CHINA AUTOMOTIVE SYSTEMS INC
Form 10-Q
May 14, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

Or

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to _________

Commission file number: **000-33123**

China Automotive Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**33-0885775**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

No. 1 Henglong Road, Yu Qiao Development Zone, Shashi District

Jing Zhou City, Hubei Province, the People's Republic of China

(Address of principal executive offices)

(86) 716- 832- 9196
Issuer's telephone number

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 x 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 x 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 (Do not check if a smaller reporting company) ¨	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of May 14, 2013, the Company had 28,043,019 shares of common stock issued and outstanding.

CHINA AUTOMOTIVE SYSTEMS, INC.

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Cautionary Statement

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or the Company's future financial performance. The Company has attempted to identify forward-looking statements by terminology including "anticipates," "believes," "expects," "can," "continues," "could," "estimates," "expects," " "may," "plans," "potential," "predicts," "should" or "will" or the negative of these terms or other comparable terminology. Suc statements are subject to certain risks and uncertainties, including the matters set forth in this Quarterly Report or other reports or documents the Company files with the Securities and Exchange Commission from time to time, which could cause actual results or outcomes to differ materially from those projected. Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements. Undue reliance should not be placed on these forward-looking statements, which speak only as of the date hereof. The Company's expectations are as of the date this Form 10-Q is filed, and the Company does not intend to update any of the forward-looking statements after the date this Quarterly Report on Form 10-Q is filed to confirm these statements to actual results, unless required by law. All of the forward-looking statements are qualified in their entirety by reference to the factors discussed under Item 1A. "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission, and Item 1A "Risk Factors" of Part II in this report.

PART I — FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Statements of Operations and Comprehensive Income (Loss)

(In thousands of USD, except share and per share amounts)

	Three Months Ended March 31,					
	2013			2012 (Note 22)		
Net product sales						
Unrelated parties	$	89,021		$	73,027	
Related parties (Note 25)		8,143			7,893	
		97,164			80,920	
Cost of product sold						
Unrelated parties		71,137			59,363	
Related parties (Note 25)		6,665			6,179	
		77,802			65,542	
Gross profit		19,362			15,378	
Gain on other sales		674			112	
Less: Operating expenses						
Selling expenses		3,164			2,180	
General and administrative expenses		4,126			3,382	
Research and development expenses		3,400			3,592	
Total operating expenses		10,690			9,154	
Income from operations		9,346			6,336	
Other income, net		70			72	
Financial expenses, net		(201	)		(912	)
Loss on change in fair value of derivative		-			(3,861	)
Income before income tax expenses and		9,215			1,635	

equity in earnings of affiliated companies					
Less: Income taxes		1,747		1,461	
Equity in earnings of affiliated companies		58		80	
Income from continuing operations		7,526		254	
Discontinued operations - net of income tax (Note 22)		-		31	
Net income		7,526		285	
Net income attributable to non-controlling interests		1,586		1,054	
Net income (loss) attributable to parent company's common shareholders	$	5,940	$	(769	)
Comprehensive income:					
Income from continuing operations	$	7,526	$	254	
Income from discontinued operations		-		31	
Net income		7,526		285	
Other comprehensive income:					
Foreign currency translation gain, net of tax - continuing operations		612		481	
Foreign currency translation gain, net of tax - discontinued operations		-		21	
Foreign currency translation gain, net of tax		612		502	
Comprehensive income - continuing operations		8,138		735	
Comprehensive income - discontinued operations		-		52	
Comprehensive income		8,138		787	
Comprehensive income attributable to non-controlling		1,689		1,099	

interests					
Comprehensive income attributable to parent company	$	6,449	$	(312	)
Net income (loss) attributable to parent company's common shareholders per share					
Basic -					
Income (loss) from continuing operations attributable to shareholders	$	0.21	$	(0.03	)
Income (loss) per share from discontinued operations		-		-	
Basic	$	0.21	$	(0.03	)
Diluted-					
Income (loss) from continuing operations attributable to shareholders	$	0.21	$	(0.03	)
Income (loss) per share from discontinued operations		-		-	
Diluted	$	0.21	$	(0.03	)
Weighted average number of common shares outstanding					
Basic		28,043,019		28,260,302	
Diluted		28,050,937		28,260,302	

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

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China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Balance Sheets

(In thousands of USD unless otherwise indicated)

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 90,352	$ 87,649
Pledged cash deposits	26,230	26,481
Accounts and notes receivable, net - unrelated parties	230,493	211,306
Accounts and notes receivable, net - related parties	15,120	12,286
Advance payments and others - unrelated parties	4,774	3,127
Advance payments and others - related parties	672	779
Inventories	45,270	43,542
Current deferred tax assets	3,600	4,392
Total current assets	416,511	389,562
Non-current assets:		
Property, plant and equipment, net	81,168	81,691
Intangible assets, net	695	676
Other receivables, net - unrelated parties	1,002	849
Other receivables, net - related parties	80	107
Advance payment for property, plant and equipment - unrelated parties	1,330	1,001
Advance payment for property, plant and equipment - related parties	3,808	4,162
Long-term investments	3,733	3,665
Non-current deferred tax assets	4,206	4,112
Total assets	$ 512,533	$ 485,825
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank and government loans	$ 46,934	$ 40,284
Accounts and notes payable - unrelated parties	176,476	166,380
Accounts and notes payable - related parties	4,864	4,521
Customer deposits	903	870
Accrued payroll and related costs	5,675	5,472
Accrued expenses and other payables	24,022	23,063
Accrued pension costs	4,177	4,255
Taxes payable	5,989	5,593
Amounts due to shareholders/directors	293	332
Deferred tax liabilities	63	46
Advances payable	2,600	-
Total current liabilities	271,996	250,816
Long-term liabilities:		
Advances payable	-	2,609
Total liabilities	271,996	253,425

Commitments and Contingencies (Note 26)

Stockholders’ equity-		
Common stock, $0.0001 par value - Authorized - 80,000,000 shares; Issued– 28,260,302 and 28,260,302 shares at March 31, 2013 and December 31, 2012, respectively	3	3
Additional paid-in capital	39,371	39,371
Retained earnings-		
Appropriated	9,953	9,953
Unappropriated	125,269	119,329
Accumulated other comprehensive income	26,406	25,898
Treasury stock - 217,283 and 217,283 shares at March 31, 2013 and December 31, 2012, respectively	(1,000)	(1,000)
Total parent company stockholders' equity	200,002	193,554
Non-controlling interests	40,535	38,846
Total stockholders' equity	240,537	232,400
Total liabilities and stockholders' equity	$ 512,533	$ 485,825

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

China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Statements of Cash Flows

(In thousands of USD unless otherwise indicated)

	Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net income	$ 7,526	$ 285
Adjustments to reconcile net income from operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,468	3,507
Increase (decrease) in allowance for doubtful accounts	(95)	69
Inventory write downs	224	117
Deferred income taxes	738	119
Equity in earnings of affiliated companies	(58)	(80)
Loss on change in fair value of derivative	-	3,861
Amortization of debt issue cost	38	-
Loss (gain) on fixed assets disposals	(165)	2
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Pledged deposits	321	(122)
Accounts and notes receivable	(21,381)	1,610
Advance payments and others	(1,529)	902
Inventories	(1,839)	(6,746)
Increase (decrease) in:		
Accounts and notes payable	9,985	954
Customer deposits	32	(567)
Accrued payroll and related costs	189	(399)
Accrued expenses and other payables	900	1,696
Accrued pension costs	(89)	229
Taxes payable	382	2,447
Advances payable	(16)	634
Net cash provided by (used in) operating activities	(1,369)	8,518
Cash flows from investing activities:		
Increase in other receivables	(122)	(600)
Proceeds from disposal of equipment	405	101
Payments to acquire property, plant and equipment	(2,843)	(1,992)
Payments to acquire intangible assets	(60)	(4)
Net cash used in investing activities	(2,620)	(2,495)
Cash flows from financing activities:		
Proceeds from government and bank loan	8,101	1,589
Repayments of bank loan	(1,595)	-

Dividends paid to the non-controlling interests	-	(796)
Increase (decrease) in amounts due to shareholders/directors	(40)	1
Net cash provided by financing activities	6,466	794
Effects of exchange rate on cash and cash equivalents	226	75
Net increase in cash and cash equivalents	2,703	6,892
Cash and cash equivalents at beginning of period	87,649	72,960
Cash and cash equivalents at end of period	$ 90,352	$ 79,852

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

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China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Statements of Cash Flows (continued)

(In thousands of USD unless otherwise indicated)

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

	Three Months Ended March 31,	
	2013	2012
Cash paid for interest	$ 374	$ 789
Cash paid for income taxes	$ 1,263	$ 552

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

	Three Months Ended March 31,	
	2013	2012
Advance payments for acquiring property, plant and equipment	$ 5,138	$ 5,960
Dividends payable to non-controlling interests	$ 163	$ 807

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

China Automotive Systems, Inc. and Subsidiaries

Notes to Condensed Unaudited Consolidated Financial Statements

Three Months Ended March 31, 2013 and 2012

1. Organization and Business

China Automotive Systems, Inc., "China Automotive," was incorporated in the State of Delaware on June 29, 1999 under the name Visions-In-Glass, Inc. China Automotive, including, when the context so requires, its subsidiaries and the joint ventures described below, is referred to herein as the "Company." The Company is primarily engaged in the manufacture and sale of automotive systems and components, as described below.

Great Genesis Holdings Limited, a company incorporated in Hong Kong on January 3, 2003 under the Companies Ordinance in Hong Kong as a limited liability company, "Genesis," is a wholly-owned subsidiary of the Company. Great Genesis is mainly engaged in the manufacture and sale of automotive systems and components through its controlled subsidiaries and the joint ventures, as described below.

Henglong USA Corporation, "HLUSA," incorporated on January 8, 2007 in Troy, Michigan, is a wholly-owned subsidiary of the Company, and is mainly engaged in marketing of automotive parts in North America, and provides after-sales service and research and development support accordingly.

The Company owns the following aggregate net interests in the entities established in the People's Republic of China, "PRC," and Brazil as of March 31, 2013 and December 31, 2012.

Name of Entity	Percentage Interest March 31, 2013	Percentage Interest December 31, 2012
Shashi Jiulong Power Steering Gears Co., Ltd., "Jiulong"[1]	81.00 %	81.00 %
Jingzhou Henglong Automotive Parts Co., Ltd., "Henglong"[2]	80.00 %	80.00 %
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., "Shenyang"[3]	70.00 %	70.00 %
Universal Sensor Application Inc., "USAI"[4]	83.34 %	83.34 %
Wuhan Jielong Electric Power Steering Co., Ltd., "Jielong"[5]	85.00 %	85.00 %
Wuhu HengLong Automotive Steering System Co., Ltd., "Wuhu"[6]	77.33 %	77.33 %
Hubei Henglong Automotive System Group Co., Ltd, "Hubei Henglong"[7]	100.00 %	100.00 %
Jingzhou Henglong Automotive Technology (Testing) Center, "Testing Center"[8]	80.00 %	80.00 %

Beijing Henglong Automotive System Co., Ltd., "Beijing Henglong"[9]	50.00	%	50.00	%
Chongqing Henglong Hongyan Automotive System Co., Ltd, "Chongqing Henglong"[10]	70.00	%	70.00	%
CAAS Brazil's Imports And Trade In Automotive Parts Ltd., "Brazil Henglong"[11]	80.00	%	80.00	%

1. Jiulong was established in 1993 and mainly engages in the production of integral power steering gear for heavy-duty vehicles.

2. Henglong was established in 1997 and mainly engages in the production of rack and pinion power steering gear for cars and light-duty vehicles.

3. Shenyang was established in 2002 and focuses on power steering parts for light duty vehicles.

4. USAI was established in 2005 and mainly engages in the production and sales of sensor modules.

5. Jielong was established in 2006 and mainly engages in the production and sales of electric power steering, "EPS."

6. Wuhu was established in 2006 and mainly engages in the production and sales of automobile steering systems.

7. On March 7, 2007, Genesis established Hubei Henglong, formerly known as Jingzhou Hengsheng Automotive System Co., Ltd., its wholly-owned subsidiary, to engage in the production and sales of automotive steering systems. The registered capital of Hubei Henglong at the time of establishment was $10 million. On February 10, 2010, the registered capital of Hubei Henglong was increased to $16 million. On October 12, 2011, the board of directors of the Company approved a reorganization of the Company's subsidiaries operating in China. As a result of the reorganization, all of Genesis's equity interests of its subsidiaries operating in China, except for Shenyang, were transferred to Hubei Henglong, the Company's new China-based holding company. The reorganization was completed on January 19, 2012, subsequent to which the registered capital of Hubei Henglong was increased to $39.0 million. As the reorganized entities were under common control of the Company, the reorganization did not have any impact on the Company's consolidated financial position or results of operations and should not impact the tax treatment of the Company or its subsidiaries in any material respect. On July 8, 2012, Hubei Henglong changed its name to Hubei Henglong Automotive System Group Co., Ltd.

