CHINA EDUCATION ALLIANCE INC.
Form 10-Q
August 14, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

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

For the transition period from ______________ to _____________

Commission file number: **333-101167**

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

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

011-86-451-8233-5794
(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 S No £

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

Large accelerated filer	£	Accelerated filer	£
Non-accelerated filer	£	Smaller reporting company	S

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

As of June 30, 2008, there 21,892,631** shares of $0.001 par value common stock issued and outstanding.

** Adjusted to reflect a 1-for-3 reverse stock split which was effective as of October 12, 2007.

FORM 10-Q
CHINA EDUCATION ALLIANCE, INC.
INDEX

		Page
PART I.	Financial Information	4
	Item 1. Financial Statements (Unaudited)	4
	Condensed Consolidated Balance Sheets as of June 30, 2008 (Unaudited) and December 31, 2007	4
	Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2008 and 2007 (Unaudited)	5
	Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2008 and 2007 (Unaudited)	6
	Notes to Condensed Consolidated Financial Statements as of June 30, 2008 (Unaudited)	7
	Item 2. Management's Discussion and Analysis of Financial Condition or Plan of Operation	20
	Item 3. Quantitative and Qualitative Disclosures About Market Risk.	31
	Item 4. Controls and Procedures	32
PART II.	Other Information	33
	Item 1. Legal Proceedings	33
	Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	33
	Item 3. Defaults Upon Senior Securities	33
	Item 4. Submission of Matters to a Vote of Security Holders.	33
	Item 5. Other Information	33
	Item 6. Exhibits	33
	Signatures	34

(Inapplicable items have been omitted)

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

China Education Alliance, Inc. and Subsidiaries
Consolidated Balance Sheet
June 30, 2008
(Unaudited)

	June 30, 2008	December 31, 2007
ASSETS	(unaudited)	
Current Assets		
Cash and cash equivalents	$ 19,377,514	$ 11,778,954
Advances to related parties	-	108,536
Other Receivable	477,094	-
Prepaid expenses	710,522	1,612,779
Total current assets	20,565,130	13,500,269
Long term investment	436,567	-
Property and equipment, net	6,137,680	6,186,824
Intangible, net	1,759,150	623,560
	$ 28,898,527	$ 20,310,653
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	$ 456,895	$ 423,109
Deferred revenues	1,298,279	1,245,507
Total current liabilities	1,755,174	1,668,616
Stockholders' Equity		
Preferred stock ($0.001 par value, 20,000,000 shares authorized, 7,597,645 and 9,397,645 issued and outstanding, respectively, aggregate liquidation preference of $2,717,152 and $3,383,152, respectively)	3,010,144	3,677,944
Common stock ($0.001 par value, 150,000,000 shares authorized, 21,892,631 and 19,409,830, issued and outstanding, respectively)	21,893	19,410
Additional paid-in capital	10,642,986	6,378,110
Accumulated other comprehensive income	2,575,382	1,243,541
Retained earnings	10,892,948	7,323,032
Total stockholders' equity	27,143,353	18,642,037
	$ 28,898,527	$ 20,310,653

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

4

China Education Alliance, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
For the Three and Six Months Ended June 30, 2008 and 2007
(Unaudited)

	Three months ended June 30		Six months ended June 30,	
	2008	2007	2008	2007
Revenues				
Online education revenues	$ 3,853,942	$ 3,717,985	$ 6,940,727	$ 6,344,653
Training center revenues	604,752	631,770	1,588,384	1,091,329
Total revenue	4,458,694	4,349,755	8,529,111	7,435,982
Cost of Goods Sold				
Online education costs	482,825	619,870	907,867	1,287,617
Training center costs	254,867	227,525	654,457	446,089
Total cost of goods sold	737,692	847,395	1,562,324	1,733,706
Gross Profit				
Online education gross profit	3,371,117	3,098,115	6,032,860	5,057,036
Training center gross profit	349,885	404,245	933,927	645,240
Total gross profit	3,721,002	3,502,360	6,966,787	5,702,276
Operating Expenses				
Selling expenses	1,415,683	1,088,728	2,613,018	1,839,166
Administrative	318,543	438,003	625,905	595,666
Depreciation and amortization	218,173	107,052	415,831	213,177
Total operating expenses	1,952,399	1,633,783	3,654,754	2,648,009
Other Income (Expense)				
Other Income	6,668	55,494	528,497	55,494
Interest income	31,528	10,459	56,436	16,086
Interest expense	(21,842)	(388,582)	(21,842)	(493,079)
Total other income (expense)	16,354	(322,629)	563,091	(421,499)
Net Income Before Provision for Income Tax	1,784,957	1,545,948	3,875,124	2,632,768
Provision for Income Taxes				
Current	128,964	152,838	305,208	236,745
Net Income	$ 1,655,993	$ 1,393,110	$ 3,569,916	$ 2,396,023
Basic Earnings Per Share	$ 0.08	$ 0.02	$ 0.17	$ 0.04
Basic Weighted Average Shares Outstanding	21,202,359	57,965,000	21,202,359	57,965,000

Diluted Earnings Per Share	$	0.07	$	0.02	$	0.14	$	0.04
Diluted Weighted Average Shares Outstanding		24,818,668		60,917,777		24,818,668		60,917,777
The Components of Other Comprehensive Income								
Net Income	$	1,655,993	$	1,393,110	$	3,569,916	$	2,396,023
Foreign currency translation adjustment		55,303		(210,170)		1,331,841		48,596
Comprehensive Income	$	1,711,296	$	1,182,940	$	4,901,757	$	2,444,619

See accompanying summary of accounting policies and notes to financial statements.

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

	Six Months Ended June 30,	
	2008	2007
Cash flows from operating activities		
Net Income	$ 3,569,916	$ 2,396,023
Adjustments to reconcile net cash provided by operating activities		
Depreciation and amortization	673,059	383,734
Amortization of loan discount - warrants attached to loans	-	420,639
Warrants issued for services	-	12,371
Stock issued for services	-	15,900
Net change in assets and liabilities		
Other receivables	(477,094)	54,723
Prepaid expenses and other	484,128	493,493
Advances from related parties	108,536	-
Accounts payable and accrued liabilities	33,786	236,875
Deferred revenue	52,772	848,425
Net cash provided by operating activities	4,445,103	4,862,183
Cash flows from investing activities		
Purchases of fixed assets	(409,378)	(500,732)
Long-term investment	(436,567)	-
Net Cash (used in) investing activities	(845,945)	(500,732)
Cash flows from financing activities		
Warrants exercised	2,667,559	2,067,447
Effect of exchange rate	1,331,841	48,596
Net increase in cash	7,598,558	6,477,494
Cash and cash equivalents at beginning of year	11,778,954	1,838,339
Cash and cash equivalents at end of year	$ 19,377,514	$ 8,315,833
Supplemental disclosure of cash flow information		
Interest paid	$ -	$ 59,588
Taxes paid	$ 94,737	$ -
Value of warrants issued for services	$ -	$ 12,371
Non-cash investing and financing activities		
Conversion of preferred stock to common	$ 667,800	$ 339,076

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

China Education Alliance, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

1. Description of Business

Nature of organization - China Education Alliance, Inc. (the "Company"), 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 the Plan of Exchange to acquire Harbin Zhong He Li Da Education Technology, Inc. ("ZHLD"), a corporation formed on August 9, 2004 in the City of Harbin of Heilongjiang Province, People's Republic of China, with an authorized capital of $60,386 (RMB500,000).

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

ZHLD is a technology company engaged in the online education industry in the People's Republic of China. Its mission is to promote distance learning development in the People's Republic of China, to improve the efficiency and effectiveness of elementary education, higher education, vocational education, skill education, continuing education, and professional training programs, and to integrate with the international education system.

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

ZHLD also owns 70% of Beijing Hua Yu Hui Zhong Technology Development Co., Ltd. ("BHYHZ"). BHYHZ was formed on September 30, 2006 in the PRC. The remaining 30% interest was given to The Vocational Education Guidance Center of China for no consideration. The 30% interest in BHYHZ that the Company transferred to The Vocational Education Guidance Center of China 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. The minority losses absorbed by the Company for the six months ended June 30, 2008 was $73,096.

On April 18, 2008, ZHLD entered into an agreement and supplementary agreement with Harbin Daily Newspaper Group to invest in a joint venture company, Harbin New Discovery Media Co., Ltd. ZHLD contributed RMB 3,000 000 (approximately, $430,000) and Harbin Daily Newspaper Group contributed RMB 3,120,000 (approximately, $445,000) towards the registered capital of Harbin New Discovery Media Co. In return for their respective contributions, ZHLD will own 49.02% equity interest and Harbin Daily Newspaper Group will own 50.98% equity interest in Harbin New Discovery Media Co., Ltd. The parties are prohibited, for the duration of the joint venture from retiring or transferring their equity 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 June 30, 2008 is $436,567.

