

CHINA EDUCATION ALLIANCE INC.

Form 10-Q

August 14, 2014

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 June 30, 2014

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

For the transition period from _____ to _____

Commission file number: **001-34386**

CHINA EDUCATION ALLIANCE, INC.

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

56-2012361

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

58 Heng Shan Road, Kun Lun Shopping Mall

Harbin, People's Republic of China

(Address of principal executive offices)

150090

(Zip Code)

86-451-8233-5794

(Registrant's telephone number, including area code)

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

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

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

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 13, 2014, there were 10,582,530 shares of \$0.001 par value common stock issued and outstanding.

FORM 10-Q

CHINA EDUCATION ALLIANCE, INC.

INDEX

	Page
PART I.	
<u>Financial Information</u>	2
<u>Item 1. Financial Statements (Unaudited).</u>	2
<u>Item 2. Management's Discussion and Analysis of Financial Condition and results of Operation.</u>	18
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk.</u>	27
<u>Item 4. Controls and Procedures.</u>	27
PART II.	
<u>Other Information</u>	28
<u>Item 1. Legal Proceedings.</u>	28
<u>Item 1A. Risk Factors.</u>	28
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.</u>	28
<u>Item 3. Defaults Upon Senior Securities.</u>	28
<u>Item 4. Mine Safety Disclosures.</u>	28
<u>Item 5. Other Information.</u>	28
<u>Item 6. Exhibits.</u>	29
<u>Signatures</u>	30

PART I –FINANCIAL INFORMATION

Item 1. Financial Statements

China Education Alliance, Inc. and Subsidiaries

Consolidated Balance Sheets

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	\$42,589,275	\$ 56,377,154
Accounts receivable	22,724	-
Other receivables	581,304	262,547
Prepaid expenses and other current assets	703,954	727,708
Total current assets	43,897,257	57,367,409
Non-current Assets		
Property and equipment, net	7,939,425	8,251,612
Intangibles and capitalized software, net	4,635,416	5,099,934
Total non-current assets	12,574,841	13,351,546
Total Assets	\$56,472,098	\$ 70,718,955
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	\$435,365	\$ 1,076,625
Deferred revenue	1,172,637	854,027
Income tax and other taxes payable	218,348	111,500
Total current liabilities	1,826,350	2,042,152
Commitments and Contingent Liabilities	-	-
Stockholders' Equity		

Edgar Filing: CHINA EDUCATION ALLIANCE INC. - Form 10-Q

Common stock (\$0.001 par value, 150,000,000 shares authorized, 10,582,530 and 10,582,530 issued as of June30, 2014 and December 31, 2013, respectively; 137,512 and 137,512 shares held in treasury, as of June30, 2014 and December 31, 2013, respectively)	10,583	10,583
Additional paid-in capital	40,942,009	40,942,009
Statutory reserve	3,792,161	3,792,161
Retained earnings	(1,852,176)	11,516,661
Accumulated other comprehensive income	12,253,850	12,705,287
Less: Treasury stock	(977,072)	(977,072)
Stockholders' equity - CEAI and Subsidiaries	54,169,355	67,989,629
Noncontrolling interests in subsidiaries	476,393	687,174
Total stockholders' equity	54,645,748	68,676,803
Total Liabilities and Stockholders' Equity	\$56,472,098	\$ 70,718,955

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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Revenue				
Online education revenue	\$ 130,383	\$ 767,888	\$ 257,647	\$ 1,394,599
Training center revenue	459,155	1,142,759	1,056,585	2,958,580
Total revenue	589,538	1,910,647	1,314,232	4,353,179
Cost of Revenue				
Online education costs	1,072,595	1,409,183	2,107,464	2,763,504
Training center costs	377,479	570,107	775,004	1,286,952
Total cost of revenue	1,450,074	1,979,290	2,882,468	4,050,456
Gross Profit/(Loss)				
Online education gross profit/(loss)	(942,212)	(641,295)	(1,849,817)	(1,368,905)
Training center gross profit	81,676	572,652	281,581	1,671,628
Total gross profit/(loss)	(860,536)	(68,643)	(1,568,236)	302,723
Operating Expenses				
Selling expenses	1,185,254	1,236,637	2,395,702	2,336,139
Administrative expenses	5,001,944	1,846,937	8,704,791	3,496,898
Depreciation and amortization	523,968	785,847	1,016,164	1,594,219
Total operating expenses	6,711,166	3,869,421	12,116,657	7,427,256
Loss from operations	(7,571,702)	(3,938,064)	(13,684,893)	(7,124,533)
Other Income (Expense)				
Other income(expenses), net	9,967	(1,090)	38,023	(2,807)
Loss on disposal of property and equipment	(10,709)	(7,363)	(16,162)	(10,132)
Impairment loss on intangible assets	-	-	-	(606,032)
Interest income	42,284	58,678	87,870	110,394
Total other income/(Expense), net	41,542	50,225	109,731	(508,577)
Net Loss Before Provision for Income Tax	(7,530,160)	(3,887,839)	(13,575,162)	(7,633,110)

