

CHINA EDUCATION ALLIANCE INC.  
Form 10-Q  
August 10, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20-549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

or

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  
(State or other jurisdiction of incorporation or organization)

56-2012361  
(I.R.S. Employer Identification No.)

58 Heng Shan Road, Kun Lun Shopping Mall,  
Harbin, The People's Republic of China  
(Address of principal executive offices)

150090  
(Zip Code)

011-86- 451-8233-5794  
(Registrant's telephone number, including area code)

Not Applicable  
(Former name, former address and former fiscal year, if changed since last report)

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

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

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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

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

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 August 10, 2010, there are 31,654,581 shares of \$0.001 par value common stock issued and outstanding.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

China Education Alliance, Inc. and Subsidiaries  
Consolidated Balance Sheets

|  | June 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|---------------------------------|-----------------------------------|
| <b>ASSETS</b>  |                                 |                                   |
| <b>Current Assets</b>  |                                 |                                   |
| Cash and cash equivalents  | \$ 74,690,538                   | \$ 65,035,332                     |
| Accounts receivable  | 1,546,937                       | 1,274,727                         |
| Prepaid expenses   | 1,979,032                       | 2,692,310                         |
| Total current assets   | 78,216,507                      | 69,002,369                        |
| Property and equipment, net  | 6,038,568                       | 6,589,982                         |
| Intangibles and capitalized software, net  | 1,362,027                       | 737,761                           |
| Advance on acquisition   | 932,000                         | 932,000                           |
| Long-term investment   | 333,512                         | 341,686                           |
|  | \$ 86,882,614                   | \$ 77,603,798                     |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                 |                                   |
| <b>Current Liabilities</b>   |                                 |                                   |
| Accounts payable and accrued expenses  | \$ 2,175,755                    | \$ 1,255,991                      |
| Deferred revenues  | 842,908                         | 1,008,884                         |
| Total current liabilities  | 3,018,663                       | 2,264,875                         |
| <b>Stockholders' Equity</b>  |                                 |                                   |
| Preferred stock (\$0.001 par value, 20,000,000 shares authorized, 0 and 4,502,142 issued and outstanding, respectively, aggregate liquidation preference of 0 and \$1,665,793, respectively) | -                               | 1,867,644                         |
| Common stock (\$0.001 par value, 150,000,000 shares authorized, 31,654,581 and 30,040,954 issued and outstanding, respectively)  | 31,655                          | 30,041                            |
| Additional paid-in capital   | 40,592,789                      | 38,231,623                        |
| Statutory reserve  | 3,016,143                       | 3,016,143                         |
| Accumulated other comprehensive income   | 3,055,752                       | 2,886,087                         |
| Retained earnings  | 37,964,599                      | 30,044,687                        |
| Stockholders' equity - China Education Alliance, Inc. and Subsidiaries   | 84,660,938                      | 76,076,225                        |
| Noncontrolling interests in subsidiaries   | (796,987)                       | (737,302)                         |
| Total stockholders' equity   | 83,863,951                      | 75,338,923                        |
|  | \$ 86,882,614                   | \$ 77,603,798                     |

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

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

|  | Three months ended June 30, |                     | Six months ended June 30, |                     |
|--|-----------------------------|---------------------|---------------------------|---------------------|
|  | 2010                        | 2009                | 2010                      | 2009                |
| <b>Revenues</b>  |                             |                     |                           |                     |
| Online education revenues                                | \$ 7,386,469                | \$ 5,470,628        | \$ 12,617,532             | \$ 10,300,116       |
| Training center revenues                                 | 2,932,222                   | 2,007,947           | 5,789,419                 | 4,555,046           |
| Other Revenues   | 533,405                     | 639,798             | 1,062,879                 | 1,467,290           |
| <b>Total revenue</b>                                     | <b>10,852,096</b>           | <b>8,118,373</b>    | <b>19,469,830</b>         | <b>16,322,452</b>   |
| <b>Cost of Goods Sold</b>                                |                             |                     |                           |                     |
| Online education costs                                   | 1,128,927                   | 1,034,312           | 2,242,485                 | 2,233,419           |
| Training center costs                                    | 630,956                     | 501,789             | 1,262,925                 | 1,366,439           |
| Other costs  | 37,060                      | 69,775              | 77,837                    | 124,914             |
| <b>Total cost of goods sold</b>                          | <b>1,796,943</b>            | <b>1,605,876</b>    | <b>3,583,247</b>          | <b>3,724,772</b>    |
| <b>Gross Profit</b>                                      |                             |                     |                           |                     |
| Online education gross profit                            | 6,257,542                   | 4,436,316           | 10,375,047                | 8,066,697           |
| Training center gross profit                             | 2,301,266                   | 1,506,158           | 4,526,494                 | 3,188,607           |
| Other gross profit                                       | 496,345                     | 570,023             | 985,042                   | 1,342,376           |
| <b>Total gross profit</b>                                | <b>9,055,153</b>            | <b>6,512,497</b>    | <b>15,886,583</b>         | <b>12,597,680</b>   |
| <b>Operating Expenses</b>                                |                             |                     |                           |                     |
| Selling expenses   | 3,478,810                   | 1,906,494           | 5,719,764                 | 4,117,182           |
| Administrative   | 572,847                     | 639,361             | 1,027,040                 | 894,112             |
| Depreciation and amortization                            | 264,663                     | 244,898             | 497,474                   | 490,351             |
| <b>Total operating expenses</b>                          | <b>4,316,320</b>            | <b>2,790,753</b>    | <b>7,244,278</b>          | <b>5,501,645</b>    |
| <b>Other Income (Expense)</b>                            |                             |                     |                           |                     |
| Other income   | 2,245                       | -                   | 21,138                    | -                   |
| Interest income  | 50,842                      | 25,783              | 97,535                    | 48,539              |
| Investment loss  | (6,076)                     | (3,678)             | (7,606)                   | (4,089)             |
| <b>Total other income</b>                                | <b>47,011</b>               | <b>22,105</b>       | <b>111,067</b>            | <b>44,450</b>       |
| <b>Net Income Before Provision for Income Tax</b>        | <b>4,785,844</b>            | <b>3,743,849</b>    | <b>8,753,372</b>          | <b>7,140,485</b>    |
| Provision for Income Taxes                               | 549,966                     | 507,977             | 893,145                   | 675,132             |
| <b>Net Income</b>  | <b>4,235,878</b>            | <b>3,235,872</b>    | <b>7,860,227</b>          | <b>6,465,353</b>    |
| Net loss attributable to the noncontrolling interests    | (21,162)                    | (40,964)            | (59,685)                  | (90,290)            |
| <b>Net Income - attributable to CEU and Subsidiaries</b> | <b>\$ 4,257,040</b>         | <b>\$ 3,276,836</b> | <b>\$ 7,919,912</b>       | <b>\$ 6,555,643</b> |
| <b>Basic Earnings Per Share</b>                          | <b>\$ 0.14</b>              | <b>\$ 0.15</b>      | <b>\$ 0.25</b>            | <b>\$ 0.30</b>      |
| <b>Diluted Earnings Per Share</b>                        | <b>\$ 0.14</b>              | <b>\$ 0.13</b>      | <b>\$ 0.25</b>            | <b>\$ 0.27</b>      |
| <b>Basic Weighted Average Shares Outstanding</b>         | <b>31,323,734</b>           | <b>21,930,272</b>   | <b>31,323,734</b>         | <b>21,930,272</b>   |
| <b>Diluted Weighted Average Shares Outstanding</b>       | <b>31,363,255</b>           | <b>25,085,474</b>   | <b>31,377,877</b>         | <b>24,459,405</b>   |

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The Components of Other Comprehensive Income

|   |              |              |              |              |
|---|--------------|--------------|--------------|--------------|
| Net income                              | \$ 4,257,040 | \$ 3,276,836 | \$ 7,919,912 | \$ 6,555,643 |
| Foreign currency translation adjustment | 242,100      | (148,642)    | 169,665      | (186,726)    |
| Comprehensive Income                    | \$ 4,499,140 | \$ 3,128,194 | \$ 8,089,577 | \$ 6,368,917 |

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

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

|   | Six Months Ended June 30, |               |
|---|---------------------------|---------------|
|   | 2010                      | 2009          |
| <b>Cash flows from operating activities</b>   |                           |               |
| Net Income  | \$ 7,860,227              | \$ 6,465,353  |
| <b>Adjustments to reconcile net income to net cash provided by Operating activities</b> |                           |               |
| Depreciation and amortization   | 913,654                   | 663,830       |
| Stock based compensation  | 157,730                   | 332,256       |
| Loss on equity investment   | 8,174                     | 4,089         |
| <b>Net change in assets and liabilities</b>   |                           |               |
| Account receivables   | (272,210)                 | (626,926)     |
| Prepaid expenses and other  | 713,278                   | 1,285,913     |
| Advances to related parties   | -                         | 215,308       |
| Accounts payable and accrued liabilities  | 919,764                   | 247,341       |
| Deferred revenue  | (165,976)                 | (186,509)     |
| Net cash provided by operating activities   | 10,134,641                | 8,400,655     |
| <b>Cash flows from investing activities</b>   |                           |               |
| Purchases of property and equipment   | (110,111)                 | (348,837)     |
| Acquisition of intangible asset   | (876,395)                 | -             |
| Long-term investment  | -                         | 227,964       |
| Net cash used in investing activities   | (986,506)                 | (120,873)     |
| <b>Cash flows from financing activities</b>   |                           |               |
| Warrants exercised  | 298,749                   | -             |
| Options exercised   | 38,657                    | -             |
| Net cash provided by financing activities   | 337,406                   | -             |
| <b>Effect of exchange rate</b>  |                           |               |
|   | 169,665                   | (188,885)     |
| Net increase in cash  | 9,655,206                 | 8,090,897     |
| Cash and cash equivalents at beginning of period  | 65,035,332                | 23,418,098    |
| Cash and cash equivalents at end of period  | \$ 74,690,538             | \$ 31,508,995 |
| <b>Supplemental disclosure of cash flow information</b>                                 |                           |               |
| Taxes paid  | \$ 2,719,163              | \$ 329,981    |
| <b>Non-cash investing and financing activities</b>                                      |                           |               |
| Conversion of preferred stock to common   | \$ 1,867,644              | \$ 125,000    |

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





China Education Alliance, Inc. and Subsidiaries

Notes to Unaudited Condensed 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. (“ZHL D”), a corporation formed on August 9, 2004 in the City of Harbin in the Heilongjiang Province, People’s Republic of China (the “PRC”), with an authorized capital of \$60,386 (RMB500,000).