8. In December 2009, Henglong, a subsidiary of Genesis, formed the Testing Center, which mainly engages in the research and development of new products. The registered capital of the Testing Center was RMB30.0 million, equivalent to approximately $4.4 million.

9. On January 24, 2010, Genesis entered into a joint venture contract with Beijing Hainachuan Auto Parts Co., Ltd., to establish Beijing Henglong as a joint venture company to design, develop and manufacture both hydraulic and electric power steering systems and parts. On September 16, 2010, with Beijing Hainchuan's agreement, Genesis transferred its interest in the joint venture to Hubei Henglong, and left the other terms of the joint venture contract unchanged. According to the joint venture agreement, the Company does not have voting control of Beijing Henglong. Therefore, the Company's consolidated financial statements do not include Beijing Henglong, and such investment is accounted for through the equity method.

10. On February 21, 2012, Hubei Henglong and SAIC-IVECO Hongyan Company, "SAIC-IVECO," established a Sino-foreign joint venture company, Chongqing Henglong, to design, develop and manufacture both hydraulic and electric power steering systems and parts. The new joint venture is located in Chongqing City and has a registered capital of RMB60 million, of which RMB42 million, or 70%, is held by Hubei Henglong. The registered capital of Chongqing Henglong was fully contributed by Hubei Henglong in cash of $6.7 million (equivalent to RMB42 million) in January and February 2012 and by SAIC-IVECO in property, plant and equipment with fair value of $2.8 million (equivalent to RMB18 million) in April 2012.

11. On August 21, 2012, Brazil Henglong was established as a Sino-foreign joint venture company by Hubei Henglong and two Brazilian citizens, Ozias Gaia Da Silva and Ademir Dal' Evedove. Brazil Henglong engages mainly in the import and sales of automotive parts in Brazil. Such joint venture is located in Brazil and has a registered capital of $1.0 million (equivalent to BRL1.6 million), of which $0.8 million (equivalent to BRL1.3 million), or 80%, is held by Hubei Henglong, and of which $0.2 million (equivalent to BRL0.3 million), or 20%, is held by Mr. Ozias Gaia Da Silva and Mr. Ademir Dal' Evedove. As of March 31, 2013, Hubei Henglong, Mr. Ozias Gaia Da Silva and Mr. Ademir Dal' Evedove have completed their capital contributions.

2. Basis of Presentation and Significant Accounting Policies

(a) Basis of Presentation

Basis of Presentation – The accompanying condensed unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. The details of subsidiaries are disclosed in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The condensed unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by such accounting principles for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of the Company's management, contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position as of March 31, 2013, the results of operations and cash flows for the three months ended March 31, 2013 and 2012, respectively.

The condensed consolidated balance sheet as of December 31, 2012 is derived from the Company's audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although the Company's management believes that the disclosures contained in these financial statements are adequate to make the information presented herein not misleading. For further information, please refer to the financial statements and the notes thereto included in the Company's 2012 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2013.

Estimation -The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

(b)Recent Accounting Pronouncements

In February 2013, the FASB issued *ASU 2013-04, "Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date"*. This update provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this update is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this update also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. For non-public entities, the amendments are effective for fiscal years ending after December 15, 2014, and interim periods and annual periods thereafter. This update should be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within this update's scope that exist at the beginning of an entity's fiscal year of adoption. An entity may elect to use hindsight for the comparative periods (if it changed its accounting as a result of adopting the amendments in this update) and should disclose that fact. Early adoption is permitted. The adoption of this standard is not expected to have any impact on the Company's financial position.

In March 2013, the FASB issued *ASU 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity"*. This update provides that when a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a non-profit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity, the parent is required to apply the guidance in *Subtopic 830-30* to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. For an equity method investment that is a foreign entity, a pro rata portion of the cumulative translation adjustment should be released into net income upon a partial sale of such an equity method investment. However, this treatment does not apply to an equity method investment that is not a foreign entity. In those instances, the cumulative translation adjustment is released into net income only if the partial sale represents a complete or substantially complete liquidation of the foreign entity that contains the equity method investment. Additionally, the amendments in this update clarify that the sale of an investment in a foreign entity includes both (1) events that result in the loss of a controlling financial interest in a foreign entity (that is, irrespective of any retained investment) and (2) events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date (sometimes also referred to as a "step acquisition"). Accordingly, the cumulative translation adjustment should be released into net income upon the occurrence of those events. This update is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. Early adoption is permitted. The adoption of this standard is not expected to have any impact on the Company's financial position.

(c)Significant Accounting Policies

Foreign Currencies – China Automotive, the parent company and HLUSA maintain their books and records in United States Dollars, "USD," their functional currency. The Company's subsidiaries based in the PRC and Genesis maintain their books and records in Renminbi, their functional currency. The Company's subsidiary based in Brazil maintains its books and records in Brazilian reais (BRL), its functional currency. In accordance with *FASB Accounting Standards Codification ("ASC") Topic 830*, foreign currency transactions denominated in currencies other than the functional currency are remeasured into the functional currency at the rate of exchange prevailing at the balance sheet date for monetary items. Nonmonetary items are remeasured at historical rates. Income and expenses are remeasured at the rate in effect on the transaction dates. Transaction gains and losses, if any, are included in the determination of net income for the period.

In translating the financial statements of the Company's China subsidiaries and Genesis from their functional currency into the reporting currency in USD, balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using an average exchange rate prevailing during the reporting period. Adjustments resulting from the translation, if any, are included in accumulated other comprehensive income (loss) in stockholders' equity.

Stock-Based Compensation – The Company may issue shares of common stock for services rendered or for financing costs. Such shares will be valued based on the market price on the transaction date. The Company may issue stock options to employees in non-capital raising transactions for services.

In July 2004, the Company adopted a stock incentive plan. The maximum number of common shares for issuance under this plan is 2,200,000 with a period of 10 years. The stock incentive plan provides for the issuance, to the Company's officers, directors, management and employees, of options to purchase shares of the Company's common stock. Since the adoption of the stock incentive plan, the Company has issued 501,350 stock options, and 1,698,650 stock options remain issuable in the future. As of March 31, 2013, the Company had 9,000 stock options outstanding.

The Company has adopted *ASC Topic 718, "Accounting for Stock-Based Compensation,"* which establishes a fair value method of accounting for stock based compensation plans. The cost of stock options issued to employees is measured on the grant date based on the fair value. The fair value is determined using the Black-Scholes option pricing model. The resulting amount is charged to expense on the straight-line basis over the period in which the Company expects to receive benefit, which is generally the vesting period.

Comprehensive Income – The Company has adopted *ASC Topic 220, "Reporting Comprehensive Income,"* which establishes standards for the reporting and display of comprehensive income, its components and accumulated balances in a full set of general purpose financial statements. *ASC Topic 220* defines comprehensive income to include all changes in equity except those resulting from investments by owners and distributions to owners, including adjustments to minimum pension liabilities, accumulated foreign currency translation, and unrealized gains or losses on marketable securities.

Financial Instruments – The Company adopted the provisions of *ASC Topic 815, "Derivatives and Hedging Activities,"* that address the determination of whether an instrument meets the definition of a derivative being indexed to a company's own stock for purposes of applying the scope exception as provided for in accordance with *ASC 815-15*. Upon adoption of the standard on the effective date, the Company bifurcated the conversion feature embedded in the convertible notes (see Note 13), classifying it in liabilities and measuring it at fair value at each reporting period, with changes reflected in earnings, until the convertible notes are settled.

Fair Value Measurements – For purposes of fair value measurements, the Company applies the applicable provisions of *ASC Topic 820, "Fair Value Measurements"*. Accordingly, fair value for the Company's financial accounting and reporting purposes represents the estimated price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the designated measurement date. With an objective to increase consistency and comparability in fair value measurements and related disclosures, the Financial Accounting Standard Board established the fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels.

Level 1 Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available. As at March 31, 2013 and December 31, 2012, the Company did not have any fair value assets and liabilities classified as Level 1.

Level 2 Inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. As at March 31, 2013 and December 31, 2012, the Company did not have any fair value assets and liabilities classified as Level 2.

Level 3 Inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. The compound derivative liabilities are classified as Level 3 as the inputs reflect management's best estimate of what market participants would use in pricing the liability at the measurement date. As at March 31, 2013 and December 31, 2012, the Company did not have any fair value assets and liabilities classified as Level 3. For a summary of changes in Level 3 derivative liabilities for the three months ended March 31, 2013 and 2012, please see Note 18.

3. Pledged cash deposits

Pledged cash deposits act as guarantee for the Company's notes payable as it regularly pays some of its suppliers by bank notes. The Company has to deposit a cash deposit, equivalent to 30% - 100% of the face value of the relevant bank note, at a bank in order to obtain the bank note.

4. Accounts and notes receivable, net

The Company's accounts and notes receivable at March 31, 2013 and December 31, 2012 are summarized as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Accounts receivable - unrelated parties [1]	$ 130,116	$ 117,136
Notes receivable - unrelated parties [2] [3]	101,598	95,436
	231,714	212,572
Less: allowance for doubtful accounts - unrelated parties	(1,221)	(1,266)
Accounts and notes receivable- unrelated parties	230,493	211,306
Accounts and notes receivable - related parties	15,120	12,286
	$ 245,613	$ 223,592

(1) As of March 31, 2013, the Company has pledged $19.3 million of accounts receivable as security for its comprehensive credit facility with banks in China.

(2) Notes receivable represent accounts receivable in the form of bills of exchange for which acceptances are guaranteed and settlements are handled by banks.

(3) Henglong collateralized RMB 280.0 million (equivalent to approximately $44.6 million) as security for the credit facility with banks in China and the Chinese government, including RMB 240.0 million (equivalent to approximately $38.2 million) in favor of Industrial and Commercial Bank of China, Jingzhou Branch, “ICBC Jingzhou,” for the purpose of obtaining the Henglong Standby Letter of Credit (as defined in Note 11 below) as security for the non-revolving credit facility in the amount of $30.0 million provided by Industrial and Commercial Bank of China (Macau) Limited, “ICBC Macau,” to the Company in May 2012, and RMB 40.0 million (equivalent to approximately $6.4 million) in favor of the Chinese government as security for the interest-free government loan (see Note 11 below).

5. Inventories

The Company’s inventories at March 31, 2013 and December 31, 2012 consisted of the following (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Raw materials	$ 12,670	$ 11,144
Work in process	8,364	7,094
Finished goods	24,236	25,304
	$ 45,270	$ 43,542

Provision for inventories valuation amounted to $0.2 million and $0.1 million for the three months ended March 31, 2013 and 2012, respectively.

6. Other receivables, net

The Company’s other receivables at March 31, 2013 and December 31, 2012 are summarized as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Other receivables - unrelated parties (1)	$ 1,057	$ 905

Less: allowance for doubtful accounts- unrelated parties	(55)	(56)
	$ 1,002	$ 849

	March 31, 2013	December 31, 2012
Other receivables - related parties [(1)]	$ 691	$ 715
Less: allowance for doubtful accounts- related parties	(611)	(608)
	$ 80	$ 107

(1) Other receivables consist of amounts advanced to both related and unrelated parties, primarily as unsecured demand loans, with no stated interest rate or due date. These receivables originate as part of the Company's normal operating activities and are periodically settled in cash.

7. Long term Investments

As of each of March 31, 2013 and December 31, 2012, the Company’s balance of long-term investment was $3.7 million. For the long-term investments in which the Company has no voting control, such investments were accounted for using the equity method or cost method.

On January 24, 2010, the Company invested $3.1 million to establish a fifty-fifty joint venture company, Beijing Henglong, with an unrelated party. The Company accounts for its operating results with the equity method of accounting. As of March 31, 2013 and 2012, the Company had $3.6 million and $3.5 million of net equity in Beijing Henglong, respectively.

The Company's share of net assets and net income is reported as "long-term investment" on the condensed unaudited consolidated balance sheets and "equity in earnings of affiliated companies" on the condensed unaudited consolidated statements of operations and comprehensive income (loss). The Company's condensed unaudited consolidated financial statements reflect the equity earnings of non-consolidated affiliates of $0.06 million and $0.08 million for the three months ended March 31, 2013 and 2012, respectively.

8. Property, plant and equipment, net

The Company's property, plant and equipment as of March 31, 2013 and December 31, 2012 are summarized as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Land use rights and buildings	$ 36,745	$ 36,881
Machinery and equipment	101,892	96,368
Electronic equipment	6,248	6,174
Motor vehicles	3,033	2,942
Construction in progress	10,454	13,280
	158,372	155,645
Less: Accumulated depreciation	(77,204)	(73,954)
	$ 81,168	$ 81,691

Depreciation charges for the three months ended March 31, 2013 and 2012, were $3.4 million and $3.5 million respectively.

As of March 31, 2013, the Company had pledged property, plant and equipment with net book value of $55.0 million for its comprehensive credit facilities with banks in China.