Pursuant to the terms of the supplementary agreement, Harbin Daily Newspaper Group assigned all its rights in the "Scientific Discovery" newspaper exclusively to the joint venture company, Harbin New Discovery Media Co. 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, Harbin Daily 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 subsidiary of ZHLD.

On April 27, 2008, the Company entered into a Share Transfer Agreement with Mr. Yuli Guo (the "Vendor") and Word Exchanges, Inc. ("WEI") to purchase from the Vendor seventy (70) issued and outstanding ordinary shares in WEI, representing 70% of the entire issued share capital of WEI. In consideration for the said shares, the Company issued to the Vendor 400,000 shares of its common stock, par value US$0.001 per share with $2.33 closing price per share. The Vendor retained the remaining 30% of the issued share capital of WEI. The Vendor has agreed not to transfer the shares of the Company to a third party for fifteen (15) years and to grant the Company a right of first refusal in the event the vendor is desirous of selling such shares. The sale transaction closed on April 29, 2008. As a result of the transaction, WEI is now a 70% owned subsidiary of the Company. The Company will absorb any losses attributable to the minority interest as the minority interest has no basis in their WEI investment. Since December 19, 1991, WEI has been registered at 30 Denton Avenue, Apartment 2216, Toronto, Canada. WEI provides English training programs, English test preparation courses and overseas study and consulting services in the PRC.

The Company's principal business is the distribution of educational resources through the Internet. The Company's website, www.edu-chn.com, is a comprehensive education network platform which is based on network video technology and large data sources of elementary education resources. The Company has a data base comprised of such resources as test papers that were used for secondary education and university level courses as well as video on demand. The data base includes more than 300,000 exams and test papers and courseware for college, secondary and elementary schools. While some of these exams were given in previous years, new instructors are engaged to develop new exams and methodologies for taking the exams. The Company markets this database under the name "Famous Instructor Test Paper Store." Also offered, though the website, is video on demand, which includes tutoring of exam papers and exam techniques. The Company complements past examination and test papers by providing an interactive platform for students to understand the key points from the papers and examinations. Although a number of the resources are available through the website without charge, our subscribers are charged for such services as the "Famous Instructor Test Paper Store" and the video on demand. Subscribers can purchase debit cards which can be used to download material from the website.

The Company also provides on-site teaching services in Harbin, which are marketed under the name "Classroom of Famed Instructors." The Company has a 36,600 square foot training facility in Harbin, Heilonjiang Province, the People's Republic of China, which has 17 classrooms and can accommodate up to 1,200 students. These classes, which complement our on-line education services, provide classroom and tutoring to our students. The courses primarily cover the compulsory education curriculum of junior, middle and high school. The Company charges tuition for these classes.

The Company operates in one business segment, that of education, in which it operates in two revenue areas of online education and education training centers. With the acquisition of WEI, the Company is also in the business of providing English training programs, English test preparation courses and overseas study and consulting services through five entities, namely, Beijing Weishi Success Education Technology Co., Ltd., Beijing World Exchanges English College, Yantai WECL English College, Xiamen Siming District Weishi English Training School and the Private Qingdao Weishi Education Training School in Beijing, Yantai, Xiamen and Qingdao. Also, with the establishment of Harbin New Discovery Media Co., Ltd, the Company is now in the business of publishing and circulating "Scientific Discover", a scientific information newspaper, with a focus on education.

2 Basis of Preparation of Financial Statements

The accompanying financial statements differ from the financial statements used for statutory purposes in 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.

The accompanying condensed consolidated financial statements have been prepared in compliance with Rule 310 of Regulation S-K and U.S. generally accepted accounting principles, but do not include all of the information and disclosures required for audited financial statements. These statements should be read in conjunction with the condensed consolidated financial statements and notes thereto included in the Company's latest Annual Report on Form 10-KSB for the year ended December 31, 2007. In the opinion of management, these interim statements include all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of operations, financial position and cash flows for the interim periods presented. Operating results for the six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

These notes and accompanying financial statements retroactively reflect a reverse split that became effective October 12, 2007. Fractional shares were rounded up resulting in the issuance of 216 shares in excess of the actual conversion rate of 3-to-1.

3. Summary of Significant Accounting Policies

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its wholly subsidiaries (ZHLD and ZHTC) and its majority owned subsidiaries (BHYHZ and WEI). All inter-company transactions and balances were eliminated. Minority interest in the net assets and earnings or losses of BHYHZ and WEI are reflected in the caption "Minority interest" in the Company's Consolidated Balance Sheet and Statements of Operations. Cumulative losses applicable to minority interest that exceed the minority's interest in the subsidiary's capital, the losses in excess of the minority's interest in the subsidiaries capital are charged against the majority interest. Subsequent profits earned by a subsidiary under such circumstances that are applicable to the minority interests should be allocated to the majority interest to the extent minority losses have been previously absorbed.

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, reserves for customer returns and allowances, uncollectible accounts receivable, slow moving, obsolete and/or damaged inventory and stock warrant valuation. 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 equivalents. The carrying amounts reported in the accompanying consolidated balance sheet 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.

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 are 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. Based on this assessment there was no impairment at December 31, 2007 and June 30, 2008.

Intangible Assets - Intangible assets consist of franchise rights, transfer of minority interest in BHYHZ subsidiary for no consideration, and WEI's intangible that are amortized over the lives of the rights agreements, which all five years except for the WEI intangible. As of June 30, 2008, the Company is determining the appropriate classification, type and life of the WEI intangible. 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 quarters ended June 30, 2008 and 2007.

Long-Lived Assets - The Company reviews its long-lived assets for impairment when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. 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 reporting period.

Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the market rate of exchange ruling 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 dealt with as a separate component within shareholders' equity.

Income recognition - Revenue is recognized in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, which states that revenue should be 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 has expired.

Interest income is recognized when earned, taking into account the average principal amounts outstanding and the applicable interest rates.

Deferred Revenue - Deferred revenue reflects the unearned portion of debit cards sold and tuition payments received. Deferred revenue as of June 30, 2008 and December 31, 2007 were $1,298,279 and $1,245,507 respectively.

Advertising - The Company expenses advertising costs for television spots at the time they are aired 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 six months ended June 30, 2008 and 2007 were $279,223 and $47,811, $422,840 and $193,411, 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 indefinitely invest these earnings in foreign operations.

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No 48, Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No 109 (FIN 48). FIN 48 is intended to clarify the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes the recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Under FIN 48, evaluation of a tax position is 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 benefit to be recognized in the financial statements. A tax position is measured at the largest amount of benefit where there is a greater than 50% likelihood of being realized upon ultimate settlement.

The tax position 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 benefits as of June 30, 2008, is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax benefits as of June 30, 2008, 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 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 People's Republic of China Concerning Income Tax on Enterprises promulgated by the State Council which came into effect on January 1, 1994, income tax is payable by Wholly Foreign Owned Enterprises 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 "Wholly Foreign Owned Enterprise." This exemption ended on December 31, 2006, at which time ZHLD qualified under the current tax structure for a 50% reduction in the statutory enterprise income tax rates for the three years ended and ending December 31, 2007, 2008 and 2009.

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.

Value added tax

The Provisional Regulations of the People's Republic of China Concerning Value Added Tax 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, value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

Value added tax 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 value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year.

Software companies are eligible for a 14% VAT tax refund under PRC tax policy. The Company applied for and received VAT refunds of $528,497 for the six months ended June 30, 2008.

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 December 31, 2007 the Company has advanced to their CEO $108,336 to develop the Company. The funds were expended within the six months ended June 30, 2008.

Fair value of financial instruments - The carrying amounts of certain financial instruments, including cash, accounts receivable, commercial notes receivable, other receivables, accounts payable, commercial notes payable, accrued expenses, and other payables approximate their fair values as of June 30, 2008 and December 31, 2007 because of the relatively short-term maturity of these instruments.

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 retained earnings.

Recent accounting pronouncements -

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS 157 are effective for the fiscal years beginning after November 15, 2007. Therefore, the Company anticipates adopting this standard as of January 1, 2008. Management has not determined the effect, if any, the adoption of this statement will have on the Company's financial condition or results of operations.

In September 2006, the FASB issued Statement No. 158,*"Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans"* ("SFAS No. 158"), an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires (a) recognition of the funded status (measured as the difference between the fair value of the plan assets and the benefit obligation) of a benefit plan as an asset or liability in the employer's statement of financial position, (b) measurement of the funded status as of the employer's fiscal year-end with limited exceptions, and (c) recognition of changes in the funded status in the year in which the changes occur through comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure the plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. This Statement has no current applicability to the Company's financial statements. Management adopted this Statement on January 1, 2007, and the adoption of SFAS No. 158 did not have a material impact to the Company's financial position, results of operations, or cash flows.

In February 2007, the FASB issued Statement No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). This statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS 159 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) will change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) will change the accounting treatment and disclosure for certain specific items in a business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141(R) will impact the Company in the event of any future acquisition.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company does not believe that SFAS 160 will have a material impact on its consolidated financial statements.

13

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133” (“FAS 161”). FAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. The guidance in FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently assessing the impact of FAS 161.