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

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

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

ZHL D also owns 70% of Beijing Hua Yu Hui Zhong Technology Development Co., Ltd. (“BHYHZ”). BHYHZ was formed on September 30, 2006 in the PRC. The remaining 30% interest was given to The Vocational Education Guidance Center of China 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.

On April 18, 2008, ZHL D entered into an agreement and supplementary agreement with Harbin Daily Newspaper Group (“Newspaper Group”) to invest in a joint venture company, Harbin New Discovery Media Co., Ltd. (“New Discovery”). ZHL D contributed RMB 3,000 000 (approximately, \$430,000) and Newspaper Group contributed RMB 3,120,000 (approximately, \$445,000) towards the registered capital of New Discovery. In return for their respective contributions, ZHL D own 49.02% equity interest and Newspaper Group own 50.98% equity interest in New Discovery. 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, 2010 and December 31, 2009 was \$333,512 and \$341,686, respectively.

On January 4, 2009, China Education Alliance’s subsidiary, Harbin Zhong He Li Da Education Technology, Inc (“ZHL D”) entered into an agreement with Mr. Guang Li to jointly incorporate and invest in a joint venture company, Zhong He Li Da (Beijing) Management Consultant Co., Ltd. (“ZHLDBJ”). ZHL D contributed RMB 425,000 (approximately, \$62,107), and Mr. Guang Li contributed RMB 75,000 (approximately, \$10,960) towards the

registered capital of ZHLDBJ, amounting to a total registered capital of 500,000 RMB (approximately, \$73,067). In return for their respective contributions, ZHLD owns an 85% equity interest, and Mr. Guang Li owns a 15% equity interest in ZHLDBJ. ZHLD has authorized Mr. Xiqun Yu, the Company CEO, to hold 20% of its equity interest of ZHLDBJ on its behalf. ZHLDBJ will be involved in the vocational training business which includes IT engineering and accounting training, in particular, in running the “Million Managers Training Program”, with the goal of improving participants’ management skills and designing a complete solution for the management, clients and suppliers.

On April 27, 2008, the Company entered into a Share Transfer Agreement with Mr. Yuli Guo (the “Vendor”) and World Exchanges, Inc. (“WEI”) to purchase from Vendor seventy (70) issued and outstanding ordinary shares in WEI, representing 70% of the entire issued share capital of WEI (the “WEI Acquisition”). WEI is incorporated under the laws of Canada and was organized on December 19, 1991. WEI has been registered at 30 Denton Avenue, Apartment 2216, Toronto, Canada. In consideration for the said shares, the Company issued but held in escrow for the Vendors benefit 400,000 shares of its common stock, with a market value at the date of issuance of \$2.33 per share or \$932,000. 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.

WEI will provide English training programs, English test preparation courses and overseas study and consulting services in the PRC. Included as part of the WEI Acquisition, will be the acquisition of five English language schools in various parts of the PRC. The Vendor owned various percentages of the interests of the five schools, and according to the transfer agreement, the Vendor was required to transfer all his interests in the schools to WEI, and complete the necessary administrative and legal procedures required by the PRC. However, so far, the Vendor had not completed all the transfer and legal procedures within the time period required in the agreement. The WEI acquisition was not fully completed as of June 30, 2010 and December 31, 2009 due to delays in transferring legal titles to these five schools. The Company currently is attempting to fully resolve all outstanding issues related to this acquisition. As of June 30, 2010 and December 31, 2009 the Company’s management decided to exclude the WEI acquisition from the consolidated financial statements until such time we have effective control over WEI’s operations which is expected to take place when the Vendor’s ownership in the five English language schools are legally and effectively transferred to WEI. Until such transfer occurs, WEI has no tangible assets and liabilities and no operations. As of June 30, 2010 and December 31, 2009 the Company had outstanding operating advances to WEI of \$202,722 and \$80,000, respectively, which were accounted for as advances to related parties. Management had fully reserved these operating advances as of June 30, 2010 and December 31, 2009. The resolution of these WEI acquisition matters will either result in the WEI acquisition being fully completed, or the abandonment of the WEI acquisition. As of June 30, 2010 and December 31, 2009, Company management has not reserved their advance on acquisition for WEI, totaling 400,000 shares of the Company’s common stock valued at \$932,000, as these shares are held in trust by the Company. These shares will either be returned to the Company or cancelled if the WEI acquisition is not successfully resolved and concluded.

As mentioned above, so far, the Vendor has not completed the transfer of his interests of all the five English schools and related PRC legal procedures within the time period required in the agreement. Accordingly, we do not have effective control over WEI’s operations as of June 30, 2010 and December 31, 2009. However, we believe the Company had both the management and voting control of WEI without inclusion of the five schools. The value of shares placed in escrow in the Vendors’ behalf was properly reflected in the financial statements as an advance on acquisition. We believe that we have properly accounted for the WEI acquisition under the cost method until such time as the acquisition is completed or abandoned. WEI does not have a readily determinable value. Based on EITF 91-5: Nonmonetary Exchange of Cost-Method Investments, issue # 2, we recognize the investment at its historical cost.

On February 3, 2010, China Education Alliance, Inc. announced that through its wholly owned subsidiary, Harbin Zhong He Li Da Education Technology, Inc. ("ZHLD"), it has incorporated a new company in the PRC, Beijing New Shifan Education & Technology ("New Shifan"), with a registered capital of RMB 1.95 million. New Shifan was created to continue the operations of Beijing Shifan Culture Communication Co., Ltd. ("Beijing Shifan"). The Company paid the original owner of Beijing Shifan RMB 6 million (approximately \$876,000) to acquire their expertise, in (i) science and math education at the secondary education level, (ii) the rights to continue publishing the magazine "Senior High School Students Mathematic, Physics, and Chemistry" and (iii) the rights to a nationwide contest for middle school and high school students. The Company considers the RMB 6 million payment as an intangible asset whose evaluation and life has not been finalized as of June 30, 2010, accordingly no amortization has been recorded. Beijing Shifan will be dissolved by the old owner. The focus of New Shifan is on the advancement of science and mathematics education, the publishing of the "Senior High School Students Mathematic, Physics, and Chemistry" magazine, which has been endorsed by the PRC Ministry of Education. Beijing Shifan is also the sponsor and organizer of a nationwide contest for middle school and high school students. This national competition tests the students' academic abilities in mathematics, physics and chemistry. There are over 100,000 students participating in the contest from 23 provinces in the PRC. Winners of the contest qualify for enrollment in some of the top universities in the People's Republic of China. The new company brings significant impact on the secondary education market in China. Mrs. Yin Xiaojie, the former sole shareholder, owner and CEO of Beijing Shifan, will take on a management position at New Shifan and will own 35% of the equity interest in New Shifan, while ZHLD owns the remaining 65% interest. There has been minimal operating activity from New Shifan for the three and six months ended June 30, 2010.

The Company's principal business is the distribution of educational resources through the Internet and training centers. The Company's website, [www.edu-chn.com](http://www.edu-chn.com), is a comprehensive education network platform which is based on network video technology and large data sources of elementary and secondary education resources. The Company has a data base comprised of such resources as test papers that are used for elementary and secondary education courses. The data base includes more than 350,000 exams and test papers and courseware for elementary and secondary school students. The Company markets this data base under the name "Famous Instructor Test Paper Store." Although a number of the resources are available through the website without charge, our subscribers are charged for services such as the "Famous Instructor Test Paper Store" and for videos 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 and other cities, which are marketed under the name "Famed Instructors Classroom." The Company has a 36,600 square foot training facility in Harbin, Heilongjiang Province, the PRC, which has 17 classrooms and can accommodate up to 1,200 students.

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## Basis of Preparation of Financial Statements

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

These consolidated financial statements for interim periods are unaudited. In the opinion of management, all adjustments, consisting of normal, recurring adjustments and disclosures necessary for a fair presentation of these interim statements have been included. The results reported in these consolidated interim financial statements are not necessarily indicative of the results that may be reported for the entire year. The accompanying consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange

Commission and do not include all information and footnotes necessary for a complete presentation of financial statements in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, filed on March 15, 2010.