9. Intangible assets

The Company's intangible assets as of March 31, 2013 and December 31, 2012 are summarized as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Costs:		
Patent technology	$ 1,962	$ 1,901
Management software license	627	622
	2,589	2,523
Less: Amortization	(1,894)	(1,847)
	$ 695	$ 676

For the three months ended March 31, 2013 and 2012, amortization expenses were $0.04 million and $0.05 million, respectively.

10. Deferred Income Tax Assets

In accordance with the provisions of *ASC Topic 740, "Income Taxes,"* the Company assesses, on a quarterly basis, its ability to realize its deferred tax assets. Based on the more likely than not standard in the guidance and the weight of available evidence, the Company believes a valuation allowance against its deferred tax assets is necessary. In determining the need for a valuation allowance, the Company considered the following significant factors: an assessment of recent years' profitability and losses by tax authorities; the Company's expectation of profits based on margins and volumes expected to be realized, which are based on current pricing and volume trends; the long period in all significant operating jurisdictions before the expiry of net operating losses, noting further that a portion of the deferred tax asset is composed of deductible temporary differences that are subject to an expiry period until realized under tax law. The Company will continue to evaluate the provision of valuation allowance in future periods.

The components of estimated deferred income tax assets as of March 31, 2013 and December 31, 2012 are as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Losses carry forward (U.S.) [1]	$ 7,962	$ 7,004
Losses carry forward (PRC) [1]	1,850	1,887
Product warranties and other reserves	3,374	3,253
Property, plant and equipment	3,859	3,774
Share-based compensation	240	240
Bonus accrual	110	196
Other accruals	914	696
Others	596	839
Total deferred tax assets	18,905	17,889
Less: taxable temporary difference related to revenue recognition	(989)	(397)
Total deferred tax assets, net	17,566	17,492
Less: Valuation allowance	(10,110)	(8,988)
Total deferred tax assets, net of valuation allowance [2]	$ 7,806	$ 8,504

(1) The net operating losses carry forward for the U.S. entity for income tax purposes are available to reduce future years' taxable income. These losses will expire, if not utilized, in 20 years. Net operating losses carry forward for non-U.S. entities can be carried forward for 5 years to offset taxable income. However, as of March 31, 2013, valuation allowance was $10.1 million, including $8.6 million allowance for the Company's deferred tax assets in the United States and $1.5 million allowance for the Company's non-U.S. deferred tax assets. Based on the Company's current operations in the United States, management believes that the deferred tax assets in the United States are not likely to be realized in the future. For the non-U.S. deferred tax assets, pursuant to certain tax laws and regulations in China, the management believes such amount will not be used to offset future taxable income.

(2) Approximately $4.2 million and $4.1 million of deferred income tax asset as of March 31, 2013 and December 31, 2012, respectively, are included in non-current deferred tax assets in the accompanying condensed unaudited consolidated balance sheets. The remaining $3.6 million and $4.4 million of deferred income tax assets as of March 31, 2013 and December 31, 2012, respectively, are included in current deferred tax assets.

11. Bank and government loans- net

Loans consist of the following at March 31, 2013 and December 31, 2012 (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Short-term bank loan [1] [2]	$ 10,573	$ 10,341

Short-term bank loan [3]	30,000	30,000
Short-term government loan [4]	6,380	-
Subtotal	46,953	40,341
Debt issue cost	(230)	(230)
Amortization	211	173
	$ 46,934	$ 40,284

(1) These loans are secured by property, plant and equipment of the Company and are repayable within one year. Please see Note 8. At March 31, 2013 and December 31, 2012, the weighted average interest rate was 5.98% and 6.46% per annum, respectively. Interest is to be paid on the twentieth day of each month and the principal repayment is at maturity.

(2) On June 30, 2012, Jiulong entered in to a one-year loan agreement with China Construction Bank Jingzhou branch in the amount of $3.2 million. The agreement contains certain financial and non-financial covenants, including but not limited to restrictions on the utilization of the funds and the maintenance of an asset-liability ratio not exceeding 60%. The Company was in compliance with these covenants as of March 31, 2013.

(3) On May 18, 2012, the Company entered into a credit facility agreement, the "Credit Agreement," with ICBC Macau to obtain a non-revolving credit facility in the amount of $30.0 million, the "Credit Facility". The Credit Facility would have expired on November 3, 2012 unless the Company drew down the line of credit in full prior to such expiration date, and the maturity date for the loan drawdown was the earlier of (i) 18 months from the drawdown or (ii) 1 month before the expiry of the standby letter of credit obtained by Henglong from ICBC Jingzhou as security for the Credit Facility, the "Henglong Standby Letter of Credit". The interest rate of the Credit Facility is calculated based on a three-month LIBOR plus 2.25% per annum, subject to the availability of funds and fluctuation at ICBC Macau's discretion. The interest is calculated daily based on a 360-day year and it is to be fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown. As of March 31, 2013, the interest rate was 2.62% per annum. As security for the Credit Facility, the Company was required to provide ICBC Macau with the Henglong Standby Letter of Credit for a total amount not less than $31.6 million if the Credit Facility is fully drawn.

On May 22, 2012, the Company drew down the full amount of $30.0 million under the Credit Facility and provided the Henglong Standby Letter of Credit for an amount of $31.6 million in favor of ICBC Macau. The loan drawdown will expire on May 15, 2013. The Henglong Standby Letter of Credit issued by ICBC Jingzhou with the collateralization of Henglong's notes receivable of RMB240 million (equivalent to approximately $38.2 million) will expire on June 15, 2013. The Company also paid an arrangement fee of $0.1 million to ICBC Macau and $0.1 million to ICBC Jingzhou. The arrangement fees are amortized over the period of the loan drawdown, and $0.04 million was amortized for the three months ended March 31, 2013.

(4) On January 31, 2013, the Company received an interest-free Chinese government loan of RMB40.0 million (equivalent to approximately $6.4 million), which will mature in a year. Henglong has pledged RMB40.0 million (equivalent to approximately $6.4 million) of notes receivable, which will mature on December 31, 2013, as security for the purpose of obtaining a RMB40.0 million (equivalent to approximately $6.4 million) interest-free loan from the Chinese government.

12. Accounts and notes payable

The Company's accounts and notes payable as of March 31, 2013 and December 31, 2012 are summarized as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Accounts payable - unrelated parties	$ 108,725	$ 99,100
Notes payable - unrelated parties [(1)]	67,751	67,280
Accounts and notes payable- unrelated parties	176,476	166,380
Accounts payable- related parties	4,864	4,521
	$ 181,340	$ 170,901

(1) Notes payable represent accounts payable in the form of bills of exchange whose acceptances are guaranteed and settlements are handled by banks. The Company has pledged cash deposits, notes receivable and certain property, plant and equipment to secure notes payable granted by banks.

13. Accrued expenses and other payables

The Company's accrued expenses and other payables as of March 31, 2013 and December 31, 2012 are summarized as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Accrued expenses	$2,369	$ 2,557
Accrued interest	93	87
Other payables	2,518	2,176
Warranty reserves [(1)]	18,879	18,081
Dividends payable to non-controlling interests	163	162
	$24,022	$ 23,063

(1) The Company provides for the estimated cost of product warranties when the products are sold. Such estimates of product warranties were based on, among other things, historical experience, product changes, material expenses, services and transportation expenses arising from the manufactured products. Estimates will be adjusted on the basis of actual claims and circumstances.

For the three months ended March 31, 2013 and 2012, and for the year ended December 31, 2012, the warranties activities were as follows (figures are in thousands of USD):

	Three Months Ended March 31,		Year Ended December 31,
	2013	2012	2012
Balance at the beginning of period	$ 18,081	$ 16,809	$ 16,809
Additions during the period	2,536	2,441	10,931
Settlement within period, by cash or actual material	(1,786)	(2,386)	(9,264)
Foreign currency translation gain	48	18	41
Decrease for warranty related to the subsidiary sold	-	-	(436)
Balance at end of period	$ 18,879	$ 16,882	$ 18,081

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14. Taxes payable

The Company’s taxes payable as of March 31, 2013 and December 31, 2012 are summarized as follows (figures are in thousands of USD):

	March 31, 2013	December 31, 2012
Value-added tax payable	$5,049	$ 4,347
Income tax payable	626	878
Other tax payable	314	368
	$5,989	$ 5,593

15. Advances payable

As of March 31, 2013 and December 31, 2012, advances payable by the Company were $2.60 million and $2.61 million, respectively.

The amounts are special subsidies made by the Chinese government to the Company to offset the cost and charges related to the improvement of production capacities and improvement of the quality of products. For the government subsidies with no further conditions to be met, the amounts are recorded as other income when received; for the amounts with certain operating conditions, the government subsidies are recorded as advances payable when received and will be recorded as a deduction of related expenses and cost when the conditions are met.

The balances are unsecured, interest-free and will be repayable to the Chinese government if the usage of such advance does not continue to qualify for the subsidy.

16. Retained earnings-

Appropriated

Pursuant to the relevant PRC laws and regulations, the profits distribution of the Company’s PRC subsidiaries, which are based on their PRC statutory financial statements, other than the financial statement that was prepared in accordance with U.S. GAAP, are available for distribution in the form of cash dividends after these subsidiaries have

paid all relevant PRC tax liabilities, provided for losses in previous years, and made appropriations to statutory surplus at 10%.

When the statutory surplus reserve reaches 50% of the registered capital of a company, additional reserve is no longer required. However, the reserve cannot be distributed to venture partners. Based on the business licenses of the PRC subsidiaries, the registered capital of Henglong, Jiulong, Shenyang, USAI, Jielong, Wuhu, Hubei Henglong and Chongqing are $10.0 million, $4.2 million (equivalent to RMB35.0 million), $8.1 million (equivalent to RMB67.5 million), $2.6 million, $6.0 million, $3.8 million (equivalent to RMB30.0 million), $39 million and $9.5 million (equivalent to RMB60.0 million), respectively.

During the three months ended March 31, 2013 and 2012, none of the parent company or the subsidiaries declared any dividend or appropriated any statutory reserves.

Unappropriated

The Company’s activities in respect of the amounts of the unappropriated retained earnings at March 31, 2013 and 2012, are summarized as follows (figures are in thousands of USD):

	Three Months Ended March 31,	
	2013	2012
Balance at beginning of the period	$119,329	$99,513
Net income (loss) attributable to parent company	5,940	(769)
Balance at end of period	$125,269	$98,744

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17. Accumulated other comprehensive income

The Company's activities in respect of the amounts of the accumulated other comprehensive income at March 31, 2013 and 2012, are summarized as follows (figures are in thousands of USD):

	Three Months Ended March 31,	
	2013	2012
Balance at beginning of the period	$25,898	$25,291
Net foreign currency translation adjustment attributable to parent company	508	457
Balance at end of period	$26,406	$25,748

18. Non-controlling interests

The Company's activities in respect of the amounts of the non-controlling interests' equity at March 31, 2013 and 2012, are summarized as follows (figures are in thousands of USD):

	Three Months Ended March 31,	
	2013	2012
Balance at beginning of the period	$38,846	$43,028
Income attributable to non-controlling interests	1,586	1,054
Dividends declared to the non-controlling interest holders of joint-venture companies	-	(794)
Discontinued operations – Zhejiang	-	(9,705)
Foreign currency translation gain	103	45
Balance at end of period	$40,535	$33,628

19. Financial expenses, net

During the three months ended March 31, 2013 and 2012, the Company recorded financial expenses, net which are summarized as follows (figures are in thousands of USD):

Three
Months Ended March
31,

	2013	2012
Coupon interest and make-whole redemption interest	$ -	$ 960
Interest expense	423	254
Interest income	(457)	(331)
Foreign exchange gain, net	68	15
Loss of note discount, net	7	2
Handling charge	160	12
Total financial expense, net	$ 201	$ 912

20. Loss on change in fair value of derivative

During the three months ended March 31, 2012, the Company recorded a loss on change in fair value of derivative of $3.9 million, and there was no gain or loss on change in fair value of derivative during the three months ended March 31, 2013.

In February 2008, the Company issued to two accredited institutional investors, namely Lehman Brothers Commercial Corporation Asia Limited ("Lehman Brothers") and YA Global Investments L.P ("YA Global"), convertible notes in the principal amount of $35.0 million, with a scheduled maturity date of February 15, 2013 ("convertible notes").

The Company and YA Global reached a settlement agreement on April 8, 2009. Under the terms of the settlement agreement, the Company paid on April 15, 2009 a redemption amount of $5.0 million to YA Global and YA Global waived its entitlement to the Other Make Whole Amount (as defined in the convertible notes).

On March 1, 2011, the provisional liquidator acting on behalf of Lehman Brothers ("LBCCA Liquidator") converted $6.4 million principal amount of the convertible notes at a conversion price of $7.0822 per share, and in turn the Company issued 907,708 shares of its common stock to LBCCA Liquidator.

