

CHINA EDUCATION ALLIANCE INC.

Form 10-Q

November 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

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

For the transition period from _____ to _____

Commission file number: **001-34386**

CHINA EDUCATION ALLIANCE, INC.

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

56-2012361

(I.R.S. Employer Identification No.)

58 Heng Shan Road, Kun Lun Shopping Mall

Harbin, People's Republic of China

150090

(Address of principal executive offices)

(Zip Code)

86-451-8233-5794

(Registrant's telephone number,

including area code)

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

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

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

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 November 13, 2013, there were 10,582,530 shares of \$0.001 par value common stock issued and outstanding.

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CHINA EDUCATION ALLIANCE, INC.

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PART I – FINANCIAL INFORMATION**Item 1. Financial Statements****China Education Alliance, Inc. and Subsidiaries****Consolidated Balance Sheets**

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current Assets		
Cash and cash equivalents	\$62,251,843	\$64,172,917
Other receivables	430,475	841,003
Prepaid expenses and other current assets	599,837	660,054
Total current assets	63,282,155	65,673,974
Non-current Assets		
Note receivable	-	7,935,122
Property and equipment, net	9,294,255	11,349,025
Intangibles and capitalized software, net	7,630,135	9,213,515
Total non-current assets	16,924,390	28,497,662
Total Assets	\$80,206,545	\$94,171,636
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	\$243,373	\$420,434
Deferred revenue	1,438,283	1,332,620
Income tax and other taxes payable	91,608	179,544
Total current liabilities	1,773,264	1,932,598
Commitments and Contingent Liabilities	-	-
Stockholders' Equity		
Common stock (\$0.001 par value, 150,000,000 shares authorized, 10,582,530 and 10,582,530 issued as of September 30, 2013 and December 31, 2012, respectively;	10,583	10,583

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137,512 and 137,512 shares held in treasury, as of September 30, 2013 and December 31, 2012, respectively)

Additional paid-in capital	40,942,009	40,941,215
Statutory reserve	3,792,161	3,792,161
Retained earnings	20,896,700	36,186,436
Accumulated other comprehensive income	12,437,792	10,322,490
Less: Treasury stock	(977,072)	(977,072)
Stockholders' equity - CEAI and Subsidiaries	77,102,173	90,275,813
Noncontrolling interests in subsidiaries	1,331,108	1,963,225
Total stockholders' equity	78,433,281	92,239,038
Total Liabilities and Stockholders' Equity	\$80,206,545	\$94,171,636

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

China Education Alliance, Inc. and Subsidiaries

Consolidated Statements of Operations and Comprehensive Income

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenue				
Online education revenue	\$ 506,725	\$ 608,080	\$ 1,901,324	\$ 3,919,487
Training center revenue	1,120,760	1,458,946	4,079,340	6,028,033
Total revenue	1,627,485	2,067,026	5,980,664	9,947,520
Cost of Revenue				
Online education costs	1,356,547	2,052,518	4,120,051	5,487,283
Training center costs	667,079	828,969	1,954,031	2,407,085
Total cost of revenue	2,023,626	2,881,487	6,074,082	7,894,368
Gross Profit/(Loss)				
Online education gross profit/(loss)	(849,822)	(1,444,438)	(2,218,727)	(1,567,796)
Training center gross profit	453,681	629,977	2,125,309	3,620,948
Total gross profit/(loss)	(396,141)	(814,461)	(93,418)	2,053,152
Operating Expenses				
Selling expenses	3,697,071	2,610,144	6,033,210	4,888,530
Administrative expenses	3,089,854	2,833,040	6,586,752	5,225,653
Depreciation and amortization	839,763	735,966	2,433,982	2,395,556
Total operating expenses	7,626,688	6,179,150	15,053,944	12,509,739
Loss from operations	(8,022,829)	(6,993,611)	(15,147,362)	(10,456,587)
Other Income (Expense)				
Other expenses, net	(7,593)	500	(10,400)	(4,189)
Loss on disposal of property and equipment	(4,324)	(83,309)	(14,456)	(99,127)
Impairment loss on intangible assets	-	-	(606,032)	(1,446,003)
Interest income	56,546	453,472	166,940	1,416,117
Total other income/(Expense), net	44,629	370,663	(463,948)	(133,202)
Net Loss Before Provision for Income Tax	(7,978,200)	(6,622,948)	(15,611,310)	(10,589,789)
Income taxes:				
Current	-	-	-	(32)
Deferred	-	-	-	(318,997)
Net Loss	(7,978,200)	(6,622,948)	(15,611,310)	(10,908,818)
	(131,331)	(50,263)	(321,574)	(242,239)