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, ZHLDBJ and New Shifan). All inter-company transactions and balances were eliminated.

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

Significant estimates include values and lives assigned to acquire intangible assets, the useful lives and impairment of property and equipment, collectability of accounts receivable, reserves for allowances and stock option 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 or cash equivalents. The carrying amounts reported in the accompanying condensed consolidated balance sheets for cash and cash equivalents approximate their fair value. All of the Company's cash that is held in bank accounts in the PRC is not protected by FDIC insurance or any other similar insurance in the PRC. The cash that the Company maintains in US banks are insured up to \$250,000 at each bank as of June 30, 2010 and December 31, 2009. The Company's cash at their US banks are in excess of statutorily insured limits at approximately \$8,331,000 and \$14,636,000, respectively, as of June 30, 2010 and December 31, 2009.

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 |
| Transportation Vehicles | 5 years  |
| Furniture and Fixtures  | 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 June 30, 2010 and December 31, 2009.

Intangibles - Intangibles consist of franchise rights on educational products, software, and New Shifan's expertise, magazine rights and contest operation rights. Most intangible assets are amortized over the lives of the rights agreements, or their respective operational useful lives. The Company has not completed its evaluation of New Shifan's intangible as of June 30, 2010, accordingly no amortization has been calculated for three and six months ended June 30, 2010.

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 as of June 30, 2010 and 2009.





**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 respective reporting period.

Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the market rate of exchange at that date. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of capital contribution. All translation adjustments resulting from the translation of the financial statements into the reporting currency ("U.S. Dollars") are recorded in accumulated other comprehensive income, a separate component within shareholders' equity.

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

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

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

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

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

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

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

Accounts Receivables - Included in accounts receivables are receivables from advertising on the Company's websites and from the sale of prepaid debit cards to resellers. The sales of prepaid debit cards to resellers are recorded as deferred revenue until such time as the cards are used to download material from the Company's website. Total accounts receivables as of June 30, 2010 and December 31, 2009 was \$1,546,937 and \$1,274,727, respectively.

The Company reviews its accounts receivables on a periodic basis and makes general and specific allowances when there is doubt as to the collectability of individual balances. In evaluating the collectability of individual receivable balances, the Company considers many factors, including the age of the balance, customer's historical payment history, its current credit-worthiness and current economic trends. Accounts are written off after exhaustive efforts at collection. If accounts receivable are to be provided for, or written off, they would be recognized in the consolidated statement of operations within operating expenses. As of June 30, 2010 and December 31, 2009, the Company has not established an allowance for doubtful accounts, in addition the Company has not provided for, or written off, accounts receivable during the three and six months ended June 30, 2010 and 2009.

Deferred Revenue - Deferred revenue reflects the unearned portion of debit cards sold and tuition payments received. Deferred revenue as of June 30, 2010 and December 31, 2009 was \$842,908 and \$1,008,884, respectively.

Advertising - The Company expenses advertising costs at the time they are published in the newspaper and for all other advertising the first time the respective advertising takes place. These costs are included in selling, general and administrative expenses. The total advertising expenses incurred for the three and six months ended June 30, 2010 and 2009 were \$293,323 and \$211,939, \$675,149 and \$523,632, respectively.

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

The Company does not accrue United States income tax on unremitted earnings from foreign operations as it is the Company's intention to invest these earnings in foreign operations for the foreseeable future. All Company revenues are generated in the PRC. The Company's US operations provide corporate and administrative functions for the entire Company. The Company's tax provisions for the three and six months periods ended June 30, 2010 and 2009 are related to the Company's PRC operations.

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

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

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax provisions or benefits as of June 30, 2010 and December 31, 2009, is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax provisions or benefits as of June 30, 2010 and December 31, 2009, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax law and policy, that the unrecognized tax provisions or benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company's results of operations, financial condition or cash flows.



#### Enterprise income tax

Under the Provisional Regulations of the PRC Concerning Income Tax on Enterprises promulgated by the State Council which came into effect on January 1, 1994, income tax is payable by Wholly Owned Foreign Enterprises (“WOFE’s”) at a rate of 15% of their taxable income. Preferential tax treatment may, however, be granted pursuant to any law or regulations from time to time promulgated by the State Council. ZHLD enjoyed a 100% exemption from enterprise income taxes during 2006 due to its classification as a WOFE. This exemption ended on December 31, 2006, at which time ZHLD qualified under the then current tax structure for a 50% reduction in the statutory enterprise income tax rates for the three years ended December 31, 2007, 2008 and 2009. For the years ended December 31, 2008 and 2007, ZHLD’s effective income tax rate was at 7.5%, based on having received a 50% exemption in the year ended December 31, 2007 when the prevailing effective tax rate was 30%, and an additional 50% exemption as ZHLD was a technology and software entity. During the year ended December 31, 2009, ZHLD obtained similar exemptions to those of the year ended December 31, 2008; however, the prevailing tax rate had a minimum threshold of 10% for the year ended December 31, 2009. In the current fiscal year ended December 31, 2010 ZHLD continues being qualified as a technology and software entity, and receives a 15% statutory PRC enterprise income tax rate. The Company’s ZETC subsidiary is currently exempt from PRC taxation, as it operates a business enterprise engaged in educational opportunities. The Company’s other subsidiaries; BHYHZ, ZHLDBJ and New Shifan are taxed at the PRC statutory rate (25%), and have not accrued for taxes since inception, due to recurring losses or no income incurred since inception.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets, including tax loss and credit carry forwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company has no net deferred tax assets or liabilities as of June 30, 2010 and December 31, 2009. In addition, the Company has not recorded a deferred tax expense for the three and six months periods ended June 30, 2010 and 2009.

#### Value added tax

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

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

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

As of June 30, 2010 and December 31, 2009 the Company has advanced \$202,722 and \$80,000, respectively, to WEI, an acquisition of the Company that has not been fully completed due to the non-resolution of ongoing administrative and legal matters in connection with the acquisition of WEI. These advances were made to expand WEI's operations either inside or outside of the PRC. Management has fully reserved these advances as of June 30, 2010 and December 31, 2009, until such time as all administrative and legal matters regarding the WEI acquisition being fully resolved. The resolution of these WEI acquisition matters will either result in the WEI acquisition being fully completed, or the abandonment of the WEI acquisition.

All advances to related parties are non- interest bearing and due upon demand.

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

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

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

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

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

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

The Company did not have any Level 2 or Level 3 assets or liabilities as of June 30, 2010.

Cash and cash equivalents of approximately \$74,691,000 and \$65,035,000 as of June 30, 2010 and December 31, 2009, respectively, include only cash on hand and banks that are considered to be highly liquid and easily tradable as of June 30, 2010. These securities are valued using inputs observable in active markets for identical securities and are therefore classified as Level 1 within our fair value hierarchy.

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

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

Recent accounting pronouncements -

Recent accounting pronouncements applicable to the Company are summarized below.

-In June 2009, the FASB issued Accounting Standards Update No. 2009-01, "Generally Accepted Accounting Principles" (ASC Topic 105) which establishes the FASB Accounting Standards Codification ("the Codification" or "ASC") as the official single source of authoritative U.S. generally accepted accounting principles ("GAAP"). All existing accounting standards are superseded. All other accounting guidance not included in the Codification will be considered non-authoritative. The Codification also includes all relevant Securities and Exchange Commission ("SEC") guidance organized using the same topical structure in separate sections within the Codification. Following the Codification, the Board will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates ("ASU") which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification. The Codification is not intended to change GAAP, but it will change the way GAAP is

organized and presented. The Codification was effective for our third-quarter 2009 financial statements and the principal impact on our financial statements is limited to disclosures as all future references to authoritative accounting literature will be referenced in accordance with the Codification. In order to ease the transition to the Codification, we are providing the Codification cross-reference alongside the references to the standards issued and adopted prior to the adoption of the Codification.



- In October 2009, the FASB issued an ASU regarding accounting for own-share lending arrangements in contemplation of convertible debt issuance or other financing. This ASU requires that at the date of issuance of the shares in a share-lending arrangement entered into in contemplation of a convertible debt offering or other financing, the shares issued shall be measured at fair value and be recognized as an issuance cost, with an offset to additional paid-in capital. Further, loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the basic and diluted earnings-per-share calculation. This ASU is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.
- In December 2009, FASB issued ASU No. 2009-16, Accounting for Transfers of Financial Assets. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140. The amendments in this Accounting Standards Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.
- In December, 2009, FASB issued ASU No. 2009-17, Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Accounting Standards Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. The Company is currently evaluating the impact of this ASU. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.
- In January 2010, FASB issued ASU No. 2010-02 regarding accounting and reporting for decreases in ownership of a subsidiary. Under this guidance, an entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation of a subsidiary, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. In contrast, an entity is required to account for a decrease in its ownership interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. This ASU clarifies the scope of the decrease in ownership provisions, and expands the disclosures about the deconsolidation of a subsidiary or de-recognition of a group of assets. This ASU is effective for beginning in the first interim or annual reporting period ending on or after December 31, 2009. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.
- In January 2010, FASB issued ASU No. 2010-01- Accounting for Distributions to Shareholders with Components of Stock and Cash. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all

shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.

