarily due to interest income from NIT notes receivable.

## Net Income

The Company had net income attributable to the Company and its subsidiaries of \$3,175,313, or \$.30 per share, basic and diluted, for the September 30, 2011 Quarter, as compared with net income of \$5,377,785, or \$.52 per share, basic and \$.51 per share diluted, for the September 30, 2010 Quarter.

## Nine Months Ended September 30, 2011 and 2010

The following table sets forth information from our statements of operations for the nine months ended September 30, 2011 and 2010:

	(Dollars)					
	Nine Months Ended September 30					
	2011		2010			
Revenue	\$26,282,613	100.0	%	\$33,847,040	100.0	%
Cost of sales	7,903,170	30.1	%	5,983,594	17.7	%
Gross Profit	18,379,443	69.9	%	27,863,446	82.3	%
Income from operations	4,391,002	16.7	%	14,435,799	42.7	%
Other income/(Expense)	567,638	2.2	%	172,556	0.5	%
Income before income taxes	4,958,639	18.9	%	14,608,355	43.2	%
Provision for income taxes	189,471	0.72	%	(1,531,361)	-4.5	%
Net income	5,148,111	19.6	%	13,076,994	38.6	%
Less: Net loss attributable to the noncontrolling interest	96,530	0.4	%	101,333	0.3	%
Net income-attributable to CEU and Subsidiaries	5,244,640	20.0	%	13,178,327	38.9	%

The following table sets forth information as to the gross margin for our three lines of business for the nine months ended September 30, 2011 and 2010:

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	(Dollars)			
	Nine Months Ended September 30			
	2011	2010		
<b>Online Education</b>	<b>\$</b>	<b>\$</b>		
Revenue	14,458,244	21,246,633		
Cost of sales	4,888,630	3,524,119		
Gross profit	9,569,614	17,722,514		
Gross margin	66.2	%	83.4	%
<b>Training Center Revenue</b>				
Revenue	11,618,155	11,013,279		
Cost of sales	2,985,553	2,344,862		
Gross profit	8,632,602	8,668,417		
Gross margin	74.3	%	78.7	%
<b>Other Revenue</b>				
Revenue	206,214	1,587,128		
Cost of sales	28,986	114,613		
Gross profit	177,227	1,472,515		
Gross margin	85.9	%	92.8	%

#### Revenue

Revenue for the nine months ended September 30, 2011 decreased by \$7,564,427, or 22.3%, to \$26,282,613 compared to \$33,847,040 for the nine months ended September 30, 2010. Revenue generated by the online education division decreased by \$6,788,389 or 32.0% during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Revenue generated by the training center division increased by \$604,876, or 5.5% during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Other Revenue decreased by \$1,380,914, or 87.0% during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010.

The reason for the decrease in online education and other revenue was the result of the Company's name brand and imagine slowly recovering. The first quarter included Chinese New Year, which is a lengthy vacation period and normally experiences a stall or decrease in business. To offset this, our on-site training revenue increased as a result of inclusion the revenue of Tianlang, Harbin Nuoya and Changchun Nuoya.

In order to negate the adverse impact resulting from the Allegations and to improve our business, we conducted extensive marketing activities during the first quarter of fiscal year 2011 and acquired three schools during the second quarter. We also set up direct training centers in Beijing and other provinces in the PRC to expand our operation. We are hopeful that with time, we will demonstrate the falsehood of such Allegations and that our business will improve.



## Cost of Sales

Our overall cost of sales increased by \$1,919,576, or 32.1%, to \$7,903,170 for the nine months ended September 30, 2011 as compared to \$5,983,594 for the nine months ended September 30, 2010. The increase in cost of sales was due to the depreciation of some items such as our online system and class related materials.

The cost of sales for our online education division increased by \$1,364,511 or 38.7% during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. This increase was a result of the depreciation of upgraded online system and amortization of course related materials. The gross margin of the online education division decreased to 66.2% for the nine months ended September 30, 2011, from 83.4% for the nine months ended September 30, 2010 due to the decrease of online education revenue and increase in costs.

The cost of sales for our training center division increased by \$640,691 or 27.3% during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. This increase was mainly attributable to higher salaries paid for developing course materials and amortization of prepaid course materials. The gross margin of the training center division decreased to 74.3% in the nine months ended September 30, 2011 from 78.7% for the nine months ended September 30, 2010.