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Net Loss attributable to the noncontrolling interests				
Net Loss - attributable to CEAI and Subsidiaries	\$ (7,846,869)	\$ (6,572,685)	\$ (15,289,736)	\$ (10,666,579)
Net Loss per common stock-basic and diluted	\$ (0.74)	\$ (0.62)	\$ (1.44)	\$ (1.01)
Weighted Average Shares Outstanding-basic and diluted	10,582,530	10,582,530	10,582,530	10,582,530
The Components of Other Comprehensive Income				
Net Loss	\$ (7,846,869)	\$ (6,572,685)	\$ (15,289,736)	\$ (10,666,579)
Foreign currency translation adjustment	326,018	71,828	2,115,302	805,384
Comprehensive Loss	\$ (7,520,851)	\$ (6,500,857)	\$ (13,174,434)	\$ (9,861,195)

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

China Education Alliance, Inc. and Subsidiaries**Consolidated Statements of Cash Flows**

(Unaudited)

	Nine Months ended September 30,	
	2013	2012
Cash flows from operating activities		
Net loss	\$ (15,611,310)	\$ (10,908,818)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization - operating expenses	2,433,982	2,395,556
Depreciation and amortization - cost of revenue	2,079,770	2,131,445
Loss on disposal of fixed assets	14,456	99,127
Bad debt written off on other receivables	-	18,953
Impairment loss on intangible assets	606,032	1,446,003
Stock based compensation	794	4,514
Accounts receivable	-	(111,754)
Prepaid expenses and other receivables	503,944	303,523
Deferred tax assets	-	318,996
Accounts payable and accrued liabilities	(183,261)	(1,058,601)
Income tax and other taxes payable	(87,936)	(408,861)
Deferred revenue	69,772	(828,987)
Net cash used in operating activities	(10,173,757)	(6,598,904)
Cash flows from investing activities		
Purchases of property and equipment	(983,654)	(1,421,353)
Loan received back from NIT	8,047,383	-
Proceeds from disposal of property and equipment	14,456	20,466
Net cash (used in) provided by investing activities	7,078,185	(1,400,887)
Cash flows from financing activities		
Advance to a stockholder	-	99,903
Dividend paid to noncontrolling shareholders	(354,085)	(158,514)
Net cash used in financing activities	(354,085)	(58,611)
Effect of exchange rate changes on cash	1,528,583	422,989
Net increase (decrease) in cash and cash equivalents	(1,921,074)	(7,635,413)
Cash and cash equivalents at beginning of period	64,172,917	73,597,159
Cash and cash equivalents at end of period	\$ 62,251,843	\$ 65,961,746
Supplemental disclosure of cash flow information		

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Income tax paid	\$ 93,858	\$ 92,832
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The accompanying notes are an integral part of these consolidated financial statements.

China Education Alliance, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

1. Description of Business

Nature of organization - China Education Alliance, Inc. (the “Company”), formerly known as ABC Realty Co., was 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., pursuant to a Plan of Exchange, acquired 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 (Renminbi (“RMB”) 500,000).

On September 15, 2004, ABC Realty Co. entered into 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 PRC. Its mission is to promote online exam preparation services in the PRC, 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 Mr. Xiqun Yu, the Company’s CEO, for the benefit of ZHL D.

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. 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 to enable us to work with the Association’s network to expand our business.

On April 18, 2008, ZHLD entered into an agreement and supplementary agreement with Harbin Daily Newspaper Group (“Newspaper Group”) to invest in a joint venture company, Harbin New Discovery Media Co., Ltd. (“New Discovery”). ZHLD contributed RMB3,000,000 (approximately \$430,000) and Newspaper Group contributed RMB3,120,000 (approximately \$445,000) towards the registered capital of New Discovery. In return for their respective contributions, ZHLD owns 49.02% equity interest and Newspaper Group owns 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. As the Company did not foresee that the investment cost is recoverable from this joint venture in the near future, the Company provided fully impairment on the investment by the year ended December 31, 2011.