4. Concentrations of Business and Credit Risk

Substantially all of the Company’s bank accounts are in banks located in the People’s Republic of China and 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 People’s Republic of China 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. The Company sells its products to students who purchase debit cards which can be used to download the Company’s products. Since the Company is paid in advance, it has no receivables and no significant credit risk.

For the three and six months ended June 30, 2008 and 2007, no single customer accounted for 10% or more of revenue.

As of June 30, 2008 and December 31, 2007, the Company had no insurance coverage of any kind. Accrual for losses is not recognized until such time as an uninsured loss has occurred. The Company has not accrued for any losses as of June 30, 2008 And December 31, 2007

Payments of dividends may be subject to some restrictions.

5. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

		June 30, 2008 (unaudited)		December 31, 2007
Cash on Hand	$	429	$	2,652
Bank Deposits		19,377,085		11,776,302
	$	19,377,514	$	11,778,954

6. Other Receivable

Other Receivables are all unsecured and due upon demand:

	June 30, 2008 (unaudited)	December 31, 2007
Joint Venture Partner	$ 454,029	$ -
Shareholder	23,065	-
	$ 477,094	$ -

7. Prepaid Expenses

Prepaid Expenses consist of the following:

	June 30, 2008 (unaudited)	December 31, 2007
Prepaid rent	$ 238,535	$ 285,269
Prepaid software development	291,045	633,562
Prepaid teachers and online material	143,172	143,927
Prepaid services and professional fees	24,011	109,589
Prepaid television advertising	-	401,918
Other prepaid expenses	13,759	38,514
	$ 710,522	$ 1,612,779

8. Property and Equipment

Property and Equipment consist of the following:

	June 30, 2008 (unaudited)	December 31, 2007
Buildings	$ 3,553,701	$ 3,434,247
Transportation vehicles	190,937	179,737
software	2,776,431	2,613,573
Furniture and fixtures	1,353,033	1,273,634
	7,874,102	7,501,191
Less: Accumulated Depreciation	(1,736,422)	(1,314,367)
Property and Equipment, Net	$ 6,137,680	$ 6,186,823

For the three and six months ended June 30, 2008 and 2007, depreciation expenses totaled $218,240 and $ 107,052, $458,520 and $308,184 respectively. Allocated in the three and six months ended June 30, 2008 and 2007 depreciation expenses totaling $68,731 and $47,504, $137,462 and $95,007, respectively were included in cost of goods sold.

As of June 30, 2008 the Company does not have any land use rights agreements with the PRC for the office buildings owned by the Company.

9. Intangibles

Intangibles of the Company consist of franchise rights, transfer of minority interest in BHYHZ subsidiary for no consideration and WEI's intangible. There are three franchise rights in the company: Usage rights, ACCP training course, and BENET training course. The Usage rights is software to help university students to search jobs, post their resumes, and communicate with potential employers. The ACCP training course is an authority for training software engineers under authorized training procedures with authorized textbooks. The BENET training course is an authority for training internet engineers under authorized training procedures with authorized textbooks.

In connection with the organization of BHYHZ, the Company transferred to an unrelated non-profit, quasi-governmental entity for no consideration a 30% ownership interest in the contributed capital of BHYHZ. The value of the transferred ownership is reflected as an intangible asset on the consolidated financial statements. At June 30, 2008, the intangible asset relating to this transaction was $38,234 net of amortization of $5,462. The minority ownership interest share of operating losses of BHYHZ are being absorbed by the Company as the minority interest holdings have no basis in their investment. The minority losses absorbed by the Company for the six months ended June 30, 2008 was $73,096. The Company is amortizing this intangible over an estimated useful life of four years.

The April 29, 2008 acquisition of WEI for $932,000, consisting entirely of 400,000 shares of the Company's common stock at a market price of $2.33, per share, was allocated entirely to the Company. The 30% minority interest of WEI has no basis in their investment accordingly; the entire acquisition was allocated to the Company. As the WEI acquisition included no assets or liabilities of WEI, the entire purchase price was allocated to an intangible asset. As of June 30, 2008 the Company is determining the appropriate classification, type and life of this intangible asset. For the six months ended June 30, 2008 the Company has amortized $15,533 of the intangible based on a preliminary life of fifteen years. At June 30, 2008, the intangible asset relating to this transaction was $916,467 net of amortization of $15,533.

Intangibles consist of the following:

	June 30, 2008 (Unaudited)	December 31, 2007
Usage rights.	$ 436,567	$ -
ACCP training course	733,433	729,703
BENET training course	51,369	53,826
Minority interest in BHYHZ subsidiary	43,696	43,696
WEI intangible	932,000	-
	2,197,065	827,225
Less: accumulated amortization	(437,915)	(203,665)
Intangibles, net	$ 1,759,150	$ 623,560

For the three and six months ended June 30, 2008 and 2007, amortization expenses totaled $118,970 and $21,848, $437,915 and $43,696 respectively.

Future amortization of intangible assets is as follows:

Year Ended December 31,	
2008	$ 236,290
2009	392,056
2010	234,999
2011	196,800
2012	62,132
Thereafter	636,873
	$ 1,759,150

10. 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. Therefore, 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 June 30, 2008 and December 31, 2007, the Company had deferred revenue of $1,298,279 and $1,245,507, respectively.

11. Stockholders' Equity

The Company recorded the following equity transactions during the six months ended June 30, 2008:

- On June 27, 2008, the Company issued 400,000 common shares with par value US$0.001 per share to Mr. Yuli Guo, to acquire 70% of WEI.

- During the six months ended June 30, 2008 warrants for the purchase of 1,482,801 shares of common stock were exercised for proceeds of $2,667,559.

- During the six months ended June 30, 2008 at total of 1,800,000 Series A Preferred Shares were converted into 600,000 shares of common stock valued at $667,800.

- On March 17, 2008, the Company's board of directors approved the repurchase of up to 1,000,000 shares of the Company's common stock from time to time in the open market at prevailing market prices. As of June 30, 2008 no shares have been repurchased.

12. Earnings Per Share

SFAS 128 requires a reconciliation of the numerator and denominator of the basic and diluted earnings per share (EPS) computations.

For the six months ended June 30, 2008, dilutive shares include 2,532,548 shares attributable to convertible preferred stock, outstanding warrants to purchase 413,156 shares of common stock at an exercise price of $1.50, warrants to purchase 83,333 shares of common stock at an exercise price of $2.25, warrants to purchase 2,055,516 shares of common stock at an exercise price of $2.07, warrants to purchase 681,035 shares of common stock at $2.40 and warrants to purchase 264,369 shares of common stock at $3.00.

For the six months ended June 30, 2007, dilutive shares include warrants to purchase 100,000 at an exercise price of $1.89 and warrants to purchase 50,000 shares at an exercise price of $1.29.

The following reconciles the components of the EPS computation

	Six Months Ended June 30,	
	2008	2007
Net income available to common shareholders	$ 3,569,916	$ 2,396,023
Weighted average shares outstanding - basic	21,202,359	57,965,000
Effect of dilutive securities	3,616,309	2,952,777
Weighted average shares outstanding - diluted	24,818,668	60,917,777
Earnings per share - basic	$ 0.17	$ 0.04
Earnings per share - diluted	$ 0.14	$ 0.04

13. Commitments and Contingencies

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 affect on the Company's financial condition and operations.

14. Warrants

	Shares underlying warrants		Weighted average Exercise Price
Outstanding as of January 1, 2007	510,003	$	1.50
Granted	4,747,707		1.99
Exercised	(127,500)		1.50
Expired or cancelled	-		-
Outstanding as of December 31, 2007	5,130,210		1.50
Granted	-		-
Exercised	(1,482,801)		1.80
Expired or cancelled	-		-
Outstanding as of June 30, 2008	3,647,409	$	2.12

The following table summarizes information about stock warrants outstanding and exercisable as of June 30, 2008.

	Exercise Price	Outstanding June 30, 2008	Weighted Average Remaining Life in Years	Number exercisable
$	1.29	50,000	1.40	50,000
$	1.50	413,156	3.66	413,156
$	1.89	100,000	2.09	75,000
$	2.07	2,055,516	3.85	2,055,516
$	2.25	83,333	1.84	83,334
$	2.40	681,035	3.85	681,035
$	3.00	264,369	3.85	264,369
		3,647,409	3.70	3,622,410

15. 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 can not 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 laws or regulations are changed by the PRC government, 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 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.

Item 2. Management's Discussion and Analysis or Plan of Operation.

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 Registration Statement filed with the U.S. Securities and Exchange Commission on Form SB-2 (file no. 333-146023) 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. There can be no assurance that actual results will not differ from those estimates.

Overview

Our principal business is the distribution of educational resources through the Internet. Our website, www.edu-chn.com, is a comprehensive education network platform which is based on network video technology and large data sources of education resources. We have a database comprising such resources as test papers for secondary education courses as well as video on demand. Our database includes more than 300,000 exams, test papers and courseware for secondary and elementary schools. We also offer, through our website, video on demand, which includes tutoring of past examination papers and examination techniques.