On May 24, 2012, the Company and LBCCA Liquidator reached a settlement agreement. Under the terms of the settlement agreement, the Company redeemed all the remaining convertible notes and paid a redemption amount of $32.4 million to LBCCA Liquidator on May 25, 2012 ("Redemption Date") including $23.6 million of principal and $8.8 million of interest. On the Redemption Date, the carrying value of the convertible notes was $33.8 million, including $23.6 million of principal, $0.6 million of coupon interest, $8.6 million of make-whole amount payable and $1.0 million of derivative liabilities related to the convertible notes.

The Company's derivative financial instruments (liabilities) consist of the compound embedded derivative that originated in connection with the above-mentioned convertible note payable and financing arrangement. Derivative liabilities are carried at fair value.

Changes in the fair value of compound derivative liabilities were recorded as a loss on change in fair value of derivative in the condensed unaudited consolidated statement of operations and comprehensive income (loss) for the three months ended March 31, 2012. The following table summarizes the components of loss on change in fair value of derivative arising from fair value adjustments to compound derivative liabilities during the three months ended March 31, 2012 (figures are in thousands of USD):

	Three Months Ended March 31, 2012	
Balances at January 1	$	559
Loss in fair value adjustments		3,861
Balances at March 31	$	4,420

The Company's embedded conversion option derivative represents the conversion option, term-extending option, certain redemption and put features in the Company's convertible notes payable. The features embedded in the convertible notes were combined into one compound embedded derivative that the Company measured at fair value using the Monte Carlo valuation technique. Monte Carlo simulates multiple outcomes over the period to maturity using multiple assumption inputs. The following table sets forth (i) the range of inputs for each significant assumption and (ii) the equivalent, or averages, of each significant assumption as of March 31, 2012.

	Range			
March 31, 2012 Assumptions:	Low	High	Equivalent	
Volatility	60.11%	69.19%	64.16	%
Market adjusted interest rates	13.00%	18.49%	16.23	%

Credit risk adjusted rates	16.63%	16.63%	16.63	%
Implied expected life (years)	-	-	0.88	

21. Income tax rate

The Company's subsidiaries registered in the PRC are subject to state and local income taxes within the PRC at the applicable tax rate of 25% on the taxable income as reported in their PRC statutory financial statements in accordance with the relevant income tax laws applicable to foreign invested enterprise, unless preferential tax treatment is granted by local tax authorities. If the enterprise meets certain preferential terms according to the China income tax law, such as assessment as a "High & New Technology Enterprise" by the government, then, the enterprise will be subject to enterprise income tax at a rate of 15%.

Pursuant to the New China Income Tax Law and the Implementing Rules ("New CIT") which became effective as of January 1, 2008, dividends generated after January 1, 2008 and payable by a foreign-invested enterprise to its foreign investors will be subject to a 10% withholding tax if the foreign investors are considered as non-resident enterprises without any establishment or place within China or if the dividends payable have no connection with the establishment or place of the foreign investors within China, unless any such foreign investor's jurisdiction of incorporation has a tax treaty with China that provides for a different withholding arrangement.

Genesis, the Company's wholly-owned subsidiary and the direct holder of the equity interests in the Company's subsidiaries in China, is incorporated in Hong Kong. According to the Mainland and Hong Kong Taxation Arrangement, dividends paid by a foreign-invested enterprise in China to its direct holding company in Hong Kong will be subject to withholding tax at a rate of no more than 5%, if the foreign investor owns directly at least 25% of the shares of the foreign-invested enterprise. Under the New CIT, if Genesis is regarded as a non-resident enterprise and therefore is required to pay an additional 5% withholding tax for any dividends payable to it from the PRC subsidiaries.

According to PRC tax regulation, the Company should withhold income taxes for the profit distributed from the PRC subsidiaries to Genesis, the subsidiaries' holding company incorporated in Hong Kong. The Company accounts for the profit that the PRC subsidiaries intended to distribute to Genesis as deferred tax liabilities. As of March 31, 2013 and December 31, 2012, the Company recognized deferred tax liabilities of $0.02 million and $0.04 million for profit to be distributed to Genesis of $0.4 million and $0.8 million, respectively. The Company intended to re-invest the remaining undistributed profits generated from the PRC subsidiaries in those subsidiaries permanently. As of December 31, 2012, the Company still has undistributed earnings of approximately $132.2 million from investment in the PRC subsidiaries that are considered permanently reinvested. Had the undistributed earnings been distributed to Genesis and not permanently reinvested, the tax provision of approximately $6.6 million would have been recorded. Such undistributed profits will be kept in Genesis and not further distributed to the parent company incorporated in the United States going forward.

During 2008, Jiulong was awarded the title of "High & New Technology Enterprise" and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2008, 2009 and 2010. In 2011, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, the Company will continue to be taxed at the 15% tax rate in 2011, 2012 and 2013.

During 2008, Henglong was awarded the title of "High & New Technology Enterprise" and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2008, 2009 and 2010. In 2011, the Company passed the re-assessment of the government, based on PRC income tax laws. Accordingly, it will continue to be taxed at the 15% tax rate in 2011, 2012 and 2013.

During 2009, Shenyang was awarded the title of “High & New Technology Enterprise” and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2009, 2010 and 2011. In 2012, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, it will continue to be taxed at the 15% tax rate in 2012, 2013 and 2014.

According to the New CIT, Wuhu has been subject to income tax at a rate of 11%, 12% and 12.5%, respectively, for 2010, 2011 and 2012. Wuhu was awarded the title of “High & New Technology Enterprise” and, based on the PRC income tax law, it will be subject to enterprise income tax at a rate of 15% for 2013 and 2014.

According to the New CIT, Jielong has been subject to tax at a rate of 12.5% in 2010 and 2011, and 25% in 2012 and 2013.

According to the New CIT, Hubei Henglong has been subject to tax at a rate of 12.5% from 2010 to 2012. In November 2011, Hubei Henglong was awarded the title of “High & New Technology Enterprise”, based on the PRC income tax law. Accordingly, it will be subject to enterprise income tax at a rate of 15% for 2013 and 2014.

According to the New CIT, USAI and Testing Center were exempted from income tax in 2009, and each has been subject to income tax at a rate of 12.5% in 2010 and 2011, and 25% in 2012 and 2013.

Chongqing Henglong was established in 2012. According to the New CIT, Chongqing Henglong is subject to income tax at a uniform rate of 25%. No provision for Chongqing Henglong is made as it had no assessable income for the three months ended March 31, 2013 and 2012.

Based on Brazilian income tax laws, Brazil Henglong is subject to income tax at a uniform rate of 15%, and a resident legal person is subject to additional tax at a rate of 10% for the part of taxable income over $0.12 million (equivalent to BRL 0.24 million). The Company had no assessable income in Brazil for the three months ended March 31, 2013 and 2012.

The profits tax rate of Hong Kong is 16.5%. No provision for Hong Kong tax is made as Genesis is an investment holding company, and had no assessable income in Hong Kong for the three months ended March 31, 2013 and 2012.

The enterprise income tax rate of the United States is 35%. No provision for U.S. tax is made as the Company had no assessable income in the United States for the three months ended March 31, 2013 and 2012.

The effective tax rate decreased to 19.0% for the three months ended March 31, 2013 from 89.4% for the same period in 2012, which was primarily due to the permanent difference of gain on change in the fair value of derivative recorded in the three months ended March 31, 2012. Since the derivative has been settled in the second quarter of 2012 pursuant to the redemption of convertible notes, there was no similar permanent difference in the first quarter of 2013.

22. Discontinued operations – Zhejiang

Zhejiang Henglong & Vie Pump-Manu Co., Ltd., "Zhejiang," in which the Company owned 51% equity interest prior to its disposal in May 2012, was mainly engaged in the production and sales of power steering pumps. Given the power steering pump business has slowly lost its market share in the recent years due to market competition, lower market demand and replacement of hydraulic pressure steering by electric power steering, the Company sold its 51% equity interest in Zhejiang to Vie Group, the non-controlling shareholder of Zhejiang, on May 21, 2012, the "Zhejiang Sale". Pursuant to *ASC Topic 205-20, "Presentation of Financial Statements—Discontinued Operations"*, the business of Zhejiang, the "Zhejiang business," is considered as discontinued operations because: (a) the operations and cash flows of Zhejiang will be eliminated from the Company's operations as the Company will not continue to purchase power steering pumps from Zhejiang starting from August 2012; and (b) the Company would not have the ability to influence the operation or financial policies of Zhejiang subsequent to the sale. Before the sale, Zhejiang was identified as a product sector for the sales of power steering pumps of the Company, please see Note 26 for the details of segment reporting. For the three months ended March 31, 2012, the purchases from Zhejiang by the Company amounted to $0.1 million, which were eliminated for the preparation of the consolidated financial statements before the disposition of Zhejiang. There was no purchase from Zhejiang for the three months ended March 31, 2013.

The condensed unaudited consolidated statements of operations and comprehensive income (loss) of the Company have been adjusted to reflect the discontinued Zhejiang business for the three months ended March 31, 2012 (figures are in thousands of USD).

	Three Months Ended March 31, 2012		
	Prior reported amount (a)	Adjustment for discontinued operations (b)	Adjusted amount (c)=(a)-(b)
Net product sales			
Unrelated parties	$ 76,506	$ 3,479	$ 73,027
Related parties	7,987	94	7,893
	84,493	3,573	80,920
Cost of product sold			
Unrelated parties	62,259	2,896	59,363
Related parties	6,188	9	6,179
	68,447	2,905	65,542
Gross profit	16,046	668	15,378
Net gain on other sales	122	10	112
Operating expenses:			
Selling expenses	2,383	203	2,180
General and administrative expenses	3,632	250	3,382
R&D expenses	3,726	134	3,592
Total operating expenses	9,741	587	9,154
Operating income	6,427	91	6,336
Other income, net	72	-	72
Financial expenses, net	(911)	1	(912)
Loss on change in fair value of derivative	(3,861)	-	(3,861)
Income before income tax expenses and equity in earnings of affiliated companies	1,727	92	1,635
Less: Income taxes	1,522	61	1,461
Add: Equity in earnings of affiliated companies	80	-	80
Income from continuing operations	285	31	254
Discontinued operations - net of income tax	-	(31)	31
Net income	285	-	285
Net income attributable to non-controlling interest	1,054	-	1,054
Net loss attributable to parent company's common shareholders	$ (769)	$ -	$ (769)
Comprehensive income:			
Income from continuing operations	$ 285	$ 31	$ 254
Discontinued operations - net of income tax	-	(31)	31
Net income	285	-	285
Other comprehensive income:			
Foreign currency translation gain, net of tax- continuing operations	502	21	481
Foreign currency translation gain, net of tax – discontinued operations	-	(21)	21
Foreign currency translation gain, net of tax	502	-	502
Comprehensive income- continuing operations	787	52	735
Comprehensive income - discontinued operations	-	(52)	52
Comprehensive income	787	-	787
Comprehensive income attributable to non-controlling interests	1,099	-	1,099
Comprehensive income attributable to parent company	$ (312)	$ -	$ (312)
Net loss attributable to parent company's common shareholders per share – Basic–			

Loss from continuing operations attributable to shareholders	$ (0.03)	$ -	$ (0.03)
Loss per share from discontinued operations	$ -	$ -	$ -
Basic	$ (0.03)	$ -	$ (0.03)
Diluted–			
Loss from continuing operations attributable to shareholders	$ (0.03)	$ -	$ (0.03)
Loss per share from discontinued operations	$ -	$ -	$ -
Diluted	$ (0.03)	$ -	$ (0.03)

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The following table summarizes the results of the Zhejiang business included in the condensed unaudited consolidated statements of operations and comprehensive income (loss) as discontinued operations (figures are in thousands of USD).

	Three Months Ended March 31, 2012
Operational profit from component of discontinued operations, net of tax	$ 31
Income from discontinued operations, net of tax	$ 31

The following table summarizes the revenue and pretax profit of the Zhejiang business reported as discontinued operations (figures are in thousands of USD).

	Three Months Ended March 31, 2012
Revenue from component of discontinued operations	$ 3,713
Pretax profit from component of discontinued operations	$ 92

Summarized assets and liabilities from the discontinued operations as of the disposal date were as follows (figures are in thousands of USD):

	May 21, 2012
Assets of discontinued operations	
Current assets	$20,735
Non-current assets	6,623
Total assets of discontinued operations	$27,358
Liabilities of discontinued operations	
Current liabilities	16,823
Non-current liabilities	-
Total liabilities of discontinued operations	$16,823

The Company did not make separate disclosure of the cash flows of Zhejiang in its condensed consolidated statements of cash flows in this Report, as they are considered to be immaterial in the periods presented.

23. Income (Loss) per share

In periods when the Company generates income, the Company calculates basic earnings per share ("EPS") using the two-class method, pursuant to *ASC Topic 260, "Earnings Per Share"*. The two-class method is required as the Company's convertible notes qualify as participating securities, having the right to receive dividends should dividends be declared on common stock. Under this method, earnings for the period are allocated on a pro-rata basis to the common stockholders and to the holders of convertible notes based on the weighted average number of common shares outstanding and the number of shares that could be converted. The Company does not use the two-class method in periods when it generates a loss as the holders of the convertible notes do not participate in losses.