The cost of sales for other revenue decreased by \$85,627 or 74.7% during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The decrease was in tandem with the decrease in other revenue. The gross margin for our other revenues decreased about 6.9% to 85.9% during the nine months ended September 30, 2011 from 92.8% during the nine months ended September 30, 2010.

## Expenses

Selling expenses decreased by \$3,159,438 or 29.0% to \$7,743,091 during the nine months ended September 30, 2011 from \$10,902,529 during the nine months ended September 30, 2010. Our selling expenses include advertising, agent fees and commissions associated with sales of our education debit cards. The decrease in selling expenses was mainly the result of the decrease in sales.

Administrative expenses increased by \$3,238,302 or 179.1%, to \$5,046,511 during the nine months ended September 30, 2011 as compared to \$1,808,209 during the nine months ended September 30, 2010. The increase was primarily related to stock issuances to employees pursuant to the Company's 2009 Incentive Stock Plan and the 2011 Incentive Stock Plan. The plans were created to reward high-quality teachers who support the development of the Company and have stood by the Company during times of hardship. The renovation expenses incurred for our new training center in Beijing also contributed to the increased administrative expenses. Additionally, technical service fees and property management fees also increased.

Depreciation and amortization, included in operating expenses, increased by \$481,931, or 67.2% to \$1,198,840 during the nine months ended September 30, 2011, as compared to \$716,909 during the nine months ended September 30, 2010. This increase was due to the purchase of fixed assets and intangible assets during the first two quarters of 2011.

In 2011, the applicable PRC income tax rate for our subsidiary, ZHLD, is 15%, as it has been approved by the local government as businesses promoting high technology industry. Without this government approval, the regular PRC statutory tax rate is at 25%. The Company's another subsidiary, ZETC, 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 regular statutory rate (25%), and have not accrued taxes since inception, due to recurring losses or no income incurred since inception.

For the nine months ended September 30, 2011, interest income increased by \$1,218,178 primarily due to interest income from NIT notes receivable.

## Net Income

The Company had a net income attributable to the Company and its subsidiaries of \$5,244,640 or \$0.50 per share, basic and diluted, during the nine months ended September 30, 2011, as compared with net income of \$13,178,327, or \$1.25 per share, basic and diluted, during the nine months ended September 30, 2010.

## Liquidity and Capital Resources

Our current assets primarily consist of cash, prepaid expenses, and account receivables. We do not have inventory. Our prepaid expenses are primarily advance payments made to teachers for on-line materials, prepaid advertisement, prepaid rent, and other prepayments. Our account receivables are primarily from our advertising business on our website.

At September 30, 2011, we had cash and cash equivalents of \$73,738,147, an increase of \$2,632,732 or 3.7%, from \$71,105,415 at December 31, 2010. This increase was primarily due to proceeds from disposal of fixed asset and decreased prepaid expense and increased accounts payable during the nine months ended September 30, 2011. The biggest expenditure was the acquisition of Tianlang, Harbin Nuoya and Changchun Nuoya for \$7,860,157. Other expenditures included the purchase of fixed assets.

Our net cash provided by operating activities was \$7,992,133 for the nine months ended September 30, 2011, a decrease of \$8,918,089 or 52.7% from \$16,910,222 for the nine months ended September 30, 2010. This decrease was due to a decrease in net income along with the decrease of deferred revenue and a loss resulting from disposal of fixed assets.

Our cash used in investing activities was \$6,094,835 for the nine months ended September 30, 2011, a net decrease of \$103,906 compared to \$6,198,741 the same period in 2010. Our cash used in investing activities was composed of cash used for acquisitions and proceeds from disposal of fixed assets. The increase in expenditure was mainly due to the acquisition of a 60% ownership interest in Tianlang and a 100% interest in Harbin Nuoya and Changchun Nuoya.

As of September 30, 2011, we had working capital of \$75,153,228, an increase of \$2,539,282 from working capital of \$72,613,946 at December 31, 2010. We consider current working capital and borrowing capabilities adequate to cover our planned operating and capital requirements.

We believe that our working capital, together with our cash flow from operations will be sufficient to enable us to meet our cash requirements for the next 12 months. However, we may incur additional expenses as we seek to expand our business to offer services in other parts of the PRC as well as to market and continue the development of our vocational training activities, and it is possible that we may require additional funding for that purpose in the future. It also is possible that we may seek to acquire one or more businesses in the education field, and we may require financing for that purpose. We cannot assure you that funding will be available if and when we require funding.