Edgar Filing: CHINA EDUCATION ALLIANCE INC. - Form 10-Q

Income taxes:

Current	-	-	-	-
Deferred	-	-	-	-
Net Loss	(7,530,160)	(3,887,839)	(13,575,162)	(7,633,110)
Net Loss attributable to the noncontrolling interests	(138,388)	(147,991)	(206,325)	(190,243)
Net Loss - attributable to CEAI and Subsidiaries	\$ (7,391,772)	\$ (3,739,848)	\$ (13,368,837)	\$ (7,442,867)
Net Loss per common stock-basic and diluted	\$ (0.70)	\$ (0.35)	\$ (1.26)	\$ (0.70)
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	\$ (7,391,772)	\$ (3,739,848)	\$ (13,368,837)	\$ (7,442,867)
Foreign currency translation adjustment	60,654	1,271,719	(451,437)	1,789,284
Comprehensive Loss	\$ (7,331,118)	\$ (2,468,129)	\$ (13,820,274)	\$ (5,653,583)

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,	
	2014	2013
Cash flows from operating activities		
Net loss	\$(13,575,162)	\$(7,633,110)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization - operating expenses	1,016,164	1,496,222
Depreciation and amortization - cost of revenue	875,902	1,375,335
Loss on disposal of fixed assets	16,162	10,132
Bad debt written off on other receivables	-	-
Impairment loss on intangible assets	-	606,032
Stock based compensation	-	794
Net changes in operating assets and liabilities		
Accounts receivable	(22,586)	(76,128)
Prepaid expenses and other receivables	(300,171)	237,990
Deferred tax assets	-	-
Accounts payable and accrued liabilities	(631,355)	(137,570)
Income tax and other taxes payable	106,848	(67,984)
Deferred revenue	322,784	(97,793)
Net cash used in operating activities	(12,191,414)	(4,286,080)
Cash flows from investing activities		
Purchases of property and equipment	(1,205,116)	(35,235)
Loan received back from NIT	-	8,013,462
Proceeds from disposal of property and equipment	2,602	1,186
Net cash (used in) provided by investing activities	(1,202,514)	7,979,413
Cash flows from financing activities		
Dividend paid to noncontrolling shareholders	-	(352,592)
Net cash used in financing activities	-	(352,592)
Effect of exchange rate changes on cash	(393,951)	1,380,701
Net increase (decrease) in cash and cash equivalents	(13,787,879)	4,721,442
Cash and cash equivalents at beginning of period	56,377,154	64,172,917
Cash and cash equivalents at end of period	\$42,589,275	\$68,894,359

Supplemental disclosure of cash flow information

Income tax paid	\$-	\$93,858
-----------------	-----	----------

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. (“ZHLD”), a corporation formed on August 9, 2004 in the City of Harbin in the Heilongjiang Province, People’s Republic of China (the “PRC”), with an authorized capital of \$60,386 (Renminbi (“RMB”) 500,000).

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

ZHLD is a technology company engaged in the online education industry in the 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.

ZHLD’s subsidiary, Heilongjiang Zhonghe Education Training Center (“ZHTEC”) was registered in the PRC on July 8, 2005 with a registered capital of RMB0.5 million (approximately \$60,788) and is accounted for as a wholly owned subsidiary of ZHLD. ZHLD owns 99% of ZHTEC with 1% held in trust by Mr. Xiqun Yu, the Company’s CEO, for the benefit of ZHLD. In December 2013, ZHTEC increased its share capital to RMB1 million (approximately \$142,412).

ZHLD also owns 70% of the equity interests of Beijing Hua Yu HuiZhong 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 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. 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. In 2012, HYPX established a wholly owned school - Beijing Xicheng District Hua Yu Pin Xue Training School, and together with a previously established wholly owned subsidiary of the Company - Beijing Shifanxuezhitang Information Science Institute, established the Company's new brand image and reputation in several districts in Beijing. HYPX focuses on expansion of our training centers in Beijing, as well as 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 loaned 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 Company would waive the interest 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 assets of certain guarantors secured the loan. 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 both schools.