We also provide on-site teaching services in Harbin, where we have a 36,600 square foot training facility with 17 classrooms that can accommodate 1,200 students. These classes complement our on-line education services. The courses cover primarily the compulsory education curriculum of junior, middle and high school. We charge tuition fees for these classes.

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 online education business through 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 People's Republic of China provide the government broad power to fix and adjust prices. We need to obtain government approval in setting our prices for classroom coursework and tutorials, which affects our revenue in our training center business. 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 Chinese 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. At June 30, 2008, we had no accounts receivable.

Our prepaid expenses account for a significant portion of our current assets - approximately 710,522 or 3.5% of current assets at June 30, 2008. Prepaid expenses are primarily comprised of advance payments made for services to teachers for online materials and video and prepaid rent. At June 30, 2008, . prepaid press releases totaled $3,638, prepayments to teachers for online materials totaled $143,172, prepayment of rent expense totaled $238,535, consulting fees totaled $8,731, legal fees totaled $11,642, software development totaled $291,045 and other prepaid expenses were $13,759. We amortize the prepayments to teachers over three 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. The prepayment to teachers decreases as the materials are delivered and the prepaid rent decreases ratably during the terms of the leases.

As a result of both the manner in which we recognize revenue and the manner that we expense the cost of our materials, there is a difference between our cash flow and both revenue and cost of revenue.

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 we increase the available material as well as depreciation related to computer equipment and software and direct labor cost. This business segment generates a relatively high gross margin, which was 86.9% for the six months ended June 30, 2008. The gross margin is affected by the payments we have to make to the teachers for the materials. In our training center business segment, the principal components of cost of sales are faculty and the amortization of intangible assets. This business segment generates a lower gross margin than the online education business segment, which was 58.8% for the six months ended June 30, 2008. The tuition that we charge our students at our training center is subject to government approval. As a result, we may not be able to pass on to our students any increases in costs we incur, including increased costs of faculty. Our gross margin in the training center is also affected by the size of our classes.

Our on-line products and our training services are dependent upon the government's education policies. Any significant changes in curriculum or testing methods could render all or a significant portion of our library of test papers and our training center obsolete and we may have to devote substantial resources in adapting to the changes.

We have recently added a platform for training agencies and schools to offer their services, and we offer job search guidance and career planning courses to college graduates through this platform. This business has become part of our online education business, since it is currently largely an Internet-based activity.

Because the purchase of both our on-line and our training center is made from discretionary funds, our business is dependent upon both the economy of the People’s Republic of China and the perception of students that they will benefit from improving their ability to perform well on standardized tests which are given before middle school, high school and university.

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-site training on network engineering and ACCP software engineering to computer vocational training school students. As a result of this acquisition, we became the partner of Beida Qingniao APTEC Software Engineering within Heilongjiang Province in the People’s Republic of China for vocational training. The acquisition includes six classrooms for on-site education classes, six computer rooms and patented course materials. Compass Training School currently has two principal education programs focused on network engineering and ACCP software engineering.

22

We, through our wholly-owned subsidiary, 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 Vocational Education Guidance Center of China, a non-profit, quasi-government entity, for no consideration in order to enable us to work with the Guidance Center's network to expand our business. The value of this 30% interest, which is based on our cost, is treated as an intangible.

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

On April 27, 2008, we entered and closed an agreement to acquire 70% (70 shares of common stock) of the issued and outstanding shares of World Exchanges Inc. ("World Exchanges"), which provides English training programs, English test preparation courses and overseas study and consulting services through its five existing "Group Entities".

The five "Group Entities" are Beijing Weishi Success Education Technology Co., Ltd., Beijing World Exchanges English College, Yantai WECL English College, Xiamen Siming District Weishi English Training School and the Private Qingdao Weishi Education Training School, all of which provide English language training services in regions of Beijing, Yantai, Xiamen and Qingdao.

Accordingly, we now have the controlling rights to operate the five "Group Entities" through World Exchanges. World Exchanges primarily operates the World Exchanges College of Language ("WECL") English Education business. The WECL has been providing English instruction for Chinese students since 1988. WECL offers 1) a Qualifying Program designed to help beginners who want to learn English as a second language to develop competence in communication skills at an elementary level; 2) a Combined Studies Program which is open to students with a College degree or at least six years of high school; 3) a General English Studies Program, which is the second year of the Combined Studies program or may be taken by someone with 3 years of university courses and a minimum of 6 years of English instruction. In addition, WECL recently started providing language test preparation programs and overseas study and consulting services for students.

We will have a share of the revenue from the English language training courses at the Group Entities and other revenue will come from their part-time, language training program, test preparation program as well as overseas study and consulting services for students.

On April 18, 2008, the Company's wholly-owned subsidiary, Harbin Zhong He Li Da Education Technology, Inc. entered an agreement to contribute RMB3, 000,000 (approximately, $430,000) for a 49.02% equity interest of Harbin New Discovery Media Co (HNDM), which provides domestic advertising, press releasing, and agency service, software services, and business services national wide.

HNDM has strong newspaper brand recognition and a loyal readership in the Heilongjiang province. Through HNDM, we may create new educational material distribution channels in readable newspaper format in the future. In addition, our joint venture partner, Harbin Daily Newspaper Group has extensive expertise, resources, and relationships in the newspaper business which we may leverage to assure success in any new ventures.

HNDM's "Scientific Discovery" newspaper has two publications per week. The first one comprises elementary and secondary school tutorship materials, synchronizing with students syllabi. The second one comprises scientific information and guidance in daily life. We anticipate a weekly circulation of 150,000 sets.

23

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 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.

Franchise rights, which we acquired from third parties, are amortized over the lives of the rights agreements, which is five years. We evaluate the carrying value of the franchise rights 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 quarter ended June 30, 2008.

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. 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 in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, which states that revenue should be 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. Revenues are 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 are no unearned advertising revenues.

Prepaid expenses are primarily comprised advance payments made for services to teachers for online materials and video 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 video clips. 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.

We have a stock option compensation plan to our new CFO, Ms. Susan Liu, to purchase a total of 10,000 shares of common stock of the company, such options to vest monthly in equal installments commencing from June 2, 2008 through June 1, 2009. The initial grant shall vest in 833 equal monthly installments.

We do not have any stock option or other equity-based incentive plans for our other officers, directors or key employees. To the extent that we do adopt such plans in the future, such grants will be valued at the granting date and expensed over the applicable vesting period as required by Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payments."

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS No.157"). SFAS No. 157 addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. We anticipate adopting this standard as of January 1, 2008. Management has not determined the effect, if any, the adoption of this statement will have on our financial condition or results of operations.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS No. 158"), an amendment of FASB Statements No. 87, 88, 106 and132(R). SFAS No. 158 requires (a) recognition of the funded status (measured as the difference between the fair value of the plan assets and the benefit obligation) of a benefit plan as an asset or liability in the employer's statement of financial position, (b) measurement of the funded status as of the employer's fiscal year-end with limited exceptions, and (c) recognition of changes in the funded status in the year in which the changes occur through comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure the plan assets and benefit

obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. This Statement has no current applicability to our financial statements. Management adopted this Statement on January 1, 2007 and our adoption of SFAS No. 158 did not have a material impact to our financial position, results of operations, or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 ("SAB No.108"). SAB No. 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB No. 108 requires companies to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is material, companies will record the effect as a cumulative effect adjustment to beginning of year retained earnings and disclose the nature and amount of each individual error being corrected in the cumulative adjustment. SAB No. 108 was effective beginning January 1, 2007. We do not believe SAB 108 will have a material impact on our results from operations or financial position.

In February 2007, the FASB issued Statement No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). This statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS159 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact of SFAS 159 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) will change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) will change the accounting treatment and disclosure for certain specific items in a business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141(R) will impact us in the event of any future acquisition.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We do not believe that SFAS 160 will have a material impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133" ("FAS 161"). FAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The guidance in FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. We are currently assessing the impact of FAS 161.

Results of Operations

Three Months Ended June 30, 2008 and 2007

The following table sets forth information from our statements of operations for the three months ended June 30, 2008 and 2007:

	(Dollars in thousands) Three Months Ended June 30,			
	2008		2007	
Revenue	$ 4,459	100%	$ 4,350	100%
Cost of sales	738	16.5%	848	19.5%
Gross profit	3,721	83.5%	3,502	80.5%
Income from operations	1,769	39.7%	1,868	42.9%
Interest expense	10	0.2%	389	8.9%
Other income	7	0.2%	66	1.5%
Income before income taxes	1,785	40.0%	1,546	35.5%
Provision for income taxes	129	2.9%	153	3.5%
Income before minority interest	1,656	37.1%	1,393	32.0%
Net income	1,656	37.1%	1,393	32.0%

The following table sets forth information as to the gross margin for our two lines of business for the three months ended June 30, 2008 and 2007.