On January 4, 2009, ZHLD entered into an agreement with Mr. Guang Li to jointly incorporate and invest in a joint venture company, Zhong He Li Da (Beijing) Management Consultant Co., Ltd. (“ZHLDBJ”). ZHLD contributed RMB425,000 (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 RMB500,000 (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 entrusted Mr. Xiqun Yu 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 February 2010, the Company, through ZHLD, incorporated a new company in the PRC, Beijing New Shifan Education & Technology Co., Ltd. ("New Shifan") with a registered capital of RMB1.95 million (approximately \$291,132). ZHLD owned a 65% equity interest in New Shifan and the other equity holders together owned a 35% equity interest in New Shifan. 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 RMB7 million (approximately \$1,056,970) 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 Mathematics, Physics, and Chemistry" and (iii) the rights to a nationwide contest for middle school and high school students. In September 2011, New Shifan changed its name to Beijing Hua Yu Pin Xue Education Technology Co., Ltd ("HYPX"). In October 2011, ZHLD took over the 35% equity interest from the other equity holders of HYPX without any consideration, and entrusted Mr. Xiqun Yu to hold the 35% equity interest on behalf of ZHLD. In November 2011, HYPX increased its share capital to RMB2 million (approximately \$298,567). In January 2012, due to changes in government regulations, the Company authorized Mr. Yu to hold the 100% equity interest on behalf of ZHLD. HYPX is focusing on expanding our training centers in Beijing, and developing extensive marketing strategy to establish new markets in other main cities.

On March 4, 2011, the Company entered into a management agreement with Nanchang Institute of Technology ("NIT"), a vocational training institution based in Nanchang, PRC. Pursuant to the agreement, the Company would assist in managing the daily operations of NIT for ten years for an annual management fee of RMB 10 million (approximately \$1,461,347). The management fee was payable on a quarterly basis and in the event of late payment, a late fee would be imposed. Additionally, a liquidated damage of RMB 50 million (approximately \$7,935,122) would be paid by any party that defaulted on the agreement.

In connection with the management agreement, the Company entered in to a loan agreement, pursuant to which the Company agreed to loan NIT RMB 50 million (approximately \$7,935,122) to build training facilities and NIT would repay the RMB 50 million (approximately \$7,935,112) in ten years from the date NIT received the principal. The loan had an annual interest rate of 20% and the interest would be waived by the Company if NIT made all payments under the management agreement in a timely manner. We received 20% annual interest income due each quarter, therefore, the management fee was waived. The loan was secured by the assets of certain guarantors. On March 29, 2013, NIT repaid the loan principal of RMB50 million and accrued interests and the loan agreement was terminated. On the same day, the management agreement with NIT was also terminated.

On February 25, 2011, the Company entered into a share transfer agreement with the shareholder of Harbin Tianlang Culture and Education School ("Tianlang"), a tutoring school with 5,000 students, based in Harbin, PRC. Pursuant to the share transfer agreement, the Company purchased 60% of the equity interests of Tianlang for RMB 35 million (approximately \$5.3 million). The shareholder and the Company also provided RMB 2 million (approximately \$0.3 million) and RMB 3 million (approximately \$0.5 million) as working capital for Tianlang, respectively. Tianlang had established a new board of directors with five directors, of which three directors were appointed by the Company and two directors were appointed by the shareholder. The acquisition of Tianlang was completed in April 2011. We are currently co-managing Tianlang with the previous majority owner. The Company and the previous majority owner will be entitled to 60% and 40%, respectively, of the profits of Tianlang.

On May 31, 2011, the Company entered into share transfer agreements with the shareholders (the “Shareholders”) of Changchun City Chaoyang District Nuoya Foreign Languages School (“Changchun Nuoya”) and Harbin City Nangang District Nuoya Foreign Languages School (“Harbin Nuoya”), two foreign language schools based in the PRC.

Pursuant to the agreements, the Company purchased 100% of the two schools for an aggregate of RMB 16 million (approximately \$2.5 million), and all consideration had been paid up. The Shareholders’ obligations under the agreements are guaranteed by a guarantor who will be jointly and severally liable in the event of a breach by the Shareholders. The acquisition of Changchun Nuoya and Harbin Nuoya was completed by the end of May 2011 and their financial statements had been consolidated with the Company’s financial statements since May 2011. The Company did not foresee that the investment cost in Harbin Nuoya and Changchun Nuoya is recoverable in the near future. As a result, the Company fully impaired its investment in the two schools. As there is little demand for non-English classes at the time being, the Company has suspended the operation of Changchun Nuoya.