-In January 2010, FASB issued ASU No. 2010-02 – Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification. The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51.” If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

- In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.
- On March 5, 2010, the FASB issued authoritative guidance to clarify the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements. Specifically, only one form of embedded credit derivative qualifies for the exemption – one that is related only to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. This guidance also has transition provisions, which permit entities to make a special one-time election to apply the fair value option to any investment in a beneficial interest in securitized financial assets, regardless of whether such investments contain embedded derivative features. This guidance is effective on the first day of the first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of any fiscal quarter beginning after March 5, 2010. This amendment is not expected to have a material impact on the Company's financial statements
- In March 2010, FASB issued an authoritative pronouncement regarding the effect of denominating the exercise price of a share-based payment awards in the currency of the market in which the underlying equity securities trades and that currency is different from (1) entity's functional currency, (2) functional currency of the foreign operation for which the employee provides services, and (3) payroll currency of the employee. The guidance clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should be considered an equity award assuming all other criteria for equity classification are met. The pronouncement will be effective for interim and annual periods beginning on or after December 15, 2010, and will be applied prospectively. Affected entities will be required to record a cumulative catch-up adjustment for all awards outstanding as of the beginning of the annual period in which the guidance is adopted. This amendment is not expected to have a material impact on the Company's financial statements.
- In April 2010, the FASB issued Update No. 2010-17, or ASU 2010-17, Revenue Recognition—Milestone Method, which updates the guidance currently included under topic 605, Revenue Recognition. ASU 2010-17 provides guidance on defining the milestone and determining when the use of the milestone method of revenue recognition for research or development transactions is appropriate. It provides criteria for evaluating if the milestone is substantive and clarifies that a vendor can recognize consideration that is contingent upon achievement of a milestone as revenue in the period in which the milestone is achieved, if the milestone meets all the criteria to be considered substantive. ASU 2010-17 is effective for milestones achieved in fiscal years, and interim periods within those years, beginning

after June 15, 2010 and should be applied prospectively. Early adoption is permitted. The Company is currently evaluating the potential impact, if any, of the new accounting guidance on its consolidated financial statements.

- In April 2010, the FASB issued an authoritative pronouncement on effect of denominating the exercise price of a share-based payment award in the currency of the market in which the underlying equity securities trades and that currency is different from (1) entity's functional currency, (2) functional currency of the foreign operation for which the employee provides services, and (3) payroll currency of the employee. The pronouncement clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition, and therefore should be considered an equity award assuming all other criteria for equity classification are met. The pronouncement is for interim and annual periods beginning on or after December 15, 2010, and will be applied prospectively. Affected companies will be required to record a cumulative catch-up adjustment for all awards outstanding as of the beginning of the annual period in which the guidance is adopted. This amendment is not expected to have a material impact on the Company's financial statements.

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

#### 4. Concentrations of Business and Credit Risk

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

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

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and trade receivables, the balances of which are stated on the balance sheet. The Company places its cash in high credit quality financial institutions; however, such funds are not insured in the PRC. As of June 30, 2010 and December 31, 2009, the Company maintains cash in the US, in a financial institution insured by the FDIC that has approximately \$8,331,000 and \$14,636,000, respectively, in funds in excess of FDIC insured amounts.

For the three and six months periods ended June 30, 2010 and 2009, no single customer accounted for 10% or more of revenue.

Payments of dividends may be subject to some restrictions.

5. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

|                       | June 30<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|-----------------------|--------------------------------|-----------------------------------|
| Cash on Hand – China  | \$ 395                         | \$ 1,398                          |
| Bank Deposits – China | 65,859,218                     | 49,898,143                        |
| Bank Deposits – US    | 8,830,925                      | 15,135,791                        |
|                       | \$ 74,690,538                  | \$ 65,035,332                     |

6. Account Receivables

Accounts Receivables are all unsecured and due upon demand:

|                          | June 30<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--------------------------|--------------------------------|-----------------------------------|
| Mobi Advertising         | \$ 890,638                     | \$ 966,308                        |
| Resellers of debit cards | 656,299                        | 308,419                           |
|                          | \$ 1,546,937                   | \$ 1,274,727                      |

The Mobi advertising is an agent for the Company's on-line advertising business with trade terms of a six-month receivable period. The others are receivables from sales of prepaid cards to re-sellers.

7. Prepaid Expenses

Prepaid Expenses consist of the following:

|  | June 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|---------------------------------|-----------------------------------|
| Prepaid rent                           | \$ 218,492                      | \$ 305,853                        |
| Prepaid teachers and online material   | 298,253                         | 294,622                           |
| Prepaid services and professional fees | 24,087                          | 81,441                            |
| Prepaid advertising                    | 1,256,115                       | 1,812,973                         |
| Other prepaid expenses                 | 182,085                         | 197,421                           |
|  | \$ 1,979,032                    | \$ 2,692,310                      |

#### 8. Property and Equipment

Property and Equipment consist of the following:

|                                | June 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--------------------------------|---------------------------------|-----------------------------------|
| Buildings                      | \$ 4,467,280                    | \$ 4,455,227                      |
| Transportation vehicles        | 266,045                         | 192,189                           |
| Communication equipment        | 3,166,261                       | 3,148,972                         |
| Furniture and fixtures         | 2,037,027                       | 2,030,114                         |
|                                | 9,936,613                       | 9,826,502                         |
| Less: Accumulated Depreciation | (3,898,045)                     | (3,236,520)                       |
| Property and Equipment, Net    | \$ 6,038,568                    | \$ 6,589,982                      |

For the three and six months ended June 30, 2010 and 2009, depreciation expenses totaled \$337,186 and \$239,989, \$661,525 and \$389,998 respectively. Allocated in the three and six months ended June 30, 2010 and 2009 is depreciation expense totaling \$161,036 and \$114,525, \$318,551 and \$179,513 respectively, that is included in cost of goods sold, the remainder of depreciation expense for the respective periods is included in operating expenses.

As of June 30, 2010 the Company does not have any land use rights agreements in the PRC for the office buildings owned by the Company.

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

#### 9. Intangibles

Intangibles of the Company consist of franchise rights on educational products, software, and New Shifan's expertise, magazine rights and contest operation rights.

##### Franchise Rights

The franchise rights owned by the Company consist of the following:

- 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.

#### Capitalized Software

The Capitalized software of the Company consists of all the Company's software, among which two main ones are the following:

- The Usage rights for job seekers is software to help university students to search jobs, post their resumes, and communicate with potential employers.
- The Usage right for learners is software to help elementary and secondary students to do assignments, test papers, and get instructions from teachers.

#### New Shifan's Expertise

New Shifan was created to continue the operations of Beijing Shifan Culture Communication Co., Ltd. ("Beijing Shifan"). The Company paid the original owner of Beijing Shifan RMB 6 million (approximately \$878,000) to acquire their expertise, in (i) science and math education at the secondary education level, (ii) the rights to continue publishing the magazine "Senior High School Students Mathematic, Physics, and Chemistry" and (iii) the rights to a nationwide contest for middle school and high school students. The Company has considered the RMB 6 million (approximately \$876,000) as an intangible asset whose evaluation and life has not been finalized as of June 30, 2010, accordingly no amortization has been recorded. There has been minimal operating activity from New Shifan for the three and six months ended June 30, 2010.

Intangibles consist of the following:

|                                | June 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--------------------------------|---------------------------------|-----------------------------------|
| ACCP training course           | \$ 733,337                      | \$ 790,975                        |
| BENET training course          | 58,749                          | 58,591                            |
| Usage rights - Job Seekers     | 440,619                         | 439,430                           |
| Usage rights - Learners        | 293,746                         | 292,954                           |
| Others                         | 677,863                         | 622,364                           |
| New Shifan Expertise           | 876,395                         | -                                 |
|                                | 3,080,709                       | 2,204,314                         |
| Less: accumulated amortization | (1,718,682)                     | (1,466,553)                       |
| Intangibles, net               | \$ 1,362,027                    | \$ 737,761                        |

For the three months and six months ended June 30, 2010 and 2009, amortization expenses totaled \$128,513 and \$136,512, \$252,129 and \$273,841 respectively.

Future amortization of intangible assets excluding the New Shifan intangible asset for which a life has not yet been determined is as follows:



| Year Ended<br>December 31, |    |         |
|----------------------------|----|---------|
| 2010                       | \$ | 142,107 |
| 2011                       |    | 240,332 |
| 2012                       |    | 80,283  |
| 2013                       |    | 13,745  |
| 2014                       |    | 9,165   |
|                            | \$ | 485,632 |

#### 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. 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, 2010 and December 31, 2009, the Company had deferred revenue of \$842,908 and \$1,008,884, respectively.

#### 11. Stockholders' Equity

The Company recorded the following equity transactions during the six months ended June 30, 2010.

- Warrants for the acquisition of 99,583 shares of common stock were exercised, resulting in the issuance of 99,583 share of common stock. Total cash received from exercised warrants were \$298,749.
- Options for the acquisition of 13,330 shares of common stock were exercised at price \$2.90, resulting in the issuance of 13,330 share of common stock. Total cash received from exercised options were \$38,657.
- Total of 4,502,143 Series A Preferred Shares were converted into 1,500,714 shares of common stock.