	Dollars in thousands Three Months Ended June 30,	
	2008	2007
Online Education:		
Revenue	$ 3,854	$ 3,718
Cost of sales	483	620
Gross profit	3,371	3,098
Gross margin	87.5%	83.3%
Training center		
Revenue	605	632
Cost of sales	255	228
Gross profit	350	404
Gross margin	57.9%	64.0%

Three Months Ended June 30, 2008 and 2007

Revenue for the three months ended June 30, 2008 (the "June, 30 2008 quarter") increased by $109,000, or 3%, to $4,459,000 compared to $4,350,000 for the three months ended June 30, 2007 (the "June, 30 2007 quarter"). The increase in revenue reflected increases of approximately $0.13 million from the online education division and decrease of $27,018 for the training center. Advertising income is included in our online education revenue. During 2007 and 2008, we added several new programs for vocational studies and certification programs, which provides new source of income for our online education business.

27

Our overall cost of sales decreased by $110,000 to $738,000 in the June 30, 2008 quarter, as compared to $848,000 in the June 30, 2007 quarter. The decrease in cost of sales reflects a $137,045 decrease in our cost of sales for the online education division for the June 30, 2008 quarter which has been partially offset by an increase of $27,342 from our training center division. The online gross margin for the June 30, 2008 quarter also reflects an increase in advertising revenue which has no substantial costs associated with it. The online training division gross margin increased to 87.5% in the June 30, 2008 quarter from 83.3% in the June 30, 2007 quarter due to the fact that online costs are somewhat fixed and margins increase with volume. In the training center division, gross margin decreased to 57.9% in the June 30, 2008 quarter from 64.0% in the June 30, 2007 quarter due to more amortization of training center related intangible assets and decreased payments to lecturers.

Selling expenses increased by $362,955 or 30% to $1,415,683 in the June 30, 2008 quarter from $1,088,728 in the June 30, 2007 quarter. Until the middle of 2007, we did not expend much effort in marketing our services and products, which is reflected in the modest selling expenses in the June 2007 quarter. Our selling expenses include agency fees associated with increased sales of our debit cards.

Administrative expenses decreased by $119, 460 or 27%, to $318,543 in the June 30, 2008 quarter as compared to $438,003 in the June 30, 2007 quarter. The decrease is due primarily to a decrease in salaries and decrease in travel and telephone expense.

Depreciation and amortization increased by $111,121, or 104%, to $218,173 in the June 30, 2008 quarter, as compared to $107,052, in the June 30, 2007 quarter. This increase was due to depreciation and amortization associated with increases in fixed assets and amortization of intangible assets.

Interest expense decreased by $366,740, or 94%, to $21,842 in the June 30, 2008 quarter. There was $388,582 interest expense in the June 30, 2007 quarter, which was attributable to a bridge loan which was made in September 2006.

Under current Chinese tax law, a wholly foreign owned enterprise has a 100% tax holiday for the first two years and a 50% tax holiday for the following three years. Since we became a wholly foreign owned enterprise in 2005, we benefited from a 100% tax holiday for 2005 and 2006 and, under the present law, we will benefit from a 50% tax holiday for 2007, 2008 and 2009. As a result our income taxes for the June 30, 2008 quarter and the June 30, 2007 quarter reflect income taxes at 50% of the applicable tax rate of 15%.

As a result of the foregoing, we had net income of $1,655,993, or $.08 per share (basic and diluted), for the June 2008 quarter, as compared with net income of $1,393,110, or $.02 per share (basic and diluted), for the June 2007 quarter.

Six Months Ended June 30, 2008 and 2007

The following table sets forth information from our statements of operations for the six months ended June 30, 2008 and 2007.

	(Dollars) Six Months Ended June 30,			
	2008		2007	
Revenue:	$ 8,529,111	100%	$ 7,435,982	100%
Cost of sales	1,562,324	18.3%	1,733,706	23.3%
Gross profit	6,966,787	81.7%	5,702,276	76.7%
Income from operations	3,312,033	38.8%	3,054,267	41.1%
Interest Expense	(34,594)	0.4%	(421,499)	5.7%
Value-added tax refund	528,497	6.2%	-	-
Income before income taxes	3,875,124	45.4%	2,632,768	35.4%
Provision for income taxes	305,208	3.6%	236,745	3.2%
Income before minority interest	3,569,916	41.9%	2,396,023	32.2%
Net income	3,569,916	41.9%	2,396,023	32.2%

Our net cash provided by operating activities was $4,445,103 for the six months ended June 30, 2008 a decrease of $417,080 or 8.58% from $4,862,183 for the same period in 2007. This decrease was due to an increase in net income of $1,173,893 along with non-cash charges related to increase of depreciation and amortization of $202,721 as compared to the six months ended June 30, 2007.

We operate in one business segment, that of education, in which we operate in two revenue areas of online education and education training centers. The following table sets forth information as to the gross margin for our two revenue areas for the six months ended June 30, 2008 and 2007.

	(Dollars) Six Months Ended June 30,	
	2008	2007
On-line Education:		
Revenue	$ 6,940,727	$ 6,344,653
Cost of sales	907,867	1,287,617
Gross profit	6,032,860	5,057,036
Gross margin	86.9%	79.7%
Training center		
Revenue	1,588,384	1,091,329
Cost of sales	654,457	446,089
Gross profit	933,927	645,240
Gross margin	58.8%	59.1%

Revenue. Revenue increased by $1,093,129 or 14.7% in for the six months ended June 30, 2008 to $8,529,111 as compared to $7,435,982 for the same period in 2007, resulting in gross profit of $6,966,787 for the six months ended June 30, 2008 as compared to gross profit of $5,702,274 for the same period in 2007. The increase in revenue reflected increases of approximately $596,074 from our on-line education area and approximately $497,055 for our

training center area. Advertising income is included in our on-line education revenue. In both 2007 and 2008, we added several new programs for vocational studies and certification programs, which provided new sources of income for our on-line education area.

Cost of sales. Our overall cost of sales decreased by approximately $171,382 to $1,562,324 for the six months ended June 30, 2008 as compared to $1,733,706 for the same period in 2007. The decrease in cost of sales reflects a $379,750 decrease in our cost of sales for our on-line education area in 2008 offset by an increase of $208,368 from our training center segment. The on-line training area gross margin increased to 86.9% for the six months ended June 30, 2008 from 79.7% for the same period in 2007 due to the fact that on-line education costs are somewhat fixed and margins increase with volume. Our training center area gross margin decreased to 58.8% in for the six months ended June 30, 2008 from 59.1% for the same period in 2007 due to decreased payments to lecturers.

Selling expenses. Selling expenses increased by approximately $773,852, or 42.1%, to $2,613,018 for the six months ended June 30, 2008 from $1,839,166 for the same period in 2007. The increase in selling expenses include increased agency fees associated with increased sales of our debit cards.

Administrative expenses. Administrative expenses increased by $30,239, or 5.1%, to $625,905 in 2008 as compared to $595,666 in 2007. The increase in administrative expenses was due to an increase in professional fees and office expenses offset by decreases in salaries and other administrative expenses.

Depreciation and amortization. Depreciation and amortization increased by $202,654, or 95%, to $415,831 for the six months ended June 30, 2008 as compared to $213,177 for the same period in 2007. This increase was due to depreciation and amortization associated with increases in fixed assets and amortization of intangible assets.

Interest income (expense). Interest expense decreased by $471,237, or 95.6% to $21,842 for the six months ended June 30, 2008 as compared to $493,079 for the same period in 2007. This reflects the conversion of the notes payable to stock during 2007.

Income Taxes. Under current Chinese tax law, a wholly foreign owned enterprise has a 100% tax exemption or "holiday" for the first two years after it so qualifies, and thereafter, a 50% tax "holiday" for three years. Since Harbin Zhong He Li Da became a wholly foreign owned enterprise in 2005, we benefited from a 100% tax holiday in 2006. Under the present law, we benefited from a 50% tax holiday for 2007 and will benefit from a 50% tax holiday in 2008 and 2009. As a result, our income taxes for 2008 and 2007 reflect income taxes at 50% of the applicable tax rate of 15%, or such other applicable tax rate as a result of changes in tax rates effective January 1, 2008. These changes will have the effect of increasing the enterprise tax rate by 2% per year until it reaches an effective tax rate of 25%.

Net income. As a result of the foregoing, we had net income of $3,569,916, or $0.17 per share basic and $0.14 diluted, for the six months ended June 30, 2008, as compared with net income of $2,396,023 or $0.04 per share (basic and diluted), for the six months ended June 30, 2007.

Liquidity and Capital Resources

Our current assets primarily consist of cash and prepaid expenses. We do not have inventory or accounts receivable, and our other receivables are not significant. Our prepaid expenses are primarily advance payments made to teachers for on-line materials and prepaid rent.

At June 30, 2008, we had cash and cash equivalents of $19,377,514, an increase of $7,598,560 or 64.4%, from $11,778,954 at December 31, 2007. This increase reflected the net income generated by our business during 2008, as well as exercises of warrants for common stock of approximately $2.7 million during the six months ended June 30, 2008.