## Off-Balance Sheet Arrangements

As of September 30, 2011, we had no off-balance sheet arrangements.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.



#### Item 4. Controls and Procedures.

##### Evaluation of our Disclosure Controls

As of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer have evaluated the effectiveness of our “disclosure controls and procedures” (“Disclosure Controls”). Disclosure Controls, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our Disclosure Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based upon their controls evaluation, our Chief Executive Officer and Chief Financial Officer noted a material weakness and concluded that the Company's disclosure controls and procedures were not effective to ensure that information required to be disclosed by the Company in the reports that the Company files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and formats. The Company's management determined that a material weakness exists with respect to the Company's disclosure controls and procedures because the Company's quarterly reports for the quarters ended March 31, 2011 and June 30, 2011 erroneously did not include interest income of \$381,476 for the quarter ended March 31, 2011 and \$381,745 for the quarter ended June 30, 2011, related to the loan made to Nanchang Institute of Technology and the tax effect of \$57,222 for the quarter ended March 31, 2011 and \$57,262 for the quarter ended June 30, 2011. Management has since resolved to take corrective actions designed to ensure that material information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and accumulated and communicated to them as appropriate to allow timely decisions regarding required disclosure.

##### Changes in internal control over financial reporting

There have been no changes in our internal controls over financial reporting during our third fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

#### Item 1. Legal Proceedings.

We are presently involved in two putative class action lawsuits filed in the U.S. District Court for the Central District of California. The first action, *Apicella v. China Education Alliance, Inc., et al.*, No. 10-cv-09239 (CAS)(JCx), was

filed on December 2, 2010; the second action, *Clemens v. China Education Alliance, Inc., et al.*, No. 10-cv-09987 (JFW)(AGR<sub>x</sub>), was filed on December 28, 2010. On March 2, 2011, both actions were consolidated in *In re China Education Alliance, Inc. Securities Litigation*, No. 10-cv-09239 (CAS) (JC<sub>x</sub>)(C.D. Cal.). The Consolidated Amended Complaint alleges that we and the other defendants are liable under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 for allegedly false and misleading statements and omissions in our public filings between 2008 and 2010 and in an investor conference call in December 2010. The Consolidated Amended Complaint also asserts claims under Section 20(a) of the Securities Exchange Act of 1934 against the individual defendants. The Court denied the company's motion to dismiss the Consolidated Amended Complaint on October 11, 2011. In addition, on October 28, 2011, a derivative lawsuit was filed on behalf of the company in the U.S. District Court for the Central District of California against the individuals named as defendants in the securities class action lawsuit for alleged breaches of fiduciary duties based on similar facts as alleged in the class action. The derivative lawsuit is *Padnos v. Yu, et al.*, No. 11-cv-8973 (C.D. Cal.). If we were to be subsequently involved in more litigation proceedings, and/or we are unable to settle these lawsuits or any other similar lawsuits on terms favorable to us and/or if adverse judgments were to be levied against us, our profitability could be severely impacted. Also, these lawsuits could result in substantial costs, potential liabilities and the diversion of management's attention and resources and result in a material adverse effect on our financial condition and results of operations.

Item 1A. Risk Factors

For information regarding risk factors, see “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2010. There have been no material changes to the Company’s risk factors during the third quarter of 2011.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved).

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

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

Exhibit No.	Title of Document
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Principal Executive Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certification of the Principal Financial Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101.INS	XBRL Instance Document**
101.SCH	XBRL Schema Document**
101.CAL	XBRL Calculation Linkbase Document**
101.LAB	XBRL Label Linkbase Document**
101.PRE	XBRL Presentation Linkbase Document**
101.DEF	XBRL Definition Linkbase Document**





\* The Exhibit attached to this Form 10-Q shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act") or otherwise subject to liability under that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except as expressly set forth by specific reference in such filing.

\*\* Attached as Exhibits 101 to this report are the following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Cash Flows, and (iv) related notes to these financial statements tagged as blocks of text. The XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed "filed" or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, and is not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of those sections.

SIGNATURES

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

CHINA EDUCATION ALLIANCE, INC.

Date: November 9, 2011

By: /s/ Xiqun Yu  
Xiqun Yu  
Chief Executive Officer and President  
(Principal Executive Officer)

Date: November 9, 2011

By: /s/ Alice Lee Rogers  
Alice Lee Rogers  
Chief Financial Officer  
(Principal Financial Officer)