The Company recorded the following equity transactions during the year ended December 31, 2009:

- On June 5, 2009, the Company issued 17,000 common shares with par value US\$0.001 per share to Red Chip Companies Inc. for its services at a market value of \$46,070.
- On June 18, 2009, the Company issued 16,334 common shares with par value US\$0.001 per share to certain employees according to the Company's 2009 Incentive Stock Plan Inc. at a market value of \$47,369.
- On October 5, 2009, the Company issued 3,162,055 common shares according to the Underwriting Agreement with Rodman & Renshaw, LLC (the "Underwriter") for the sale of 3,162,055 shares of the Company's common stock, par value \$0.001 per share, for a purchase price of \$5.17 per share (net of discounts and commissions), which is 94% of the per share public offering price of \$5.50 per share.

- On October 16, 2009, the Company issued 434,308 common shares according to the Underwriting Agreement with Rodman & Renshaw, LLC (the "Underwriter") for the sale of additional 434,308 shares (overallotment), par value \$0.001 per share, for a purchase price of \$5.17 per share (net of discounts and commissions), which is 94% of the per share public offering price of \$5.50 per share.
- On October 29, 2009, the Company issued 137,005 common shares with par value US\$0.001 per share to certain employees according to the Company's 2009 Incentive Stock Plan Inc. at a market value of \$685,025.
- On November 30, 2009, the Company issued 53,000 common shares with par value US\$0.001 per share to Red Chip Companies Inc. for its services according to a Joint Marketing Agreement at a market value of \$265,000.
- During the year ended December 31, 2009 a total of 3,095,502 Series A Preferred Shares were converted into 1,031,834 shares of common stock.
- During the year ended December 31, 2009, warrants for the acquisition of 3,497,825 shares of common stock were exercised, resulting in the issuance of 3,296,787 share of common stock, of which 364,804 shares were from cashless exercises. Total cash received from exercised warrants were \$6,429,725.

12. Warrants and Options

Warrants

For Six months ended June 30, 2010 and the year ended December 31, 2009, the Company did not grant any warrants.

Stock warrant activities for the six months ended June 30, 2010 is summarized as follows:

|                                   | Shares<br>underlying<br>warrants | Weighted<br>average<br>Exercise Price |
|-----------------------------------|----------------------------------|---------------------------------------|
| Outstanding as of January 1, 2010 | 99,584                           | \$ 3.00                               |
| Granted                           | -                                | -                                     |
| Exercised                         | (99,584)                         | 3.00                                  |
| Expired or cancelled              | -                                | -                                     |
| Outstanding as of June 30, 2010   | -                                | -                                     |

As of June 30, 2010, all the Company's previously issued warrants have been exercised and the Company did not have any warrants outstanding.

Stock Options:

During the six months ended June 30, 2010, the Company did not grant any stock options. Options for the purchasing of 13,330 shares of common stock were exercised at an exercise price of \$2.90, resulting in the issuance of 13,330 share of common stock.

During the year ended December 31, 2009 the Company established the 2009 Incentive Stock Plan, with 1,000,000 authorized shares to be issued or granted in stock options.



In June 2009 the Company granted options to employees to purchase 396,000 shares of common stock at prices ranging from \$2.90 to \$3.19 per share. All options granted have a three year life from the date of issuance and all options have an exercise price equal to the market value of the Company's common shares on the date of grant. Of these granted options, a total of 366,000 vest in three equal tranches over two years with the first tranche vesting immediately upon the grant date, with the remaining two tranches vesting in equal amounts of shares on the following two anniversary dates from the date of grant. The remaining 30,000 options granted to an employee all vest on the first anniversary of their grant date.

In June 2009 the Company granted an option to purchase 20,000 shares of common stock at \$2.90 per share, to a non-employee for legal services rendered. This option has a three year life, is fully vested on the date of grant, and has an exercise price equal to the market value for the Company's common shares on the date of grant. The fair value of options granted in June 2009 were estimated on the date of grant using the Blacks-Scholes valuation model and the following assumptions: a risk free interest rate of 1.88%, a weighted expected life of 2.25 years, a dividend rate of 0.0%, and a weighted expected volatility of 151.88%. The Company recorded \$136,590 in compensation expenses, net of related tax effects, related to these option grant during the six months ended June 30, 2010.

In September 2009 the Company granted options to an employee to purchase 30,000 shares of common stock at an exercise price of \$5.59 per share. All options granted have a three year life from the date of issuance and all options have an exercise price equal to the market value of the Company's common shares on the date of grant. These options, vest in three equal tranches over two years with the first tranche vesting immediately upon the grant date, with the remaining two tranches vesting in equal amounts of shares on the following two anniversary dates from the date of grant.

The fair value of the September 2009 granted options were estimated on the date of grant using the Blacks-Scholes valuation model and the following assumptions: a risk free interest rate of 1.45%, a weighted expected life of 2.25 year, a dividend rate of 0.0%, and a weighted expected volatility of 231.45%. The Company recorded \$21,140 in compensation expenses, net of related tax effects, related to this option grant during the six months ended June 30, 2010.

In November 2009 the Company granted options to an independent director to purchase 10,000 shares of common stock at an exercise price of \$5.40 per share. All options granted have one year life from the date of issuance and all options have an exercise price equal to the market value of the Company's common shares on the date of grant. These options, vest immediately at the grant date.

The fair value of the November 2009 granted options were estimated on the date of grant using the Blacks-Scholes valuation model and the following assumptions: a risk free interest rate of 0.51%, a weighted expected life of 0.75 year, a dividend rate of 0.0%, and a weighted expected volatility of 83.17%. This option was all expensed at the time of issuance in 2009.

The Company measures the intrinsic value of options at the end of each reporting period until options are exercised, cancelled or expire unexercised. As of June 30, 2010 there are 294,000 options with a weighted average exercise price of \$3.28 and a weighted average remaining life of 2.25 years, which remain outstanding and continue to be remeasured at the intrinsic value over their remaining vesting period ranging from 3 months to 1.50 years. Compensation expense in any given period is calculated as the difference between total earned compensation at the end of the period, less total earned compensation at the beginning of the period. Compensation earned is calculated on a straight line basis over the requisite service period for any given option award. A total of approximately \$94,400 in compensation expense remains unearned as of June 30, 2010. The intrinsic value for exercisable options as of June 30, 2010 is approximately \$282,000.

The Company during the six months ended June 30, 2010 recorded stock based compensation of \$157,730 for options that are vesting.

Stock option activity for the six months ended June 30, 2010 is summarized as follows:

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|                                     | Number<br>of<br>Options | Weighted<br>average<br>Exercise Price |
|-------------------------------------|-------------------------|---------------------------------------|
| Balance as of January 1, 2009       | 10,000                  | \$ 3.05                               |
| Granted                             | 456,000                 | 3.33                                  |
| Exercised                           | -                       | -                                     |
| Expired/ Cancelled/ Forfeifed       | (10,000)                | 3.05                                  |
| Outstanding as of December 31, 2009 | 456,000                 | 3.33                                  |
| Granted                             | -                       | -                                     |
| Exercised                           | (13,330)                | 2.90                                  |
| Expired/ Cancelled/ Forfeifed       | -                       | -                                     |
| Outstanding as of June 30, 2010     | 442,670                 | 3.33                                  |

The following table summarizes the Company's stock options outstanding at June 30, 2010:

| Exercise Price | Outstanding<br>June 30,<br>2010 | Weighted<br>Average<br>Remaining<br>Life in Years | Number<br>exercisable |
|----------------|---------------------------------|---|-----------------------|
| \$3.19         | 300,000                         | 2.00  | 100,000               |
| \$2.90         | 102,670                         | 2.00  | 28,670                |
| \$5.59         | 30,000                          | 2.25  | 10,000                |
| \$5.40         | 10,000                          | 0.42  | 10,000                |
|                | 442,670                         | 1.98  | 148,670               |

### 13. Earnings Per Share

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

For the three months and six ended June 30, 2010, dilutive shares include shares attributable to exercisable option only.

The following reconciles the components of the EPS computation:

|  | Three Months ended<br>June 30, |              | Six Months ended<br>June 30, |              |
|--|--------------------------------|--------------|------------------------------|--------------|
|  | 2010                           | 2009         | 2010                         | 2009         |
| Net income available to<br>common shareholders   | \$ 4,257,040                   | \$ 3,276,836 | \$ 7,919,912                 | \$ 6,555,643 |
| Weighted average shares<br>outstanding - basic   | 31,323,734                     | 21,930,272   | 31,323,734                   | 21,930,272   |
| Effect of dilutive securities                    | 39,521                         | 3,155,202    | 54,143                       | 2,529,133    |
| Weighted average shares<br>outstanding - diluted | 31,363,255                     | 25,085,474   | 31,377,877                   | 24,459,405   |
| Earnings per share – basic                       | \$ 0.14                        | \$ 0.15      | \$ 0.25                      | \$ 0.30      |
| Earnings per share - diluted                     | \$ 0.14                        | \$ 0.13      | \$ 0.25                      | \$ 0.27      |



14. 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.