For diluted earnings per share, the Company uses the more dilutive of the if-converted method or the two-class method for convertible notes and the treasury stock method for options, assuming the issuance of common shares, if dilutive, resulting from the exercise of options and warrants.

The calculations of diluted income per share attributable to the parent company were (figures are in thousands of USD, except share and per share amounts):

	Three Months Ended March 31,	
	2013	2012
Numerator:		
Net income (loss) attributable to the parent company's common shareholders – Basic and diluted	$ 5,940	$ (769)
Denominator:		
Weighted average shares outstanding	28,043,019	28,260,302
Dilutive effects of stock options	7,918	-
Denominator for dilutive income per share – Diluted	28,050,937	28,260,302
Net income (loss) per common share attributable to parent company – Basic and diluted	$ 0.21	$ (0.03)

The calculations of diluted income from continuing operations per share attributable to the parent company were (figures are in thousands of USD, except share and per share amounts):

	Three Months Ended March 31,	
	2013	2012
Numerator:		
Net income from continuing operations	$ 7,526	$ 254
Net income from continuing operations attributable to non-controlling interest	1,586	1,039
Net income (loss) from continuing operations attributable to the parent company's common shareholders – Basic and diluted	5,940	(785)
Denominator:		
Weighted average shares outstanding	28,043,019	28,260,302
Dilutive effects of stock options	7,918	-
Denominator for dilutive income per share – Diluted	28,050,937	28,260,302
Net income (loss) from continuing operations per common share attributable to parent company – Basic and diluted	$ 0.21	$ (0.03)

The following table summarizes potential common shares outstanding excluded from the calculation of diluted income per share for the three months ended March 31, 2013 and 2012, because such an inclusion would have an anti-dilutive effect.

	Three Months Ended March 31,	
	2013	2012
Shares issuable under stock options	-	45,000
Shares issuable upon conversion of convertible notes	-	3,328,264
Total	-	3,373,264

As of March 31, 2013 and 2012, the exercise prices for 45,000 shares and 22,500 shares, respectively, of outstanding stock options were less than the weighted average market price of the Company's common stock during the three months ended March 31, 2013 and 2012, respectively, and these stock options were excluded form the calculation of the diluted income per share for the corresponding periods presented.

24. Significant concentrations

A significant portion of the Company's business is conducted in China where the currency is the RMB. Regulations in China permit foreign owned entities to freely convert the RMB into foreign currency for transactions that fall under the "current account," which includes trade related receipts and payments, interest and dividends. Accordingly, the Company's Chinese subsidiaries may use RMB to purchase foreign exchange for settlement of such "current account" transactions without pre-approval. However, pursuant to applicable regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with the PRC law. In calculating accumulated profits, foreign investment enterprises in China are required to allocate at least 10% of their annual net income each year, if any, to fund certain reserve funds, including mandated employee benefits funds, unless these reserves have reached 50% of the registered capital of the enterprises.

China Automotive, the parent company, may depend on Genesis and HLUSA dividend payments, which are mainly generated from their subsidiaries in the PRC after they receive payments from the PRC subsidiaries. Under PRC law the PRC subsidiaries are required to set aside at least 10% of their respective accumulated profits, up to 50% of their paid-in capital, to fund certain mandated reserve funds that are not payable or distributable as cash dividends.

The PRC government also imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currencies out of China, and the PRC subsidiaries may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currencies. If China Automotive is unable to receive dividend payments from its subsidiaries, China Automotive may be unable to effectively finance its operations or pay dividends on its shares.

Transactions other than those that fall under the "current account" and that involve conversion of RMB into foreign currency are classified as "capital account" transactions; examples of "capital account" transactions include repatriations of investment by or loans to foreign owners, or direct equity investments in a foreign entity by a China domiciled entity. "Capital account" transactions require prior approval from China's State Administration of Foreign Exchange, or SAFE, or its provincial branch to convert a remittance into a foreign currency, such as USD, and transmit the foreign currency outside of China.

This system could be changed at any time and any such change may affect the ability of the Company or its subsidiaries in China to repatriate capital or profits, if any, outside China. Furthermore, SAFE has a significant degree of administrative discretion in implementing the laws and has used this discretion to limit convertibility of current account payments out of China. Whether as a result of a deterioration in the Chinese balance of payments, a shift in the Chinese macroeconomic prospects or any number of other reasons, China could impose additional restrictions on capital remittances abroad. As a result of these and other restrictions under the laws and regulations of the PRC, the Company’s PRC subsidiaries are restricted in their ability to transfer a portion of their net assets to the parent. The Company has no assurance that the relevant Chinese governmental authorities in the future will not limit further or eliminate the ability of the Company’s PRC subsidiaries to purchase foreign currencies and transfer such funds to the Company to meet its liquidity or other business needs. Any inability to access funds in China, if and when needed for use by the Company outside of China, could have a material and adverse effect on the Company’s liquidity and its business.

The Company grants credit to its customers including to Xiamen Joylon, Shanghai Fenglong and Jiangling Yude, that are related parties of the Company. The Company’s customers are mostly located in the PRC.

During the three months ended March 31, 2013, the Company’s ten largest customers accounted for 72.6% of its consolidated net sales, with the largest customer individually accounting for more than 10% of consolidated net sales, i.e., 10.4%. As of March 31, 2013, approximately 3.4% of accounts receivable were from trade transactions with the aforementioned one customer, and there was no individual customer with a receivables balance of more than 10% of total accounts receivable.

During the three months ended March 31, 2012, the Company’s ten largest customers accounted for 84.3% of its consolidated net sales, with each of four customers individually accounting for more than 10% of consolidated net sales, i.e., 13.1%, 11.0%, 10.7% and 10.1%, individually, or an aggregate of 44.9%. As of March 31, 2012, approximately 25.0% of accounts receivable were from trade transactions with the aforementioned four customers and there was no individual customer with a receivables balance of more than 10% of total accounts receivable.

25. Related party transactions and balances

Related party transactions are as follows (figures are in thousands of USD):

Related sales

	Three Months Ended March 31,	
	2013	2012
Merchandise sold to related parties	$ 8,143	$ 7,893

Related purchases

	Three Months Ended March 31,	
	2013	2012
Materials purchased from related parties	$ 6,665	$ 6,179
Technology purchased from related parties	96	-
Equipment purchased from related parties	332	748
Total	$ 7,093	$ 6,927

Related receivables

	March 31, 2013	December 31, 2012
Accounts receivable	$ 15,120	$ 12,286
Other receivables	80	107
Total	$ 15,200	$ 12,393

Related advances

	March 31, 2013	December 31, 2012
Advanced equipment payment to related parties	$3,808	$ 4,162
Advanced payments and others to related parties	672	779
Total	$4,480	$ 4,941

Related payables

	March 31, 2013	December 31, 2012
Accounts payable	$4,864	$ 4,521

These transactions were consummated under similar terms as those with the Company's third party customers and suppliers.

Related parties pledged certain land use rights and buildings as security for the Company’s credit facilities provided by banks.

As of May 14, 2013, Hanlin Chen, Chairman, owns 63.65% of the common stock of the Company and has the effective power to control the vote on substantially all significant matters without the approval of other stockholders.

26. Commitments and contingencies

Legal proceedings

Securities Action - Southern District of New York. On October 25, 2011, a purported securities class action (the “Securities Action”) was filed in the United States District Court for the Southern District of New York on behalf of all purchasers of the Company’s securities between March 25, 2010 and March 17, 2011. On February 24, 2012, the plaintiffs filed an amended complaint, changing the purported class period to between May 12, 2009 and March 17,

2011. The amended complaint alleges that the Company, certain of its present officers and directors and the Company’s former independent accounting firm violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and the rules promulgated thereunder, and seeks unspecified damages. The Company filed a motion to dismiss the amended complaint, which was fully briefed on April 18, 2012. On August 8, 2012, the court denied the Company’s motion to dismiss the amended complaint. On September 4, 2012, the Company filed an answer to the amended complaint. On January 15, 2013, Plaintiffs filed a motion to certify the purported class. That motion is currently pending as the parties engage in discovery. On October 12, 2012, the court issued an order scheduling a starting date of October 25, 2013 for a trial. The Company continues to believe that the allegations in the complaint are without merit and intends to defend itself vigorously against the claims.

Derivative Action - Delaware Chancery Court. On December 23, 2011, a purported shareholder derivative action was filed in the Court of Chancery of the State of Delaware (the “Court of Chancery”) on behalf of the Company. The complaint alleges that certain of the Company’s current officers and directors breached their fiduciary duties to the Company in relation to the Company’s accounting of convertible notes issued in February 2008. On January 25, 2012, a second purported shareholder derivative action was filed in the Court of Chancery on behalf of the Company. On February 3, 2012, the Court of Chancery consolidated the two cases, which were stayed pending the outcome of the motion to dismiss in the Securities Action. On October 23, 2012, the derivative plaintiffs filed a consolidated amended complaint on behalf of the Company (the “Derivative Action”). The consolidated complaint alleges that certain of the Company’s current officers and directors breached their fiduciary duties to the Company in relation to the Company’s accounting of the convertible notes issued in February 2008. The consolidated complaint sets forth three causes of action for breach of fiduciary duties, unjust enrichment and insider trading. On January 7, 2013, the Company filed a motion to dismiss the Derivative Action. That motion was fully briefed on February 28, 2013, and is currently pending before the Court of Chancery. The Company believes the allegations in the shareholder suit are without merit, and intends to defend itself vigorously against the claims.

The above-referenced actions do not specify an amount of damages that the plaintiffs seek. Moreover, because these matters are in early stages, the Company cannot determine whether an adverse outcome is probable, nor can it provide a reasonable estimate of potential losses related to these matters. Although the Company believes that it has meritorious defenses to each of these actions and intends to defend them vigorously, an adverse outcome in one or more of these matters could have a material adverse effect on the Company’s business, financial condition, results of operations or liquidity.

Other than the above, the Company is not a party to any pending or, to the best of the Company’s knowledge, any threatened legal proceedings. In addition, no director, officer or affiliate of the Company, or owner of record of more than five percent of the securities of the Company, or any associate of any such director, officer or security holder is a party adverse to the Company or has a material interest adverse to the Company in reference to pending litigation.

Other commitments and contingencies

In addition to the bank loans, notes payables and the related interest, the following table summarizes the Company’s major commitments and contingencies as of March 31, 2013 (figures are in thousands of USD):

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	Payment obligations by period					
	2013[(1)]	2014	2015	2016	Thereafter	Total
Interest on short-term bank loan	$398	$-	$-	$ -	$ -	$398
Obligations for purchasing agreements	10,239	1,425	219	-	-	11,883
Total	$10,637	$1,425	$219	$ -	$ -	$12,281

(1) Remaining 9 months in 2013.

27. Off-balance sheet arrangements

As of March 31, 2013 and 2012, the Company did not have any significant transactions, obligations or relationships that could be considered off-balance sheet arrangements.

28. Segment reporting

The accounting policies of the product sectors are the same as those described in the summary of significant accounting policies except that the disaggregated financial results for the product sectors have been prepared using a management approach, which is consistent with the basis and manner in which management internally disaggregates financial information for the purposes of assisting them in making internal operating decisions. Generally, the Company evaluates performance based on stand-alone product sector operating income and accounts for inter segment sales and transfers as if the sales or transfers were to third parties, at current market prices.

As of March 31, 2013 and 2012, the Company had eleven product sectors, five of which were principal profit makers and were reported as separate sectors and engaged in the production and sales of power steering (Henglong, Jiulong, Shenyang, Wuhu and Hubei Henglong). The other six sectors were engaged in the production and sale of sensor modular (USAI), EPS (Jielong), provision of after sales and R&D services (HLUSA), production and sale of power steering (Chongqing Henglong), trade (Brazil Henglong), and the holding company (Genesis). Since the revenues, net income and net assets of these six sectors are less than 10% of its segment in the condensed unaudited consolidated financial statements, the Company incorporated these six sectors into “Other Sectors.”

As discussed in Discontinued Operations - Zhejiang (see Note 22) above, Zhejiang was identified as a product sector for the sales of power steering pumps of the Group prior to disposal on May 21, 2012. After the Company sold its 51% equity interest in Zhejiang on May 21, 2012 and presented it as a discontinued operation, the Company has adjusted the information for Zhejiang’s business in segment reporting for the same period in 2012.