In June 2012, the Company, through ZHLD, incorporated a new company in the PRC, Harbin Zhong He Li Da Information Technology Co., Ltd. (“ZHLDT”) with a registered capital of RMB2 million. Mr. Yu has been entrusted to hold the 100% equity interest on behalf of ZHLD. ZHLDT was established to initiate and design a platform for online education programs, and provide this effective and efficient communication service to all the teachers and students.

2 Basis of Preparation of Financial Statements

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”). The consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation. The portion of the income applicable to noncontrolling interests in subsidiaries undertakings is reflected in the consolidated statement of operations.

The consolidated interim financial information as of June 30, 2014 and for the three and six month periods ended June 30, 2014 and 2013 have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures, which are normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have not been included. The consolidated interim financial information should be read in conjunction with the Financial Statements and the notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013, previously filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company’s consolidated financial position as of June 30, 2014, its consolidated results of operations and cash flows for the three and six month periods ended June 30, 2014 and 2013, as applicable, have been made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

SUPPLEMENTAL SCHEDULE SERVICEMASTER PROFIT SHARING AND RETIREMENT PLAN

FORM 5500 SCHEDULE H, PART IV, LINE 4i SCHEDULE OF ASSETS (HELD AT END OF YEAR) AS OF DECEMBER 31, 2006

(b) Identity of Issue/ (a) (c) Description of Investment	(d) Cost	(e) Current Value
MUTUAL FUNDS:		
* T. Rowe Price Retirement 2005 Fund	N/A	\$ 4,072,150
* T. Rowe Price Retirement 2010 Fund	N/A	11,684,317
* T. Rowe Price Retirement 2015 Fund	N/A	17,505,295
* T. Rowe Price Retirement 2020 Fund	N/A	25,400,875
* T. Rowe Price Retirement 2025 Fund	N/A	25,486,564
* T. Rowe Price Retirement 2030 Fund	N/A	19,412,061
* T. Rowe Price Retirement 2035 Fund	N/A	11,576,048
* T. Rowe Price Retirement 2040 Fund	N/A	7,686,783
* T. Rowe Price Retirement 2045 Fund	N/A	869,879
* T. Rowe Price Retirement Income Fund	N/A	1,266,484

Edgar Filing: CHINA EDUCATION ALLIANCE INC. - Form 10-Q

(b) Identity of Issue/ (a) (c) Description of Investment		(d) Cost	(e) Current Value
* T. Rowe Price International Growth & Income Fund		N/A	10,080,607
* T. Rowe Price Mid-Cap Value Fund		N/A	5,261,837
* T. Rowe Price Growth Stock Fund		N/A	5,898,858
* T. Rowe Price New Horizons Fund		N/A	3,511,198
* T. Rowe Price Equity Income Fund		N/A	25,275,395
Vanguard Mid-Cap Growth Fund		N/A	5,316,021
Vanguard Small Cap Value Index Fund		N/A	8,268,646
COMMON/COLLECTIVE TRUST FUNDS:			
* T. Rowe Price Bond Index		N/A	31,776,258
* ServiceMaster Stable Value Fund		N/A	20,383,082
* T. Rowe Price Equity Index		N/A	42,092,705
EMPLOYER SECURITIES Common shares:			
* The ServiceMaster Company Common Stock Fund		\$ 37,117,191	44,625,597
* PARTICIPANT LOANS (Interest rates generally from 5.00% to 9.75% maturing 2006 to 2012)		N/A	10,257,260
Total			\$ 337,707,920

* Party-in-interest.

N/A: Cost information is not required for participant-directed investments and, therefore, is not included. The ServiceMaster Company Common Stock Fund includes both participant-directed and nonparticipant-directed investments.

15

SERVICEMASTER PROFIT SHARING AND RETIREMENT PLAN

**FORM 5500, SCHEDULE H, PART IV, QUESTION 4a
DELINQUENT PARTICIPANT CONTRIBUTIONS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Question 4a Did the employer fail to transmit to the plan any participant contributions within the time period described in 29 CFR 2510.3-102, was answered yes.

Identity of Party Involved	Relationship to Plan, Employer, or Other Party-in-Interest	Description of Transactions	Amount
The ServiceMaster Company	Employer/Plan Sponsor	Participant contributions for employees were not funded within the time period prescribed by D.O.L. Regulation 2510.3-102. Certain participant contributions for January through March of 2005 were deposited by May 25, 2005.	\$34,608

16