If a loss should occur, or if management deems that a loss is probable, relating to our Company's product or performance of our services, an accrual for such loss or losses would be recognized at such time of occurrence or determination. The Company has not accrued for any losses as of June 30, 2010 and December 31, 2009.

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

(d) Political risk

Currently, the People's Republic of China is in a period of growth and is openly promoting business development in order to bring more business into the People's Republic of China. Additionally, the People's Republic of China allows a Chinese corporation to be owned by a United States corporation. If the 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.

16. Subsequent Events

In accordance with ASC 855, "Subsequent Events" the Company evaluated subsequent events after the balance sheet date of June 30, 2010. The Company has reported all required subsequent events.

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

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

Except for the historical information contained herein, the following discussion, as well as other information in this report, contain "forward-looking statements," within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the "safe harbor" created by those sections. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may, and are likely to, differ materially from what is expressed or forecasted in the forward-looking statements due to numerous factors, including those discussed from time to time in this report, as well as and any risks described in the "risk factors" section of our Registration Statement filed with the U.S. Securities and Exchange Commission on Form S-1 (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](http://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 350,000 exams, test papers and courseware for secondary and elementary schools.

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 other online education business including the sale of advertising on our website. We recognize revenue from our training center's classes ratably over the term of the course, and we recognize revenue from face-to-face tutorials with students who attend our training center and face-to-face information technology training courses.

The laws of the 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 PRC regulatory authorities.

Because students who purchase our on-line programs purchase debit cards for the programs that they use and students who enroll in our training classes pay their tuition before starting classes, we do not have significant accounts receivable. As of June 30, 2010, we had \$1,546,937 of accounts receivable, comprised of \$890,638 from on-line advertising and \$656,299 from the sale of prepaid debit cards sold to re-sellers.

Our prepaid expenses at \$1,979,032 account for 2.5% of current assets as of June 30, 2010. Prepaid expenses are primarily comprised of advance payments made for services to teachers, online materials and video, prepaid advertising and prepaid rent. As of June 30, 2010, prepayments to teachers and online materials totaled \$298,253, prepayment of rent expense totaled \$218,492, prepayments for advertising totaled \$1,256,115, prepaid services and professional fees totaled \$24,087, and other prepaid expenses were \$182,085. 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 and 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 our 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. Our on-line education business generates a gross margin of 84.7% and 82.2% for the three months and six months ended June 30, 2010, respectively. The gross margin is affected by the payments we have to make to the teachers for the materials. In our training center business, the principal components of cost of sales are costs of the faculty and the amortization of intangible assets. This business generates a gross margin close to on-line education business, which was 78.5% and 78.2% for the three months and six months ended June 30, 2010, respectively. 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 entrance exams for 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-line education resources to computer vocational training school students. As a result of this acquisition, we became the exclusive partner of Beida Qingniao APTEC Software Engineering within Heilongjiang Province in the PRC for vocational training. The acquisition included materials and resources to provide on-site education classes and patented course materials. Compass Training School currently has two principal education programs focused on network engineering and ACCP software engineering with 9 on-site classrooms and 9 multimedia/computer classrooms at two centers.

We own 70% of Beijing Hua Yu Hui Zhong Technology Development Co., Ltd, which was formed on September 30, 2006. At the time of its organization, we transferred a 30% interest in this subsidiary to the National Vocational Education Association of China, a non-profit, quasi-government entity, for no consideration in order to enable us to work with the Guidance Center’s network to expand our business.

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

On April 18, 2008, ZHLD entered into an agreement and supplementary agreement with Harbin Daily Newspaper Group (“Newspaper Group”) to invest in a joint venture company, Harbin New Discovery Media Co., Ltd. Media Co., Ltd. ZHLD contributed RMB 3,000 000 (approximately, \$430,000) and Newspaper Group contributed RMB 3,120,000 (approximately, \$445,000) towards the registered capital of Harbin New Discovery Media Co., Ltd. In return for their respective contributions, ZHLD will own 49.02% equity interest and 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, 2010 is \$333,512.

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

On April 27, 2008, the Company entered into a Share Transfer Agreement with Mr. Yuli Guo (the “Vendor”) and World Exchanges, Inc. (“WEI”) to purchase from Vendor seventy (70) issued and outstanding ordinary shares in WEI, representing 70% of the entire issued share capital of WEI (the “WEI Acquisition”). WEI is incorporated under the laws of Canada and was organized on December 19, 1991. WEI has been registered at 30 Denton Avenue, Apartment 2216, Toronto, Canada. In consideration for the said shares, the Company issued but held in escrow for the Vendors benefit 400,000 shares of its common stock, with a market value at the date of issuance of \$2.33 per share or \$932,000. 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.





WEI will provide English training programs, English test preparation courses and overseas study and consulting services in the PRC. Included as part of the WEI Acquisition, will be the acquisition of five English language schools in various parts of the PRC. The Vendor owned various percentages of the interests of the five schools, and according to the transfer agreement, the Vendor was required to transfer all his interests in the schools to WEI, and complete the necessary administrative and legal procedures required by the PRC. However, the Vendor has not, to date, completed all the transfer and legal procedures within the time period required in the agreement. The WEI acquisition was not fully completed as of June 30, 2010 and December 31, 2009 due to delays in transferring legal titles to these five schools. The Company currently is attempting to fully resolve all outstanding issues related to this acquisition. As of June 30, 2010 and December 31, 2009 the Company's management decided to exclude the WEI acquisition from the consolidated financial statements until such time we have effective control over WEI's operations which is expected to take place when the Vendor's ownership in the five English language schools are legally and effectively transferred to WEI. Until such transfer occurs WEI has no tangible assets and liabilities and no operations. As of June 30, 2010 and December 31, 2009 the Company had outstanding advances to WEI of \$202,722 and \$80,000, respectively, which were accounted for as advances to related parties. Management had fully reserved these advances as of June 30, 2010 and December 31, 2009. The resolution of these WEI acquisition matters will either result in the WEI acquisition being fully completed, or the abandonment of the WEI acquisition. As of June 30, 2010 and December 31, 2009, Company management has not reserved their advance on acquisition for WEI, totaling 400,000 shares of the Company's common stock valued at \$932,000, as these shares are held in trust by the Company. These shares will either be returned to the Company or cancelled if the WEI acquisition is not successfully resolved and concluded.

The Vendor has not completed the transfer of his interests of all the five English schools and related PRC legal procedures within the time period required in the agreement to WEI and as such, we do not have effective control over WEI's operations as of June 30, 2010 and December 31, 2009. However, we believe the Company had both the management and voting control of WEI without inclusion of the five schools. The value of shares placed in escrow in the Vendors' behalf was properly reflected in the financial statements as an advance on acquisition. We believe that we have properly accounted for the WEI acquisition under the cost method until such time as the acquisition is completed or abandoned. WEI does not have a readily determinable value. Based on EITF 91-5: Nonmonetary Exchange of Cost-Method Investments, issue # 2, we recognize the investment at its historical cost.

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

On February 3, 2010, China Education Alliance, Inc. announced that through its wholly owned subsidiary, Harbin Zhong He Li Da Education Technology, Inc. ("ZHL"), it has incorporated a new company in the PRC, Beijing New Shifan Education & Technology ("New Shifan"), with a registered capital of RMB 1.95 million. New Shifan was created to continue the operations of Beijing Shifan Culture Communication Co., Ltd. ("Beijing Shifan"). The Company paid the original owner of Beijing Shifan RMB 6 million (approximately \$878,000) to acquire their expertise, in (i) science and math education at the secondary education level, (ii) the rights to continue publishing the magazine "Senior High School Students Mathematic, Physics, and Chemistry" and (iii) the rights to a nationwide contest for middle school and high school students. The Company considers the RMB 6 million payment as an

intangible asset whose evaluation and life has not been finalized as of June 30, 2010, accordingly no amortization has been recorded. Beijing Shifan will be dissolved by the old owner. The focus of New Shifan is on the advancement of science and mathematics education, the publishing of the "Senior High School Students Mathematic, Physics, and Chemistry" magazine, which has been endorsed by the PRC Ministry of Education. Beijing Shifan is also the sponsor and organizer of a nationwide contest for middle school and high school students. This national competition tests the students' academic abilities in mathematics, physics and chemistry. There are over 100,000 students participating in the contest from 23 provinces in the PRC. Winners of the contest qualify for enrollment in some of the top universities in the People's Republic of China. The new company brings significant impact on the secondary education market in China. Mrs. Yin Xiaojie, the former sole shareholder, owner and CEO of Beijing Shifan, will take on a management position at New Shifan and will own 35% of the equity interest in New Shifan, while ZHLD owns the remaining 65% interest. There has been minimal operating activity from New Shifan for the three and six months ended June 30, 2010.

### 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.

Intangible assets and capitalized software, which we acquired from third parties, are amortized over the lives of the rights agreements, which is two to five years. We evaluate the carrying value of the franchise rights and other intangibles during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the intangible asset below its carrying amount. There were no impairments recorded during the quarter ended June 30, 2010 and 2009.