The Company's product sector information from continuing operations is as follows (figures are in thousands of USD):

	Net Sales		Net Income	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2013	2012	2013	2012
Henglong	$ 64,162	$ 41,417	$ 6,313	$ 4,454
Jiulong	19,024	21,766	621	1,139
Shenyang	8,867	6,783	289	255
Wuhu	6,476	7,685	(157)	(436)
Hubei Henglong	10,405	9,743	739	3,808 (1)
Other Sectors	9,584	9,699	66	(261)
Total Segments	118,518	97,093	7,871	8,959
Corporate	-	-	(1,442)	(5,391)
Eliminations	(21,354)	(16,173)	1,097	(3,314)
Total consolidated from continuing operations	$ 97,164	$ 80,920	$ 7,526	$ 254

(1) $3.2 million included in the balance was income from investment of Henglong, which has been eliminated at the consolidation level.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis should be read in conjunction with the Company's condensed unaudited consolidated financial statements and the related notes thereto and the other financial information contained elsewhere in this Report. This information excludes Zhejiang as discontinued operations (see Note 22 to the consolidated financial statements in this Report) unless otherwise noted.

General Overview

China Automotive Systems, Inc. is a leading power steering systems supplier for the China automobile industry. The Company has business relations with more than sixty vehicle manufacturers, including FAW Group, Dongfeng Auto Group and Changan Automobile Group, three of the five largest automobile manufacturers in China; Shenyang Brilliance Jinbei Co., Ltd., the largest light vehicle manufacturer in China; Chery Automobile Co., Ltd, the largest state owned car manufacturer in China; BYD Auto Co., Ltd and Zhejiang Geely Automobile Co., Ltd., the largest privately owned car manufacturers in China. The PRC-based joint ventures of General Motors (GM), Volkswagen, Citroen and Chrysler North America are all key customers. Starting in 2008, the Company has supplied power steering pumps and power steering gear to the Sino-foreign joint ventures established by GM, Citroen and Volkswagen in China. The Company has supplied power steering gear to Chrysler North America since 2009.

Most of the Company's production and research and development institutes are located in China. The Company has approximately 3,000 employees dedicated to design, development, manufacture and sales of its products. By leveraging its extensive experience, innovative technology and geographic strengths, the Company aims to grow leading positions in automotive power steering systems and to further improve overall margins, long-term operating profitability and cash flows. To achieve these goals and to respond to industry factors and trends, the Company is continuing work to improve its operations and business structure and achieve profitable growth.

Corporate Structure

The Company, through its subsidiaries, engages in the manufacture and sales of automotive systems and components. Great Genesis Holdings Limited, a company incorporated in Hong Kong on January 3, 2003 under the Companies Ordinance of Hong Kong as a limited liability company, "Genesis," is a wholly-owned subsidiary of the Company and the holding company of the Company's joint ventures in the PRC. Henglong USA Corporation, "HLUSA," incorporated on January 8, 2007 in Troy, Michigan, is a wholly-owned subsidiary of the Company, and mainly engages in marketing of automotive parts in North America, and provides after-sales service and research and development support. CAAS Brazil's Imports And Trade In Automotive Parts Ltd., "Brazil Henglong," was established by Hubei Henglong Automotive System Group Co., Ltd. (formerly known as Jingzhou Hengsheng Automotive System Co.,

Ltd), “ Hubei Henglong,” as a Sino-foreign joint venture company with two Brazilian citizens in Brazil in August 2012.

For more information on the Company’s corporate structure, including the recently completed reorganization of certain PRC-based subsidiaries and the Zhejiang Sale, please see Note 1, “Organization and Business” and Note 22, “Discontinued operations – Zhejiang” to the consolidated financial statements in this Report.

Critical Accounting Estimates

The Company prepares its condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amount of revenues and expenses during the reporting periods. Management periodically evaluates the estimates and judgments made. Management bases its estimates and judgments on historical experience and on various factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates as a result of different assumptions or conditions. The following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company’s condensed consolidated financial statements.

The Company considers an accounting estimate to be critical if:

- It requires the Company to make assumptions about matters that were uncertain at the time it was making the estimate, and

- Changes in the estimate or different estimates that the Company could have selected would have had a material impact on the Company’s financial condition or results of operations.

The table below presents information about the nature and rationale for the Company's critical accounting estimates:

Balance Sheet Caption	Critical Estimate Item	Nature of Estimates Required	Assumptions/Approaches Used	Key Factors
Accrued liabilities and other long-term liabilities	Warranty obligations	Estimating warranty requires the Company to forecast the resolution of existing claims and expected future claims on products sold. VMs (Vehicle Manufacturers) are increasingly seeking to hold suppliers responsible for product warranties, which may impact the Company's exposure to these costs.	The Company bases its estimate on historical trends of units sold and payment amounts, combined with its current understanding of the status of existing claims and discussions with its customers.	· VM sourcing · VM policy decisions regarding warranty claims
Property, plant and equipment, intangible assets and other long-term assets	Valuation of long- lived assets and investments	The Company is required from time-to-time to review the recoverability of certain of its assets based on projections of anticipated future cash flows, including future profitability assessments of various product lines.	The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.	· Future production estimates · Customer preferences and decisions
Accounts and notes receivables	Provision for doubtful accounts and notes receivable	Estimating the provision for doubtful accounts and notes receivable requires the Company to analyze and monitor each customer's credit standing and financial condition regularly. The Company grants credit to its customers, generally on an open account basis. It will impact the Company's expense disclosure and results of operations if such estimate is	The Company grants credit to its customers for three to four months based on each customer's current credit standing and financial data. The Company assesses the allowance on an individual customer basis, under normal circumstances. The Company records provision for bad debts based on specific identification methods.	· Customers' credit standing and financial condition

		improper.		
Deferred income taxes	Recoverability of deferred tax assets	The Company is required to estimate whether recoverability of its deferred tax assets is more likely than not based on forecasts of taxable earnings in the related tax jurisdiction.	The Company uses historical and projected future operating results, based upon approved business plans, including a review of the eligible carry forward period, tax planning opportunities and other relevant considerations.	· Tax law changes · Variances in future projected profitability, including by taxing entity
Convertible notes payable, warrant liabilities, compound derivative liabilities	Warrant liabilities and compound derivative liabilities	The Company is required to estimate the fair value of warrant liabilities and compound derivative liabilities at the beginning and end of each reporting period.	The Company uses Black-Scholes option pricing model to determine fair value of warrant; uses Monte Carlo simulation ("MCS") valuation techniques to determine fair value of compound derivative liabilities.	· Expected volatility · Risk-free rate · Interest market risk · Credit risk · Redemption activities before maturity
Tax payable and deferred tax assets/liabilities	Uncertain tax positions	The Company is required to determine and assess all material positions, including all significant uncertain positions in all tax years that are still subject to assessment or challenge under relevant tax statutes.	The Company applies a more likely than not threshold and a two-step approach for tax position measurement and financial statement recognition. For the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement.	· An allocation or a shift of income between jurisdictions · The characterization of income or a decision to exclude reporting taxable income in a tax return · A decision to classify a transaction, entity, or other position in a tax return as tax exempt

In addition, there are other items within the Company's financial statements that require estimation, but are not as critical as those discussed above. These include the allowance for reserves for excess and obsolete inventory. Although not significant in recent years, changes in estimates used in these and other items could have a significant effect on the Company's condensed unaudited consolidated financial statements.

Recent Accounting Pronouncements

Please see Note 2 to the consolidated financial statements under Item 1 of Part I of this Report.

Results of Operations

Results of Operations—Three Months Ended March 31, 2013 and 2012

The Company disposed of its 51% equity interest in Zhejiang in May 2012. Pursuant to ASC Topic 205-20, the business of Zhejiang is considered as discontinued operations. Previously reported condensed unaudited consolidated statements of operations and comprehensive income for the three months ended March 31, 2012 presented have been adjusted to reflect the discontinued operations. Please refer to Note 22 to the condensed unaudited consolidated financial statements in this Report.

	Net Sales (in thousands of USD, except percentages)				Cost of Product Sold (in thousands of USD, except percentages)			
	2013	2012	Change		2013	2012	Change	
Henglong	$64,162	$41,417	$22,745	54.9 %	$52,648	$32,140	$20,508	63.8 %
Jiulong	19,024	21,766	(2,742)	-12.6	16,381	18,625	(2,244)	-12.0
Shenyang	8,867	6,783	2,084	30.7	7,767	5,904	1,863	31.5
Wuhu	6,476	7,685	(1,209)	-15.7	6,173	7,307	(1,134)	-15.5
Hubei Henglong	10,405	9,743	662	6.8	8,605	8,802	(197)	-2.2
Other Sectors	9,584	9,699	(115)	-1.2	8,680	8,800	(120)	-1.4
Total Segments	118,518	97,093	21,425	22.1	100,254	81,578	18,676	22.9
Elimination	(21,354)	(16,173)	(5,181)	32.0	(22,452)	(16,036)	(6,416)	40.0
Total	$97,164	$80,920	$16,244	20.1 %	$77,802	$65,542	$12,260	18.7 %

Net Sales

Net sales were $97.2 million for the three months ended March 31, 2013, compared to $80.9 million for the same period in 2012, representing an increase of $16.3 million, or 20.1%. The increase was mainly due to the continuing growth of automotive market demand in China and the increased sales of newly developed products to North America.

The main market for the Company's products is China. The Chinese government issued an incentive policy relating to purchase of low-emission cars and fuel-efficient cars in May 2012. Encouraged by such incentive policy, the sales volume of passenger vehicles in the China market continues to increase. The Company's sales of steering gears for passenger vehicles, one of the main products of the Company, also increased.

In 2013, the Chinese government continues to implement macro-control policies on infrastructure industries and real estate, which led to a continued decrease in the sales of commercial vehicles in the China market. The Company's sales of steering gears for commercial vehicles, one of the main products of the Company, also decreased.

Under the pressure of over-production, the competition among various auto sellers and manufacturers in China has intensified, which resulted in a continued decrease in the sale price of cars in China in 2013. The decrease of sale price for single-brands' cars was even more significant than joint-brands' cars. In order to preserve the market share of the Company among its single-brands' cars customers, the Company correspondingly lowered the sale price of one of its main products, the steering gears.

In summary, the Company had an increase in sales volume leading to a sales increase of $20.0 million, a decrease in selling price leading to a sales decrease of $4.2 million, and the effect of foreign currency translation of the RMB against the U.S. dollar which resulted in a sales increase of $0.4 million.

Further analysis is as follows:

Net sales for Henglong were $64.2 million for the three months ended March 31, 2013, compared to $41.4 million for the same period in 2012, representing an increase of $22.8 million, or 54.9%, which was mainly due to an increase in sales volume for passenger vehicles in the China market. An increase in sales volume led to a sales increase of $25.1 million, a decrease in selling price led to a sales decrease of $2.6 million and the effect of foreign currency translation of the RMB against the U.S. dollar resulted in a sales increase of $0.2 million.

Net sales for Jiulong were $19.0 million for the three months ended March 31, 2013, compared to $21.8 million for the same period in 2012, representing a decrease of $2.8 million, or 12.6%, which was mainly due to a decrease in sales volume for commercial vehicles in the China market. A decrease in sales volume led to a sales decrease of $2.5 million and a decrease in selling price led to a sales decrease of $0.3 million.

Net sales for Shenyang were $8.9 million for the three months ended March 31, 2013, compared to $6.8 million for the same period in 2012, representing an increase of $2.1 million, or 30.7%, which was mainly due to an increase in sales volume for passenger vehicles in the China market. An increase in sales volumes led to a sales increase of $2.5 million and a decrease in selling price led to a sales decrease of $0.4 million.

Net sales for Wuhu were $6.5 million for the three months ended March 31, 2013, compared to $7.7 million for the same period in 2012, representing a decrease of $1.2 million, or 15.7%. Since the majority of the products of Wuhu were sold to local Chinese brand auto distributors, the decreased demand for local Chinese brand autos from end-customers due to the aggressive pricing strategy adopted by Sino-foreign joint brand auto distributors led to the decrease in sales volumes and prices for Wuhu's products.

Net sales for Hubei Henglong were $10.4 million for the three months ended March 31, 2013, compared to $9.7 million for the same period in 2012, representing an increase of $0.7 million, or 6.8%. Hubei Henglong's products were all sold to the United States. The net sales increase was mainly due to sales of the newly developed products to a United States customer. An increase in sales volumes led to a sales increase of $0.2 million and an increase in selling price led to a sales increase of $0.5 million.

Net sales for Other Sectors were $9.6 million for the three months ended March 31, 2013, compared to $9.7 million for the same period in 2012, representing a decrease of $0.1 million, or 1.2%. In March 2012, the Company introduced new steering products to the auto market to replace some of its old products. As the introduction of these new products was still at a very early stage, the Company reduced the selling price of the new steering products as a promotion. As a result, a decrease in selling price led to a sales decrease of $1.0 million and an increase in sales volumes led to a sales increase of $0.9 million.