Our net cash provided by operating activities was $4,445,103 for the six months ended June 30, 2008, a decrease of $417,080 or 8.58% from $4,862,183 for the same period in 2007. This decrease was due to an increase in net income of approximately $1.2 million along with non-cash charges related to increase of depreciation and amortization of approximately $0.3 million and an increase in other receivables of approximately $0.4 million as compared to the six months ended June 30, 2007.

As of June 30, 2008, we had working capital of $18,809,956, an increase of $7,031,002 from working capital of $11,831,653 at December 31, 2007. We consider current working capital and borrowing capabilities adequate to cover our planned operating and capital requirements.

Accounts payable and accrued expenses as of June 30, 2008, were $456,895, an increase of $33,786, or 8.0%, from $423,109 at December 31, 2007, resulting from the increased level of cash during the quarter.

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 People’s Republic of China 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. Although we do not have any current plans to make any acquisitions, it 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.

The securities purchase agreement relating to our May 2007 private placement prohibits us (i) from issuing convertible debt or preferred stock until the earlier of five years from the closing or until the investors have converted or exercised and sold the securities issued in the private placement or (ii) from having debt in an amount greater than twice our EBITDA until three years from the closing or until 90% of the securities have been converted or exercised and sold. The investors in the private placement also have a right of first refusal on future financings. These provisions may make it difficult for us to raise money for our operations or for acquisitions.

Off-Balance Sheet Arrangements

As of June 30, 2008, we had no off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We have exposure to market risk of changes in foreign currency exchange rates. We neither hold nor issue financial instruments for trading purposes nor do we make use of derivative instruments to hedge the risks discussed below.

The following sections provide quantitative information on our exposure to market risks. Our use of sensitivity analyses are inherently limited in estimating actual losses in fair value that can occur from changes in market conditions.

Foreign Currency Exchange Rates

We collect revenue from operations principally in the Chinese Renminbi. All of our local sales revenue is collected in and substantially all of our expenses are paid in the Chinese Renminbi. We face foreign currency rate translation risk when our Chinese subsidaries results are translated to U.S. Dollars and with respect to financial instruments denominated in foreign currencies. Our results of operations denominated in foreign currency are translated at the average rate of exchange during the reporting period. Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the market rate of exchange ruling 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.

The Chinese Renminbi had remained stable against the U.S. Dollar at approximately 8.28 Renminbi to 1.00 U.S. Dollar for several years and it was not until July 21, 2005 that the Chinese currency regime was altered, with a 2.1% revaluation versus the United States Dollar. This move initially valued the Renminbi at 8.11 Renminbi per United States Dollar. In addition, the Renminbi is no longer linked to the U.S. currency but rather to a basket of currencies with a 0.3% margin of fluctuation. However, there remains international pressure on the Chinese government to adopt an even more flexible currency policy and as of June 30, 2008 the exchange rate was 6.8718 Renminbi to 1.00 U.S. Dollar. The exchange rate of Renminbi is subject to changes in the People's Republic of China's government policies which are, to a large extent, dependent on the economic and political development both internationally and locally and the demand and supply of Renminbi in the domestic market. There can be no assurance that such exchange rate will continue to remain stable in the future amongst the volatility of currencies, globalization and the unstable economies in recent years. Since (i) our income and profit are mainly denominated in Renminbi, and (ii) the payment of dividends will be in U.S. dollars, if any, any exchange fluctuation of the Renminbi against other foreign currencies would adversely affect the value of the shares and dividends payable to shareholders, in foreign currency terms.

As of June 30, 2008, our outstanding financial instruments with foreign currency exchange rate risk exposure had an aggregate fair value of approximately $16.5 million. The potential increase in the fair values of these instruments resulting from a 10% adverse change in quoted foreign currency exchange rates would be $2,138,815 at June 30, 2008.

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 CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Our management, including the CEO and CFO, 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 CEO and CFO have concluded that our Disclosure Controls are effective at a reasonable assurance level.

Changes in internal control over financial reporting

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

32

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

There is no material legal proceeding pending against us.

December 31, 2011, 2012 and 2013, respectively, we expect our ability to maintain high renewal rates for these subscriptions and services to have a material impact on our future financial performance.

Follow-On Sales. After the initial sale to a new customer, we focus on expanding our relationship with such customer to sell additional products, subscriptions and services. To grow our revenue, it is important that our customers make additional purchases of our platform. Sales to our existing customer base can take the form of incremental sales of appliances, subscriptions and services, either to deploy our platform into additional parts of their network or to protect additional threat vectors. Our opportunity to expand our customer relationships through follow-on sales will increase as we add new customers, broaden our product portfolio to support more threat vectors, increase network performance and enhance functionality. Follow-on sales lead to increased revenue over the lifecycle of a customer relationship and can significantly increase the return on our sales and marketing investments. With some of our most significant customers, we have realized follow-on sales that were multiples of the value of their initial purchases.

Components of Operating Results

Revenue

We generate revenue from the sales of our products, subscriptions and services. As discussed further in "—Critical Accounting Policies and Estimates—Revenue Recognition" under "Management's Discussion and Analysis of Financial Condition and Results of Operations" below , revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured.

Our total revenue consists of the following:

- Product revenue. Our product revenue is generated from sales of our appliances. For our Web MPS, File MPS, MAS and CMS appliances, we recognize product revenue at the time of shipment, provided that all other revenue recognition criteria have been met. For our Email MPS appliances, we recognize product revenue ratably over the longer of the contractual term of the subscription service or the estimated period the customer is expected to benefit from the product.

- Subscription and services revenue. Subscription and services revenue is generated primarily from our DTI cloud, our Email MPS Attachment/URL engine, and support and maintenance services. Our DTI cloud subscription is determined as a percentage of the price of the related appliance. The Email MPS Attachment/URL engine is priced on a per-user basis. We recognize revenue from subscriptions and support and maintenance services over the one or three year contract term, as applicable.

Cost of Revenue

Our total cost of revenue consists of cost of product revenue and cost of subscription and services revenue. Personnel costs associated with our operations and global customer support organizations consist of salaries, benefits, bonuses and stock-based compensation. Overhead costs consist of certain facilities, depreciation, benefits, and information technology costs.

- Cost of product revenue. Cost of product revenue primarily consists of costs paid to our third-party contract manufacturers for our appliances and personnel and other costs in our manufacturing operations department. Our cost of product revenue also includes product testing costs, allocated costs and shipping costs. We expect our cost of product revenue to increase as our product revenue increases.

50

- Cost of subscription and services revenue. Cost of subscription and services revenue consists of personnel costs for our global customer support organization and allocated costs. We expect our cost of subscription and services revenue to increase as our customer base grows and as we hire additional professional services personnel.

Gross Margin

Gross margin, or gross profit as a percentage of revenue, has been and will continue to be affected by a variety of factors, including the average sales price of our products, subscriptions and services, manufacturing costs, the mix of products sold, and the mix of revenue among products, subscriptions and services. We expect our gross margins to fluctuate over time depending on the factors described above.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing, and general and administrative expense. Personnel costs are the most significant component of operating expenses and consist of salaries, benefits, bonuses, stock-based compensation and, with regard to sales and marketing expense, sales commissions. Operating expenses also include overhead costs for facilities, IT and depreciation.

- Research and development. Research and development expense consists primarily of personnel costs and allocated overhead. Research and development expense also includes prototype related expenses. We expect research and development expense to continue to increase in absolute dollars as we continue to invest in our research and product development efforts to enhance our product capabilities, address new threat vectors and access new customer markets, although such expense may fluctuate as a percentage of total revenue.

- Sales and marketing. Sales and marketing expense consists primarily of personnel costs, incentive commission costs and allocated overhead. We expense commission costs as incurred. Sales and marketing expense also includes costs for market development programs, promotional and other marketing activities, travel, office equipment, depreciation of proof-of-concept evaluation units and outside consulting costs. We expect sales and marketing expense to continue to increase in absolute dollars as we increase the size of our sales and marketing organizations and expand our international operations, although such expense may fluctuate as a percentage of total revenue.

- General and administrative. General and administrative expense consists of personnel costs, professional services and allocated overhead. General and administrative personnel include our executive, finance, human resources, facilities and legal organizations. Professional services consist primarily of legal, auditing, accounting and other consulting costs. We expect general and administrative expense to continue to increase in absolute dollars as we have recently incurred, and expect to continue to incur, additional general and administrative expenses as we grow our operations and comply with public company regulations, including higher legal, corporate insurance, and accounting expenses.

Interest Income

Interest income consists of interest earned on our cash and cash equivalent balances. We have historically invested our cash in money-market funds and other short-term, investment-grade investments. We expect interest income to vary each reporting period depending on our average investment balances during the period, types and mix of investments and market interest rates.

Interest Expense

Interest expense consists of interest on our outstanding debt. See Note 6 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K for more information about our debt.