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

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

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

Revenue is recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) the service has been rendered; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. We believe that these criteria are satisfied upon customers' download of prepaid study materials. Prepaid debit cards allow our subscribers to purchase a predetermined monetary amount of download materials posted on our website. Prepaid service contracts are amortized to income on a straight line basis over the length of the service contract. These service contracts allow the user to obtain materials for a designed period of time. At the time that the prepaid debit card is purchased, the receipt of cash is recorded as deferred revenue. Revenue is recognized in the month when services are actually rendered. Unused value relating to debit cards is recognized as revenue when the prepaid debit card has expired. Revenue from advertising on our website is recognized when the advertisement is run. Since advertising customers are billed monthly, there are no unearned advertising revenue.

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

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

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

#### Recent Accounting Pronouncements

Recent accounting pronouncements applicable to the Company are summarized below.

-In June 2009, the FASB issued Accounting Standards Update No. 2009-01, "Generally Accepted Accounting Principles" (ASC Topic 105) which establishes the FASB Accounting Standards Codification ("the Codification" or "ASC") as the official single source of authoritative U.S. generally accepted accounting principles ("GAAP"). All existing accounting standards are superseded. All other accounting guidance not included in the Codification will be considered non-authoritative. The Codification also includes all relevant Securities and Exchange Commission ("SEC") guidance organized using the same topical structure in separate sections within the Codification. Following the Codification, the Board will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates ("ASU") which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification. The Codification is not intended to change GAAP, but it will change the way GAAP is organized and presented. The Codification was effective for our third-quarter 2009 financial statements and the principal impact on our financial statements is limited to disclosures as all future references to authoritative accounting literature will be referenced in accordance with the Codification. In order to ease the transition to the Codification, we are providing the Codification cross-reference alongside the references to the standards issued and adopted prior to the adoption of the Codification.



- In October 2009, the FASB issued an ASU regarding accounting for own-share lending arrangements in contemplation of convertible debt issuance or other financing. This ASU requires that at the date of issuance of the shares in a share-lending arrangement entered into in contemplation of a convertible debt offering or other financing, the shares issued shall be measured at fair value and be recognized as an issuance cost, with an offset to additional paid-in capital. Further, loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the basic and diluted earnings-per-share calculation. This ASU is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.
- In December 2009, FASB issued ASU No. 2009-16, Accounting for Transfers of Financial Assets. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140. The amendments in this Accounting Standards Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.
- In December, 2009, FASB issued ASU No. 2009-17, Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Accounting Standards Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. The Company is currently evaluating the impact of this ASU. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.
- In January 2010, FASB issued ASU No. 2010-02 regarding accounting and reporting for decreases in ownership of a subsidiary. Under this guidance, an entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation of a subsidiary, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. In contrast, an entity is required to account for a decrease in its ownership interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. This ASU clarifies the scope of the decrease in ownership provisions, and expands the disclosures about the deconsolidation of a subsidiary or de-recognition of a group of assets. This ASU is effective for beginning in the first interim or annual reporting period ending on or after December 31, 2009. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.
- In January 2010, FASB issued ASU No. 2010-01- Accounting for Distributions to Shareholders with Components of Stock and Cash. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all

shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.

-In January 2010, FASB issued ASU No. 2010-02 – Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification. The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51.” If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

- In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this ASU has had minimal to no impact on our consolidated financial statements.
- On March 5, 2010, the FASB issued authoritative guidance to clarify the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements. Specifically, only one form of embedded credit derivative qualifies for the exemption – one that is related only to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. This guidance also has transition provisions, which permit entities to make a special one-time election to apply the fair value option to any investment in a beneficial interest in securitized financial assets, regardless of whether such investments contain embedded derivative features. This guidance is effective on the first day of the first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of any fiscal quarter beginning after March 5, 2010. This amendment is not expected to have a material impact on the Company's financial statements
- In March 2010, FASB issued an authoritative pronouncement regarding the effect of denominating the exercise price of a share-based payment awards in the currency of the market in which the underlying equity securities trades and that currency is different from (1) entity's functional currency, (2) functional currency of the foreign operation for which the employee provides services, and (3) payroll currency of the employee. The guidance clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should be considered an equity award assuming all other criteria for equity classification are met. The pronouncement will be effective for interim and annual periods beginning on or after December 15, 2010, and will be applied prospectively. Affected entities will be required to record a cumulative catch-up adjustment for all awards outstanding as of the beginning of the annual period in which the guidance is adopted. This amendment is not expected to have a material impact on the Company's financial statements.
- In April 2010, the FASB issued Update No. 2010-17, or ASU 2010-17, Revenue Recognition—Milestone Method, which updates the guidance currently included under topic 605, Revenue Recognition. ASU 2010-17 provides guidance on defining the milestone and determining when the use of the milestone method of revenue recognition for research or development transactions is appropriate. It provides criteria for evaluating if the milestone is substantive and clarifies that a vendor can recognize consideration that is contingent upon achievement of a milestone as revenue in the period in which the milestone is achieved, if the milestone meets all the criteria to be considered substantive. ASU 2010-17 is effective for milestones achieved in fiscal years, and interim periods within those years, beginning



after June 15, 2010 and should be applied prospectively. Early adoption is permitted. The Company is currently evaluating the potential impact, if any, of the new accounting guidance on its consolidated financial statements.

- In April 2010, the FASB issued an authoritative pronouncement on effect of denominating the exercise price of a share-based payment award in the currency of the market in which the underlying equity securities trades and that currency is different from (1) entity's functional currency, (2) functional currency of the foreign operation for which the employee provides services, and (3) payroll currency of the employee. The pronouncement clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition, and therefore should be considered an equity award assuming all other criteria for equity classification are met. The pronouncement is for interim and annual periods beginning on or after December 15, 2010, and will be applied prospectively. Affected companies will be required to record a cumulative catch-up adjustment for all awards outstanding as of the beginning of the annual period in which the guidance is adopted. This amendment is not expected to have a material impact on the Company's financial statements.

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

#### Results of Operations

Three Months Ended June 30, 2010 and 2009

The following table sets forth information from our statements of operations for the three months ended June 30, 2010 and 2009:



Three Months Ended June 30, 2010 and 2009

Revenue for the three months ended June 30, 2010 (the “June 30, 2010 quarter”) increased by \$2,733,723, or 33.7%, to \$10,852,096 compared to \$8,118,373 for the three months ended June 30, 2009 (the “June 30, 2009 quarter”). The increase in revenue reflects an increase of \$1,915,841, or 35.0 % from the online education division, an increase of \$924,275, or 46.0% for the training center, and a decrease of 106,393, or 16.6% from other revenues, including advertising and network services. Other revenue is not the focus of our business, and in the future we will continue to focus on our two main business lines – examination preparation and vocational training. We will not expect to see significant changes on the current level of other revenue during this year.

Our deferred revenue reflects the unearned portion of debit cards sold in the online division and unearned tuition from training center. The deferred revenue is not necessarily in direct proportion to our revenue. Usually the Company’s deferred revenue remains at a relatively low level in relation to revenue from debit cards, as most students consume their debit cards in a short period, and mostly tuition are expensed monthly. A change in deferred revenue is not necessarily related to students’ enrollment, and also has no impact in subsequent quarters.

We believe the education market in China is quite large and significantly fragmented. Our current activities are primarily in the Northeast four provinces of China. China has about 150 million students aged 6 -18, which are the target of our education services. In the Northeast four provinces, there are about 10 million students in the 6-18 age group, while the number of student we are serving is only about 500,000 – 600,000, only about 5% of the students in our current market. Therefore, we believe that we have great potential to grow. Our growth will depend on how we penetrate and expand into the market. Our expansion may take the form of organic growth and acquisitions and the key to our growth will be the increase in students’ enrollment.

Our overall cost of sales increased by \$191,067 or 11.9% to \$1,796,943 in the June 30, 2010 quarter, as compared to \$1,605,876 in the June 30, 2009 quarter. The increase in cost of sales reflects a \$94,615 or 9.1% increase in our cost of sales for the online education division for the period, an increase of \$129,167 or 25.7% from our training center division –which is related to the revenue increase, and \$32,715 decrease for the other costs. The online education’s gross margin increased to 84.7% in the June 30, 2010 quarter from 81.1% in the June 30, 2009 quarter due to the increase of online revenues and relatively stable costs. For our training centers, gross margin increased to 78.5% in the June 30, 2010 quarter from 75.0% in the June 30, 2009 quarter also due to revenue increases exceeding costs increases. In the other revenues segment, gross margin increased from 89.1% in the June 30, 2009 quarter to 93.1% in the June 30, 2010 quarter.

Selling expenses increased by \$1,572,316 or 82.5% to \$3,478,810 in the June 30, 2010 quarter from \$1,906,494 in the June 30, 2009 quarter. Selling expenses experienced significant increase quarter over quarter, from 23% of total revenue in the June 30, 2009 quarter to 32% current quarter. Our selling expenses include media advertising, outdoor advertising agent fees and commissions associated with sales of our exam prep debit cards and enrollment of onsite training centers.

Administrative expenses decreased by \$66,514 or 10.4%, to \$572,847 in the June 30, 2010 quarter as compared to \$639,361 in the June 30, 2009 quarter. Depreciation and amortization increased by \$19,765, or 8.1%, to \$264,663 in the June 30, 2010 quarter, as compared to \$244,898, in the June 30, 2009 quarter.