Cost of Sales

For the three months ended March 31, 2013, the cost of sales was $77.8 million, compared to $65.5 million for the same period of 2012, representing an increase of $12.3 million, or 18.7%. The increase in the cost of sales was mainly due to the net effect of a net increase in sales volumes with a cost of sales increase of $16.0 million, a decrease in unit cost with a cost of sales decrease of $4.0 million and the appreciation of the RMB against the U.S. dollar with a cost of sales increase of $0.3 million. The decrease in the unit cost of sales was primarily due to a decrease in the cost of raw materials, such as steel. Further analysis is as follows:

Cost of sales for Henglong was $52.6 million for the three months ended March 31, 2013, compared to $32.1 million for the same period of 2012, representing an increase of $20.5 million, or 63.8%. This was mainly due to an increase in sales volumes which led to a cost of sales increase of $22.4 million, which was offset by the adoption of technical innovations in the production processes in 2013, a decrease in unit material costs which led to a cost of sales decrease of $2.0 million, and the effect of foreign currency translation of the RMB against the U.S. dollar which resulted in a cost of sales increase of $0.1 million.

Cost of sales for Jiulong was $16.4 million for the three months ended March 31, 2013, compared to $18.6 million for the same period of 2012, representing a decrease of $2.2 million, or 12.0%. The decrease in cost of sales was mainly due to a decrease in sales volumes which led to a cost of sales decrease of $2.1 million, and a decrease in unit cost which led to a cost of sales decrease of $0.1 million.

Cost of sales for Shenyang was $7.8 million for the three months ended March 31, 2013, compared to $5.9 million for the same period of 2012, representing an increase of $1.9 million, or 31.5%. The increase in cost of sales was mainly due to an increase in sales volumes which led to a cost of sales increase of $2.2 million and a decrease in unit cost which led to a cost of sales decrease of $0.3 million.

Cost of sales for Wuhu was $6.2 million for the three months ended March 31, 2013, compared to $7.3 million for the same period of 2012, representing a decrease of $1.1 million, or 15.5%. The decrease in cost of sales was mainly due to a decrease in sales volumes which led to a cost of sales decrease of $0.8 million and a decrease in unit cost which led to a cost of sales decrease of $0.3 million.

Cost of sales for Hubei Henglong was $8.6 million for the three months ended March 31, 2013, compared to $8.8 million for the same period of 2012, representing a decrease of $0.2 million, or 2.2%. The decrease in cost of sales was mainly due to the decrease in unit cost.

Cost of sales for Other Sectors was $8.7 million for the three months ended March 31, 2013, compared to $8.8 million for the same period of 2012, representing a decrease of $0.1 million, or 1.4%. The decrease in cost of sales was mainly due to an increase in sales volume which led to a cost of sales increase of $0.8 million and a decrease in unit cost which led to a cost of sales decrease of $0.9 million.

Gross margin was 19.9 % for the three months ended March 31, 2013, representing a 0.9% increase from 19.0% for the same period of 2012, which was primarily due to a magnitude of decrease in unit cost that was greater than the magnitude of decrease in sales price.

Gain on Other Sales

Gain on other sales mainly consisted of net amount retained from sales of materials, scraps and equipment. For the three months ended March 31, 2013, gain on other sales amounted to $0.7 million, while it amounted to $0.1 million for the same period of 2012, representing an increase of $0.6 million, which was mainly due to an increase in materials and scraps sales.

Selling Expenses

Selling expenses were $3.2 million for the three months ended March 31, 2013, compared to $2.2 million for the same period of 2012, representing an increase of $1.0 million, or 45.2%, mainly due to an increase in salaries and wages expenses of salesmen and transportation expenses, as a result of an increase in the number of salesmen.

General and Administrative Expenses

General and administrative expenses were $4.1 million for the three months ended March 31, 2013, compared to $3.4 million for the same period of 2012, representing an increase of $0.7 million, or 22.0%, which was mainly due to increases in attorney fee.

Research and Development Expenses

Research and development expenses were $3.4 million for the three months ended March 31, 2013, compared to $3.6 million for the three months ended March 31, 2012, representing a decrease of $0.2 million, or 5.3%. The Company's research and development expenses were mainly used for the development and trial production of EPS and other new products. Research and development expenditures have continued to be significant in the past three years. In summary, expenses for mold improvement increased by $0.2 million, external technical support fees decreased by $0.1 million and the salaries and wages expenses of research and development related staff decreased by $0.5 million.

The global automotive parts industry is highly competitive; winning and maintaining new business requires suppliers to rapidly produce innovative products on a cost-competitive basis. In the past three years, the Company has continued to purchase advanced manufacturing equipment for newly developed products and hiring senior technicians, and give bonuses to technical personnel who make an outstanding contribution to product research and development.

Income from Operations

Income from operations was $9.3 million for the three months ended March 31, 2013, compared to $6.3 million for the three months ended March 31, 2012, representing an increase of $3.0 million, or 47.5%, including an increase of $4.0 million, or 25.9%, in gross profit, an increase of $0.6 million, in gain on other sales, and an increase of $1.6 million, or 16.8%, in operating expenses.

Other Income, Net

Other income, net, was $0.1 million for the three months ended March 31, 2013, which was consistent with $0.1 million for the three months ended March 31, 2012.

Financial Expenses, Net

Financial expenses, net were $0.2 million for the three months ended March 31, 2013, compared to $0.9 million for the three months ended March 31, 2012, representing a decrease of $0.7 million, or 77.9%, which was mainly due to the Company having redeemed all convertible notes by May 2012. Therefore, there were no financial expenses associated with convertible notes for the three months ended March 31, 2013.

Loss on Change in Fair Value of Derivative

Loss on change in fair value of derivative was $3.9 million for the three months ended March 31, 2012. The Company had redeemed all convertible notes by May 2012. Therefore, there was no gain or loss on change of fair value of derivative associated with convertible notes for the three months ended March 31, 2013.

Income Before Income Tax Expenses and Equity In Earnings Of Affiliated Companies

Income before income tax expenses and equity in earnings of affiliated companies was $9.2 million for the three months ended March 31, 2013, compared to $1.6 million for the three months ended March 31, 2012, representing an increase of $7.6 million, which was mainly due to an increase in operating income of $3.0 million, a decrease in financial expenses of $0.7 million, and a decrease in loss on change in fair value of derivative of $3.9 million.

Income Taxes

Income tax expense was $1.7 million for the three months ended March 31, 2013, compared to $1.5 million of income tax expense for the three months ended March 31, 2012, representing an increase of $0.2 million, or 19.5%, which was mainly due to an increase of income before income tax. The effective tax rate decreased to 19.0% for the three months ended March 31, 2013 from 89.4% for the same period in 2012, which was primarily due to the permanent difference of loss on change in the fair value of derivative recorded in the first quarter of 2012. Since the derivative has been settled in the second quarter of 2012 pursuant to the redemption of convertible notes, there is no similar permanent difference in the first quarter of 2013.

Income From Continuing Operations

Net income from continuing operations was $7.5 million for the three months ended March 31, 2013, compared to $0.3 million for the three months ended March 31, 2012, representing an increase of $7.2 million, which was mainly due to an increase in income before income tax expenses and equity in earnings of affiliated companies of $7.6 million and an increase in income tax expenses of $0.2 million.

Net Income

Net income was $7.5 million for the three months ended March 31, 2013, compared to net income of $0.3 million for the three months ended March 31, 2012, representing an increase of $7.2 million, which was mainly due to an increase in income from continuing operations of $7.2 million.

Net Income Attributable to Non-controlling Interests

Net income attributable to non-controlling interests amounted to $1.6 million for the three months ended March 31, 2013, compared to $1.1 million for the three months ended March 31, 2012, representing an increase of $0.5 million, or 45.5%, primarily due to the increase in non-wholly owned subsidiaries' net income.

Taking into account the Zhejiang Sale, the Company owns different equity interests in ten non-wholly owned subsidiaries established in the PRC and Brazil, through which it conducts its operations. Except for Beijing Henglong, which is accounted under the equity method, all the operating results of these non-wholly owned subsidiaries were consolidated in the Company's financial statements as of March 31, 2013 and 2012. For the three months ended March 31, 2013 and 2012, the Company recorded $1.6 million and $1.0 million for the non-controlling interests' share in the earnings of the consolidated non-wholly owned subsidiaries, respectively.

Net Income (Loss) Attributable to Parent Company

Net income attributable to parent company was $5.9 million for the three months ended March 31, 2013, compared to net loss attributable to parent company of $0.8 million for the three months ended March 31, 2012, representing an increase of $6.7 million, reflecting an increase in net income.

Liquidity and Capital Resources

Capital Resources and Use of Cash

The Company has historically financed its liquidity requirements from a variety of sources, including short-term borrowings under bank credit agreements, bankers' acceptances, issuances of capital stock and notes and internally generated cash. As of March 31, 2013, the Company had cash and cash equivalents of $90.4 million, compared to $87.6 million as of December 31, 2012, representing an increase of $2.8 million, or 3.2%.

The Company had working capital of $144.5 million as of March 31, 2013, compared to $138.7 million as of December 31, 2012, representing an increase of $5.8 million, or 4.2%.

The Company intends to indefinitely reinvest the funds in subsidiaries established in the PRC.

The Company believes that, in view of its current cash position as of March 31, 2013, the cash expected to be generated from the operations and funds available from bank borrowings as detailed in subsequent paragraphs will be sufficient to meet its working capital and capital expenditure requirements (including the repayment of bank loans) for at least twelve months commencing from March 31, 2013.

Capital Source

The Company's capital source is multifaceted, such as bank loans and banker's acceptance facilities. In financing activities and operating activities, the Company's banks require the Company to sign line of credit agreements and repay all existing borrowings under such facilities within one year. On the condition that the Company can provide adequate mortgage security and has not violated the terms of the line of credit agreement, such one year facilities can be extended for another year.

The Company had short-term bank and government loans of $46.9 million, including bank loans of $41.5 million and a government loan of $6.4 million (see Note 11); and bankers' acceptances of $67.8 million (see Note 12) as of March 31, 2013.

The Company currently expects to be able to obtain similar bank loans (i.e., RMB loans) and bankers' acceptance facilities in the future if it can provide adequate mortgage security following the termination of the above-mentioned agreements (see the table under "Bank Arrangements" below for more information). If the Company is not able to do so, it will have to refinance such debt as it becomes due or repay that debt to the extent it has cash available from operations or from the proceeds of additional issuances of capital stock. Owing to depreciation, the value of the mortgages securing the above-mentioned bank loans and banker's acceptances will be devalued by approximately $14.6 million over the next 12 months. If the Company wishes to obtain the same amount of bank loans and banker's acceptances, it will have to provide $14.6 million additional mortgages as of the maturity date of such agreements (see the table under "Bank Arrangements" below for more information). The Company can still obtain a reduced line of credit with a reduction of $8.7 million, which is 59.4% (the mortgage rates) of $14.6 million, if it cannot provide additional mortgages. The Company expects that the reduction of bank loans will not have a material adverse effect on its liquidity.

On May 18, 2012, the Company entered the Credit Agreement with ICBC Macau to obtain the Credit Facility. The Credit Facility would have expired on November 3, 2012, unless the Company drew down the line of credit in full prior to such expiration date and the maturity date for the loan drawdown was the earlier of (i) 18 months from the drawdown or (ii) 1 month before the expiry of the Henglong Standby Letter of Credit.

The interest rate of the Credit Facility is calculated based on a three-month LIBOR plus 2.25% per annum, subject to the availability of funds and fluctuation at ICBC Macau's discretion. The interest is calculated daily on a 360-day basis and it is to be fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown. As of March 31, 2013, the interest rate was 2.62% per annum.

As security for the Credit Facility, the Company was required to provide ICBC Macau with the Henglong Standby Letter of Credit for a total amount of not less than $31.6 million if the Credit Facility is to be fully drawn.

On May 22, 2012, the Company drew down the full amount of $30.0 million under the Credit Facility and provided the Henglong Standby Letter of Credit for an amount of $31.6 million in favor of ICBC Macau. The loan drawdown will expire on May 15, 2013. The Henglong Standby Letter of Credit issued by ICBC Jingzhou with the collateralization of Henglong's notes receivable of RMB240 million (equivalent to approximately $38.2 million) will expire on June 15, 2013. The Company also paid an arrangement fee of $0.1 million to ICBC Macau and $0.1 million to ICBC Jingzhou. The arrangement fees are amortized over the period of loan drawdown, and $0.04 million was amortized for the three months ended March 31, 2013.

Bank Arrangements

As of March 31, 2013, the principal outstanding under the Company's credit facilities and lines of credit was as follows (figures are in thousands of USD):

	Bank	Due Date	Amount Available (4)	Amount Used	Assessed Mortgage Value (6)
1. Comprehensive credit facilities	Bank of China	Mar 2014	$ 22,492	$ 13,361	$ 15,360
2. Comprehensive credit facilities	Jingzhou Commercial Bank	Jun 2013	31,904	13,470	61,356
3. Comprehensive credit facilities	China Construction Bank	Sep 2013	11,166	5,863	32,296
4. Comprehensive credit facilities (1)	Shanghai Pudong Development Bank	Dec 2013	15,951	11,873	12,933
5. Comprehensive credit facilities (1)	China CITIC Bank	Nov 2013	16,590	17,985 (5)	14,843
6. Comprehensive credit facilities	Industrial and Commercial Bank of China	Jul 2013	12,761	3,915	12,761
7. Comprehensive credit facilities	China Everbright Bank	Aug 2014	4,786	3,395	8,168
8. Comprehensive credit facilities	ICBC Macau	May 2013	30,000	30,000	38,246
Total			**$ 145,650**	**$ 99,862** (2)	**$ 195,963** (3)

(1) Henglong's comprehensive credit facility provided by China CITIC Bank and each of Henglong and Jielong's comprehensive credit facilities provided by Shanghai Pudong Development Bank, are required to be guaranteed by Jiulong, another subsidiary of the Company, in addition to the above pledged assets.