Other Expense, Net

Other expense, net consists primarily of the change in fair value of our preferred stock warrant liability and gains or losses on disposal of fixed assets. Convertible preferred stock warrants are classified as a liability on our consolidated balance sheets and remeasured to fair value at each balance sheet date with the corresponding change recorded as other expense. Upon the completion of our initial public offering, the liability was reclassified to stockholders' equity, at which time it was no longer subject to fair value accounting.

Provision for (Benefit from) Income Taxes

Provision for (benefit from) income taxes consists primarily of U.S. federal and state income taxes in the United States and income taxes in certain foreign jurisdictions in which we conduct business. Our effective tax rate for the year ended December 31, 2013 was different from the U.S. statutory tax rate applied to our pretax loss primarily due to tax benefits from the valuation allowance release on U.S. deferred tax assets offset by different tax rates in foreign jurisdictions which are indefinitely reinvested. Our effective tax rate for the years ended December 31, 2012 and 2011 was different than the U.S. statutory tax rate primarily due to the valuation allowance on our U.S. deferred tax assets.

Results of Operations

The following tables summarize our results of operations for the periods presented and as a percentage of our total revenue for those periods. The period-to-period comparison of results is not necessarily indicative of results for future periods.

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
Revenue:			
Product	$88,253	$52,265	$24,888
Subscription and services	73,299	31,051	8,770
Total revenue	161,552	83,316	33,658
Cost of revenue:			
Product	28,912	14,467	5,690
Subscription and services	18,853	3,163	1,590
Total cost of revenue	47,765	17,630	7,280
Total gross profit	113,787	65,686	26,378
Operating expenses:			
Research and development	66,036	16,522	7,275
Sales and marketing	167,466	67,562	30,389
General and administrative	52,503	15,221	4,428
Total operating expenses	286,005	99,305	42,092
Operating loss	(172,218)	(33,619)	(15,714)
Interest income	68	7	3
Interest expense	(525)	(537)	(194)
Other expense, net	(7,257)	(2,572)	(806)
Loss before income taxes	(179,932)	(36,721)	(16,711)
Provision for (benefit from) income taxes	(59,297)	(965)	71
Net loss attributable to common stockholders	$(120,635)	$(35,756)	$(16,782)

52

	Year Ended December 31,		
	2013	2012	2011
	(As a percentage of total revenue)		
Revenue:			
Product	55 %	63 %	74 %
Subscription and services	45	37	26
Total revenue	100	100	100
Cost of revenue:			
Product	18	17	17
Subscription and services	12	4	5
Total cost of revenue	30	21	22
Total gross profit	70	79	78
Operating expenses:			
Research and development	41	20	22
Sales and marketing	104	81	90
General and administrative	32	18	13
Total operating expenses	177	119	125
Operating loss	(107)	(40)	(47)
Interest income	—	—	—
Interest expense	—	(1)	(1)
Other expense, net	(4)	(3)	(2)
Loss before income taxes	(111)	(44)	(50)
Provision for (benefit from) income taxes	(36)	(1)	—
Net loss attributable to common stockholders	(75)%	(43)%	(50)%

Comparison of the Years Ended December 31, 2013 and 2012

Revenue

	Year Ended December 31,					
	2013		2012		Change	
	Amount	% of Total Revenue	Amount	% of Total Revenue	Amount	%
	(Dollars in thousands)					
Revenue:						
Product	$88,253	55 %	$52,265	63 %	$35,988	69 %
Subscription and services	73,299	45 %	31,051	37 %	42,248	136 %
Total revenue	$161,552	100 %	$83,316	100 %	$78,236	94 %
Revenue by geographic region:						
United States	$116,730	72 %	$66,556	80 %	$50,174	75 %
EMEA	22,845	14 %	6,628	8 %	16,217	245 %
APAC	16,004	10 %	6,488	8 %	9,516	147 %
Other	5,973	4 %	3,644	4 %	2,329	64 %
Total revenue	$161,552	100 %	$83,316	100 %	$78,236	94 %

Total revenue increased by $78.2 million, or 94%, during the year ended December 31, 2013 compared to the year ended December 31, 2012. The increase in product revenue was primarily driven by growth in our installed base of customers, which grew from 927 as of December 31, 2012 to 1,964 as of December 31, 2013, as well as follow-on purchases from customers expanding their initial deployments of our product portfolio. Our Web Threat Prevention

product continued to account for the largest portion of our product revenue as customers that purchase our product portfolio generally purchase more Web Threat Prevention appliances than Email Threat Prevention or File Threat Prevention appliances, reflecting the fact that their networks typically have more Web entry points than email or file entry points to protect. In addition, revenue associated with our Web Threat Prevention product is recognized upon shipment whereas revenue associated with our Email Threat Prevention product is recognized ratably over the longer of the contractual term or the estimated period the customer is expected to benefit from the product.

Revenue from the amortization of deferred subscription and services revenue related to initial customer purchases was $55.1 million and $25.1 million for the years ended December 31, 2013 and 2012, respectively. Revenue from the amortization of deferred subscription and services revenue related to renewals was $18.0 million and $6.0 million for the years ended December 31, 2013 and 2012, respectively. Given our high renewal rate and increasing base of customers, we expect revenue from the amortization of deferred subscription and services revenue related to renewals to increase as a percentage of our total revenue from deferred subscription and services revenue. Our renewal rate for subscription and services agreements expiring in the 12 months ended December 31, 2013 was in excess of 90%.

International revenue increased $28.1 million, or 167%, during the year ended December 31, 2013 compared to the year ended December 31, 2012, which reflects our increasing presence international markets.

Cost of Revenue and Gross Margin

	Year Ended December 31,						
	2013			2012			Change
	Amount	Gross Margin		Amount	Gross Margin		Amount
	(Dollars in thousands)						
Cost of revenue:							
Product	$28,912			$14,467			$14,445
Subscription and services	18,853			3,163			15,690
Total cost of revenue	$47,765			$17,630			$30,135
Gross margin:							
Product		67	%		72	%	
Subscription and services		74	%		90	%	
Total gross margin		70	%		79	%	

Total cost of revenue increased $30.1 million, or 171% , during the year ended December 31, 2013 compared to the year ended December 31, 2012. The increase in cost of product revenue was driven primarily by an increase in product revenue and an increase in personnel costs in our manufacturing operations department as we continue to add capacity and built out our global supply chain. The increase in cost of subscription and services revenue was driven primarily by increased personnel costs in customer support.

Gross margin decreased for the year ended December 31, 2013 compared to the year ended December 31, 2012. The decrease in product gross margin was driven primarily by our increased investment in our manufacturing operations to increase capacity. The decrease in subscription and services gross margin was due primarily to an increase in our investment in customer support personnel and infrastructure.

Operating Expenses

	Year Ended December 31,								
	2013			2012			Change		
	Amount	% of Total Revenue		Amount	% of Total Revenue		Amount	%	
	(Dollars in thousands)								
Operating expenses:									
Research and development	$66,036	41	%	$16,522	20	%	$49,514	300	%
Sales and marketing	167,466	104		67,562	81		99,904	148	
General and administrative	52,503	32		15,221	18		37,282	245	
Total operating expenses	$286,005	177	%	$99,305	119	%	$186,700	188	%

Includes stock-based compensation expense of:		
Research and development	$6,958	$1,465
Sales and marketing	10,748	1,672
General and administrative	8,342	3,536
Total	$26,048	$6,673

Research and Development

Research and development expense increased $49.5 million, or 300%, during the year ended December 31, 2013 compared to the year ended December 31, 2012, primarily due to a $24.3 million increase in personnel costs and a $1.3 million increase in related consulting costs as we increased our headcount and consultants to support continued investment in our future product and service offerings and a $2.9 million increase in nonrecurring engineering activities. Additionally, overhead allocations and depreciation related to capital expenditures for departmental expansion increased by $18.6 million during the year ended December 31, 2013.

Sales and Marketing

Sales and marketing expense increased $99.9 million, or 148%, during the year ended December 31, 2013 compared to the year ended December 31, 2012, primarily due to a $56.9 million increase in personnel costs of which$13.2 million related to increased commissions for higher headcount and billings, a $4.7 million increase in depreciation expense, a $1.1 million increase in recruiting expenses related to new hires, a $6.8 million increase in travel-related costs and a $2.6 million increase in marketing activity, primarily related to an increase in lead generation services and costs associated with trade shows and conventions, Website development and partner programs. The change was also attributable to a $2.0 million increase in consulting costs and a $23.8 million increase in overhead allocations driven by the increase in sales and marketing personnel.

General and Administrative

General and administrative expense increased $37.3 million, or 245%, during the year ended December 31, 2013 compared to the year ended December 31, 2012, primarily due to a $14.3 million increase in personnel costs, a $13.1 million increase in professional services, including legal, accounting and recruiting services, and a $0.8 million increase in consulting costs. The change was also attributable to a $5.6 million increase in overhead allocations associated with departmental expansion. The increase in personnel costs, professional services and consulting costs was primarily a result of growth in our operations and our preparations to operate as a public company.