As a result of the foregoing, the Company had net income of \$4,257,040, or \$.14 per share for both basic and diluted, for the June 30, 2010 quarter, as compared with net income of \$3,276,836, or \$.15 per share for basic and \$.13 for diluted, for the June 30, 2009 quarter.

Six Months Ended June 30, 2010 and 2009

The following table sets forth information from our statements of operations for the six months ended June 30, 2010 and 2009.

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|   | (Dollars)                      |            |        |    |            |        |
|---|--------------------------------|------------|--------|----|------------|--------|
|   | Six months Ended September 30, |            | 2010   |    | 2009       |        |
| Revenue   | \$                             | 19,469,830 | 100.0% | \$ | 16,322,452 | 100.0% |
| Cost of sales   |                                | 3,583,247  | 18.4%  |    | 3,724,772  | 22.8%  |
| Gross profit  |                                | 15,886,583 | 81.6%  |    | 12,597,680 | 77.2%  |
| Income from operations                                |                                | 8,642,305  | 44.4%  |    | 7,096,035  | 43.5%  |
| Other income  |                                | 111,067    | 0.6%   |    | 44,450     | 0.3%   |
| Income before income taxes                            |                                | 8,753,372  | 45.0%  |    | 7,140,485  | 43.7%  |
| Provision for income taxes                            |                                | 893,145    | 4.6%   |    | 675,132    | 4.1%   |
| Income before minority interest                       |                                | 7,860,227  | 40.4%  |    | 6,465,353  | 39.6%  |
| Net income  |                                | 7,860,227  | 40.4%  |    | 6,465,353  | 39.6%  |
| Net loss attributable to the noncontrolling interests |                                | (59,685)   | (0.3)% |    | (90,290)   | (0.6)% |
| Net Income - attributable to CEU and Subsidiaries     |                                | 7,919,912  | 40.7%  |    | 6,555,643  | 40.2%  |

The following table sets forth information as to the gross margin for our three revenue areas for the six months ended June 30, 2010 and 2009.

|                          | (Dollars)                 |            |      |    |            |  |
|--------------------------|---------------------------|------------|------|----|------------|--|
|                          | Six months Ended June 30, |            | 2010 |    | 2009       |  |
| <b>Online Education:</b> |                           |            |      |    |            |  |
| Revenue                  | \$                        | 12,617,532 |      | \$ | 10,300,116 |  |
| Cost of sales            |                           | 2,242,485  |      |    | 2,233,419  |  |
| Gross profit             |                           | 10,375,047 |      |    | 8,066,697  |  |
| Gross margin             |                           | 82.2%      |      |    | 78.3%      |  |
| <b>Training center:</b>  |                           |            |      |    |            |  |
| Revenue                  |                           | 5,789,419  |      |    | 4,555,046  |  |
| Cost of sales            |                           | 1,262,925  |      |    | 1,366,439  |  |
| Gross profit             |                           | 4,526,494  |      |    | 3,188,607  |  |
| Gross margin             |                           | 78.2%      |      |    | 70.0%      |  |
| <b>Advertising:</b>      |                           |            |      |    |            |  |
| Revenue                  |                           | 1,062,879  |      |    | 1,467,290  |  |
| Cost of sales            |                           | 77,837     |      |    | 124,914    |  |
| Gross profit             |                           | 985,042    |      |    | 1,342,376  |  |
| Gross margin             |                           | 92.7%      |      |    | 91.5%      |  |

Revenue. Revenue increased by \$3,147,378 or 19.3% in for the six months ended June 30, 2010 to \$19,469,830 as compared to \$16,322,452 for the same period in 2009, resulting in gross profit of \$15,886,583 and gross margin of 81.6% for the six months ended June 30, 2010 as compared to gross profit of \$12,597,580 and gross margin 77.2% for the same period in 2009. The increase in revenue reflected increases of \$2,317,416 from our on-line education area, \$1,234,373 for our training center area, and a decrease of \$404,411 from our other revenue area. Other revenue is not the focus of our business, and in the future we will continue to focus on our two main business lines – examination preparation and vocational training. We will not expect to see significant changes on the current level of advertising revenue during this year.



Cost of sales. Our overall cost of sales decreased by \$141,525 to \$3,583,247 for the six months ended June 30, 2010 as compared to \$3,724,772 for the same period in 2009. The cost decrease occurred during the first quarter of this year due to the flat growth during that period. For the six month ended June 30, 2010, our on-line education area's cost of sales experienced a slight increase of \$9,066, or 0.4%. For our training centers and other areas, costs decreased \$103,514 and \$47,077 respectively. The decrease of costs from our training center division is due to the low cost in our IT training center. At our IT center, most teachers are our own employees, and the cost for an employee-teacher is only about one tenth of contracted non-employee teachers.

The on-line training area gross margin increased to 82.2% for the six months ended June 30, 2010 from 78.3% for the same period in 2009. Our training center area gross margin increased to 78.2% for the six months ended June 30, 2010 from 70.0% for the same period in 2009. In the other areas, gross margin kept at above 90% for the six months both at the June 30, 2010 and 2009.

Selling expenses. Selling expenses increased by \$1,602,582, or 38.9%, to \$5,719,764 for the six months ended June 30, 2010 from \$4,117,182 for the same period in 2009. The second quarter of the year experienced more increases in selling expenses.

Administrative expenses. Administrative expenses increased by 132,928, or 14.9% to \$1,027,040 for the first six months in 2010 as compared to \$894,112 in 2009. Depreciation and amortization expenses changed very slightly due to some intangible and fixed assets having been fully depreciated.

Interest income. Interest income increased by \$48,996, or 101% to \$97,535 for the six months ended June 30, 2010 as compared to \$48,539 for the same period in 2009.

Income Taxes. The provision for income tax increased by \$218,103, or 32.3% for the six months ended June 30, 2010 compared to the same period of last year. In 2010, the applicable income tax rate for the Company is 15% for the Company's subsidiary ZHLD, as ZHLD had been approved by the local government as being involved in a high technology industry. Otherwise, the regular Chinese statutory tax rate is at 25%. The Company's ZETC subsidiary is currently exempt from PRC taxation, as it operates a business enterprise engaged in educational opportunities. The Company's other subsidiaries; BHYHZ, ZHLDBJ and New Shifan are taxed at the PRC regular statutory rate (25%), and have not accrued for taxes since inception, due to recurring losses or no income incurred since inception.

Net income. As a result of the foregoing, we had net income of \$7,919,912, or \$0.25 per share basic and diluted, for the six months ended June 30, 2010, as compared with net income of \$6,555,643 or \$0.30 per share basic and \$0.27 per share diluted, for the six months ended June 30, 2009. The decreased EPS is due to the increased number of shares outstanding.

#### Liquidity and Capital Resources

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

At June 30, 2010, we had cash and cash equivalents of \$74,690,538, an increase of \$9,655,206 or 14.8%, from \$65,035,332 at December 31, 2009. This increase reflected the net income generated by our business during the six months ended June 30, 2010.

Our net cash provided by operating activities was \$10,134,641 for the six months ended June 30, 2010, an increase of \$1,733,986 or 20.6% from \$8,400,655 for the six months ended June 30, 2009. This increase was due to an increase in net income along with the decrease of prepaid expenses and accounts receivable.

As of June 30, 2010, we had working capital of \$75,197,844, an increase of \$8,460,350 from working capital of \$66,737,494 at December 31, 2009. We consider our current working capital and borrowing capabilities adequate to cover our planned operating and capital requirements.

Accounts payable and accrued expenses as of June 30, 2010, were \$2,175,755, an increase of \$919,764, or 73.2%, from \$1,255,991 at December 31, 2009.

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. 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.

#### Off-Balance Sheet Arrangements

As of June 30, 2010, we had no off-balance sheet arrangements

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

We currently do not hold or use any derivative or other financial instruments that expose us to substantial market risk and we have no foreign exchange contracts.

We are exposed to foreign exchange risk arising from fluctuations in the exchange rate between U.S. Dollars and Renminbi. Our operations are located in the People's Republic of China and substantially all of our revenues and assets are denominated in Renminbi. However our reporting currency is the U.S. Dollar and some of our expenses are denominated in U.S. Dollars. As a result, our financial results are potentially subject to the impact of changes in value between U.S. Dollars and Renminbi. If the Renminbi depreciates relative to the U.S. Dollar, the value of our revenues, earnings and assets as reported in our financial statements will decline.

#### 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.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings.

There is no material legal proceeding pending against us.

### Item 1A. Risk Factors

There have not been any material changes to the Company's risk factors from its to our Annual Report on Form 10-K on June 7, 2010.

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

None.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. (Removed and Reserved).

### Item 5. Other Information

Not applicable.

### Item 6. Exhibits

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

| Exhibit No. | SEC Ref. No. | Title of Document  |
|-------------|--------------|--|
| 1           | 31.1         | Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *   |
| 2.          | 31.2         | Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *   |
| 3           | 32.1         | Certification of the Principal Executive Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002* |
| 4           | 32.2         |  |

Certification of the Principal Financial Officer pursuant to U.S.C. Section 1350  
as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*

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

SIGNATURES

In accordance with the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHINA EDUCATION ALLIANCE, INC.

Date: August 10, 2010

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

Date: August 10, 2010

/s/ Zibing Pan  
Zibing Pan  
Chief Financial Officer (Principal Financial  
and Accounting Officer)