Interest Income

	Year Ended December 31,		Change	
	2013	2012	Amount	%
	(Dollars in thousands)			
Interest income	$68	$7	$61	871%

The change in interest income resulted from the significant increase in the average balances in cash and cash equivalents during the year ended December 31, 2013 compared to the year ended December 31, 2012.

Interest Expense

	Year Ended December 31,		Change	
	2013	2012	Amount	%
	(Dollars in thousands)			
Interest expense	$(525)	$(537)	$12	(2)%

The decrease in interest expense resulted from decreased bank borrowings during the year ended December 31, 2013 compared to the year ended December 31, 2012.

Other Expense, Net

	Year Ended December 31,		Change	

	2013	2012	Amount	%
	(Dollars in thousands)			
Other expense, net	$(7,257)	$(2,572)	$(4,685)	182%

The change in other expense, net was primarily due to an increase in the estimated fair value of preferred stock warrant liability during the year ended December 31, 2013 compared to the year ended December 31, 2012. At the time of our IPO, our preferred stock warrants were converted into common stock warrants, and the warrant liability was reclassified to stockholders’ equity. We will not incur expenses related to these warrants in future periods.

55

Provision for (Benefit from) Income Taxes

	Year Ended December 31,	
	2013	2012
	(Dollars in thousands)	
Provision for (benefit from) income taxes	$(59,297)	$(965)
Effective tax rate	33%	3%

The increase in our tax benefit from income taxes during the year ended December 31, 2013 is primarily due to the release of the valuation allowance on the majority of U.S. deferred tax assets resulting from recording a deferred tax liability on acquisition related intangibles for which no tax benefit will be derived, partially offset by different tax rates in foreign jurisdictions. The tax benefit for the year ended December 31, 2012 is primarily due to a reduction of the valuation allowance for U.S. deferred tax assets resulting from recording a deferred tax liability on acquisition related intangibles for which no tax benefit will be derived, partially offset by an increase in pre-tax income related to international operations.

Comparison of the Years Ended December 31, 2012 and 2011

Revenue

	Year Ended December 31,					
	2012		2011		Change	
	Amount	% of Total Revenue	Amount	% of Total Revenue	Amount	%
	(Dollars in thousands)					
Revenue:						
Product	$52,265	63%	$24,888	74%	$27,377	110%
Subscription and services	31,051	37%	8,770	26%	22,281	254%
Total revenue	$83,316	100%	$33,658	100%	$49,658	148%
Revenue by geographic region:						
United States	$66,556	80%	$30,050	89%	$36,506	121%
EMEA	6,628	8%	1,129	3%	5,499	487%
APAC	6,488	8%	1,142	4%	5,346	468%
Other	3,644	4%	1,337	4%	2,307	173%
Total revenue	$83,316	100%	$33,658	100%	$49,658	148%

Total revenue increased by $49.7 million, or 148%, during the year ended December 31, 2012 compared to the year ended December 31, 2011. The increase in product revenue was primarily driven by growth in our installed base of customers, which grew from 485 as of December 31, 2011 to 927 as of December 31, 2012, as well as follow-on purchases from customers expanding their initial deployments of our product portfolio. Our Web Threat Prevention product accounted for the largest portion of our product revenue.

Revenue from the amortization of deferred subscription and services revenue related to initial customer purchases was $25.1 million and $7.6 million for the years ended December 31, 2012 and 2011, respectively. Revenue from the amortization of deferred subscription and services revenue related to renewals was $6.0 million and $1.2 million for the years ended December 31, 2012 and 2011, respectively. Our renewal rate for subscription and services agreements that expired in 2012 and 2011 was in excess of 90%.

Cost of Revenue and Gross Margin

	Year Ended December 31,				
	2012		2011		Change
	Amount	Gross Margin	Amount	Gross Margin	Amount
	(Dollars in thousands)				
Cost of revenue:					
Product	$14,467		$5,690		$8,777
Subscription and services	3,163		1,590		1,573
Total cost of revenue	$17,630		$7,280		$10,350
Gross margin:					
Product		72 %		77 %	
Subscription and services		90 %		82 %	
Total gross margin		79 %		78 %	

Total cost of revenue increased $10.4 million, or 142% , during the year ended December 31, 2012 compared to the year ended December 31, 2011, respectively. The increase in cost of product revenue was driven primarily by an increase in product revenue and an increase in personnel costs in our manufacturing operations department. The increase in cost of subscription and services revenue was driven primarily by increased personnel costs in customer support. The decrease in product gross margin was driven by our increased investment in our manufacturing operations department. The increase in subscription and services gross margin was due to the growth of our product, subscription and services revenue, partially offset by an increase in our investment in customer support personnel and infrastructure.

Operating Expenses

	Year Ended December 31,					
	2012		2011		Change	
	Amount	% of Total Revenue	Amount	% of Total Revenue	Amount	%
	(Dollars in thousands)					
Operating expenses:						
Research and development	$16,522	20 %	$7,275	22 %	$9,247	127 %
Sales and marketing	67,562	81	30,389	90	37,173	122
General and administrative	15,221	18	4,428	13	10,793	244
Total operating expenses	$99,305	119 %	$42,092	125 %	$57,213	136 %
Includes stock-based compensation expense of:						
Research and development	$1,465		$148		$1,317	
Sales and marketing	1,672		360		1,312	
General and administrative	3,536		168		3,368	
Total	$6,673		$676		$5,997	

Research and Development

Research and development expense increased $9.2 million, or 127%, during the year ended December 31, 2012 compared to the year ended December 31, 2011, primarily due to a $6.1 million increase in personnel costs and a $0.6 million increase in consulting costs as we increased our headcount and consultants to support continued investment in our future product and service offerings. Additionally, overhead allocations and depreciation related to capital expenditures for departmental expansion increased by $1.7 million during the year ended December 31, 2012.

Sales and Marketing

Sales and marketing expense increased $37.2 million, or 122%, during the year ended December 31, 2012 compared to the year ended December 31, 2011, primarily due to a $20.7 million increase in personnel costs attributable to increased headcount and higher commissions, a $2.0 million increase in depreciation expense and costs associated with shipping evaluation units, a $0.8 million increase in consulting costs and a $3.5 million increase in marketing activity, primarily related to an increase in lead generation services and costs associated with trade shows and conventions, Website development and partner programs. The change was also attributable to a $2.8 million increase in travel-related costs and a $5.0 million increase in overhead allocations associated with additional sales and marketing personnel.

General and Administrative

General and administrative expense increased $10.8 million, or 244%, during the year ended December 31, 2012 compared to the year ended December 31, 2011, primarily due to a $5.5 million increase in personnel costs, a $1.4 million increase in consulting costs and a $2.6 million increase in professional services, including legal, accounting and recruiting services. The change was also attributable to a $1.1 million increase in overhead allocations associated with departmental expansion.

Interest Income

	Year Ended December 31,		Change	
	2012	2011	Amount	%
	(Dollars in thousands)			
Interest income	$7	$3	$4	133 %

The change in interest income resulted from the fluctuation of the average balances in cash and cash equivalents during the year ended December 31, 2012 compared to the year ended December 31, 2011.

Interest Expense

	Year Ended December 31,		Change	
	2012	2011	Amount	%
	(Dollars in thousands)			
Interest expense	$(537)	$(194)	$(343)	177 %

The increase in interest expense resulted from increased bank borrowings during the year ended December 31, 2012 compared to the year ended December 31, 2011.

Other Expense, Net

	Year Ended December 31,		Change	
	2012	2011	Amount	%
	(Dollars in thousands)			
Other expense, net	$(2,572)	$(806)	$(1,766)	219 %

The change in other expense, net was due to an increase in fair value of preferred stock warrant liability during the year ended December 31, 2012 compared to the year ended December 31, 2011. Upon the completion of our initial public offering, the liability was reclassified to stockholders' equity, at which time it was no longer subject to fair value accounting.

Provision for (Benefit from) Income Taxes

	Year Ended December 31,	
	2012	2011
	(Dollars in thousands)	
Provision for (benefit from) income taxes	$(965)	$71
Effective tax rate (benefit)/provision	3 %	— %

The increase in provision for (benefit from) income taxes during the year ended December 31, 2012 compared to the year ended December 31, 2011 was primarily due to a reduction in the valuation allowance resulting from recording a

deferred tax liability on acquisition related intangibles for which no tax benefit will be derived partially offset by an increase in pre-tax income related to international operations.

Quarterly Results of Operations

The following unaudited quarterly statements of operations data for each of the eight quarters in the period December 31, 2013 have been prepared on a basis consistent with our audited annual financial statements included in this Annual Report on Form 10-K and include, in our opinion, all normal recurring adjustments necessary for the fair presentation of the financial information contained in

those statements. Our historical results are not necessarily indicative of the results that may be expected in the future. The following quarterly financial data should be read in conjunction with our audited financial statements and the related notes included in this Annual Report on Form 10-K.

	Three Months Ended							
	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
	(In thousands)							
Revenue:								