(2) The amount used includes bank loans of $40.6 million and notes payable of $59.3 million as of March 31, 2013. The remainder of the $8.5 million of notes payable was 100% secured by bank notes without utilization of credit lines.

(3) As of March 31, 2013, the pledged assets included $66.4 million accounts and notes receivable and other pledged assets with assessed value of $128.9 million.

(4) The amount available is used for the drawdown of bank loans and issuance of bank notes. For the drawdown of bank loans, this amount represents the amount that the Company can borrow immediately; for issuance of bank notes, the Company needs to pledge additional collateral in order to utilize these bank facilities.

(5) The amount used was in excess of the amount available because certain issued bank notes were 100% secured by pledged deposits without utilization of credit lines.

(6) The pledged cash deposits, which are disclosed in Note 3 to the consolidated financial statements in this Report, were not included in the assessed mortage value.

The Company may request the banks to issue notes payable or bank loans within its credit line using a 365-day revolving line.

The Company renewed its existing short-term debt and borrowed new debt during 2013 at annual interest rates of 6.00% to 7.57 %, and maturity terms of twelve months. Pursuant to the comprehensive credit line arrangement the Company pledged: (1) accounts receivable with an assessed value of $15.4 million as security for its comprehensive credit facility with the Bank of China; (2) equipment with an assessed value of approximately $61.4 million as security for its revolving comprehensive credit facility with Jingzhou Commercial Bank; (3) equipment, land use rights and buildings with an assessed value of approximately $32.3 million as security for its comprehensive credit facility with China Construction Bank; (4) land use rights and buildings with an assessed value of approximately $12.9 million as security for its comprehensive credit facility with Shanghai Pudong Development Bank; (5) land use rights and buildings with an assessed value of approximately $14.8 million as security for its comprehensive credit facility with China CITIC Bank; (6) accounts receivable with an assessed value of approximately $12.8 million as security for its comprehensive credit facility with Industrial and Commercial Bank of China; (7) land use rights and buildings with an assessed value of approximately $8.2 million as security for its comprehensive credit facility with China Everbright Bank; and (8) $38.2 million of notes receivable held by Henglong.

Cash Requirements

The following table summarizes the Company's expected cash outflows resulting from financial contracts and commitments. The Company has not included information on its recurring purchases of materials for use in its manufacturing operations. These amounts are generally consistent from year to year, closely reflecting the Company's levels of production, and are not long-term in nature (being less than three months in length).

Y: inline">669,197

Net Income	15,116,701	9,918,536
Less: net loss attributable to the noncontrolling interests	(90,071)	(90,963)
Net Income - attributable to China Education Alliance, Inc. and Subsidiaries	$ 15,206,772	$ 10,009,499
Basic Earnings Per Share	$ 0.63	$ 0.46
Diluted Earnings Per Share	$ 0.59	$ 0.41
Basic Weighted Average Shares Outstanding	24,081,002	21,549,381
Diluted Weighted Average Shares Outstanding	25,622,606	24,662,830
The Components of Other Comprehensive Income		
Net income	$ 15,206,772	$ 10,009,499
Foreign currency translation adjustment	189,644	1,444,539
Comprehensive Income	$ 15,396,416	$ 11,454,038

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

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China Education Alliance, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity

	Preferred Stock		Common Stock							
	Number of Shares	Amount	Number of Shares	Par Value	Additional Paid-In Capital	Statutory Reserve	Accumulated Other Comprehensive Income	Retained Earnings	Noncontrolling Interests	To Stockh Eq
e at 1,	9,397,645	$ 3,677,944	19,409,830	$ 19,410	$ 6,378,110	$ 1,151,885	$ 1,250,470	$ 6,692,674	$ (528,456)	$ 18,6
e of s			1,482,801	1,483	2,666,076					2,6
sion of d	(1,800,000)	(667,800)	600,000	600	667,200					
on sued rld ge Inc			400,000	400	931,600					9
y on ent							1,445,973		(1,434)	1,4
ased sation					5,326					
ts or rvices					103,420					1
riation tory						838,353		(838,353)		
ome								10,009,499	(90,963)	9,9
e at ber 31,	7,597,645	3,010,144	21,892,631	21,893	10,751,732	1,990,238	2,696,443	15,863,820	(620,853)	33,7
e of s			3,296,787	3,297	6,426,428					6,4
sion of d	(3,095,502)	(1,142,500)	1,031,834	1,032	1,141,468					
on sued ices			223,339	223	1,043,241					1,0
on old per			3,596,363	3,596	18,381,299					18,3

riting ent										
ased sation					487,455					4
y on ent							189,644		(26,378)	1
riation tory						1,025,905		(1,025,905)		
ome								15,206,772	(90,071)	15,1
e at per 31,	4,502,143	$ 1,867,644	30,040,954	$ 30,041	$ 38,231,623	$ 3,016,143	$ 2,886,087	$ 30,044,687	$ (737,302)	$ 75,3

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

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

	Year Ended December 31,	
	2009	2008
Cash flows from operating activities		
Net Income	$ 15,206,772	$ 10,009,499
Adjustments to reconcile net income to net cash provided by		
Operating activities		
Depreciation and amortization	1,586,417	1,598,624
Warrants issued for services	-	103,420
Stock based compensation	487,455	5,326
Common stock issued for services	1,043,464	-
Loss on equity investment	671	95,331
Loss attributable to the noncontrolling interests	(90,071)	(90,963)
Net change in assets and liabilities		
Account receivables	(805,120)	(469,607)
Prepaid expenses and other	745,196	(1,824,727)
Advances to related parties	142,006	(33,470)
Accounts payable and accrued liabilities	455,299	377,583
Deferred revenue	(218,922)	(17,701)
Net cash provided by operating activities	18,553,167	9,753,315
Cash flows from investing activities		
Purchases of property and equipment	(1,840,377)	(996,434)
Purchases of intangible assets	(73,442)	(792,147)
Long-term investment	-	(437,688)
Net cash used in investing activities	(1,913,819)	(2,226,269)
Cash flows from financing activities		
Warrants exercised	6,429,725	2,667,559
Proceeds from issuance of common stock per underwriting agreement	18,384,895	-
Net cash provided by financing activities	24,814,620	2,667,559
Effect of exchange rate	163,266	1,444,539
Net increase in cash	41,617,234	11,639,144
Cash and cash equivalents at beginning of year	23,418,098	11,778,954
Cash and cash equivalents at end of year	$ 65,035,332	$ 23,418,098
Supplemental disclosure of cash flow information		
Taxes paid	$ 1,199,414	$ 669,197
Non-cash investing and financing activities		
Conversion of preferred stock to common	$ 1,142,500	$ 667,800

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

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

1. Organization and Description of Business

Nature of organization - China Education Alliance, Inc. (the "Company"), formerly known as ABC Realty Co., was originally organized under the laws of the State of North Carolina on December 2, 1996. ABC Realty Co.'s primary purpose was to act as a broker or agent in residential real estate transactions. On September 15, 2004, ABC Realty Co. was reorganized pursuant to the Plan of Exchange to acquire Harbin Zhong He Li Da Education Technology, Inc. ("ZHLD"), a corporation formed on August 9, 2004 in the City of Harbin of Heilongjiang Province, the 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 ZHLD and Duane C. Bennett, the former Chairman of ABC Realty Co., pursuant to which the shareholders of ZHLD exchanged all of their registered capital of $60,386 for 18,333,334 shares of common stock of the Company, or approximately 95% of the Company's common stock. On November 17, 2004, ABC Realty Co. changed its name to China Education Alliance, Inc. On December 13, 2004, China Education Alliance, Inc. consummated the Plan of Exchange with ZHLD and ZHLD's shareholders. As a result of the Plan of Exchange, the transaction was treated for accounting purposes as a recapitalization of ZHLD.

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

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

The Company's principal business is the distribution of educational resources through the Internet. The Company's website, www.edu-chn.com, is a comprehensive education network platform which is based on network video technology and large data sources of elementary education resources. The Company has a data base comprised of such resources as test papers that were used for secondary education and university level courses as well as video on demand. The data base includes more than 350,000 exams and test papers and courseware for college, secondary and elementary schools. While some of these exams were given in previous years, new instructors are engaged to develop new exams and methodologies for taking the exams. The Company markets this data base under the name "Famous Instructor Test Paper Store." Also offered, though the website, is video on demand, which includes tutoring of exam papers and exam techniques. The Company compliments the past exams and test papers by providing an interactive platform for students to understand the key points from the papers and exams. 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, which are marketed under the name "Classroom of Famed Instructors." The Company has a 36,600 square foot training facility in Harbin, Heilonjiang Province, China, which has 17 classrooms and can accommodate up to 1,200 students. These classes, which complement our on-line education services, provide classroom and tutoring to our students. The courses primarily cover the compulsory education curriculum of junior, middle and high school. The Company charges tuition for these classes.

ZHLD also owns 70% of Beijing Hua Yu Hui Zhong Technology Development Co., Ltd. ("BHYHZ"). BHYHZ was formed on September 30, 2006 in the PRC. The remaining 30% interest was given to the National Vocational Education Association of China for no consideration. The 30% interest in BHYHZ that the Company transferred to The National Vocational Education Association of China for no consideration was treated as an intangible asset. The minority ownership interest of BHYHZ have no basis in their investment.

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 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, ZHLD will own 49.02% equity interest and Newspaper Group will 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 December 31, 2009 and 2008 was $341,686 and $342,357, respectively.

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, New Discovery. 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, New Discovery is now a 49.02% owned equity investment of ZHLD, referred to as a long-term investment in the accompanying balance sheet.

On January 4, 2009, China Education Alliance's subsidiary ZHLD entered into an agreement with Mr. Guang Li to jointly incorporate and invest in a joint venture company, Zhong He Li Da (Beijing) Management Consultant Co., Ltd. ("ZHLDBJ"). ZHLD contributed RMB 425,000 (approximately, $62,107), and Mr. Guang Li contributed RMB 75,000 (approximately, $10,960) towards the registered capital of ZHLDBJ, amounting to a total registered capital of 500,000 RMB (approximately, $73,067). In return for their respective contributions, ZHLD own 85% equity interest, and Mr. Guang Li own 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 to the Vendor 400,000 shares of its common stock, with a market value 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 provides English training programs, English test preparation courses and overseas study and consulting services in the PRC. Included as part of the WEI Acquisition, is the acquisition of five English language schools in various parts of the PRC. The WEI acquisition has not been fully completed as of December 31, 2009 due to the non-resolution of ongoing administrative and legal matters in connection with the acquisition of WEI. The Company currently is attempting to fully resolve all outstanding issues related to this acquisition. As of December 31, 2009 the Company's management decided to exclude completed portions of its WEI acquisition from the consolidated financial statements until such time as the WEI acquisition is fully completed. As of December 31, 2009 and December 31, 2008 the Company has outstanding advances made to WEI of $223,860 and $80,000, respectively. Management has fully reserved these advances as of December 31, 2009, until such time as all administrative and legal matters regarding the WEI acquisition are 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. As of 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 Company operates in one business segment, that of education, in which it operates in two revenue areas of online education and education training centers. With the Company's equity investment in New Discovery the Company is invested in the business of publishing and circulating "Scientific Discovery", a scientific information newspaper, with a focus on education.

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

3. Summary of Significant Accounting Policies

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its wholly subsidiaries (ZHLD and ZETC) and its majority owned subsidiaries (BHYHZ and ZHLDBJ). All inter-company transactions and balances were eliminated.

Minority interest in the net assets and earnings or losses of BHYHZ and ZHLDBJ have been absorbed by the Company as minority interest holders in these subsidiaries have no basis in their investment in these subsidiaries.

Use of estimates - The preparation of these consolidated 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 consolidated financial statements and the reported amounts of net sales and expenses during the reported periods.

Significant estimates include values and lives assigned to acquired intangible assets, reserves for allowances, uncollectible accounts receivable and stock warrant valuation. Actual results may differ from these estimates.

Cash and cash equivalents - The Company considers all highly liquid debt instruments purchased with a maturity period of three months or less to be cash or cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents approximate their fair value. Substantially all of the Company's cash is held in bank accounts in the PRC and is not protected by FDIC insurance or any other similar insurance. The cash that the Company maintains in US banks are insured up to $250,000 at each bank as of December 31, 2009. The Company's cash at their US bank is in excess of statutorily insured limits as of December 31, 2009.

Property and equipment - Property and equipment are stated at the historical cost, less accumulated depreciation. Depreciation on property, plant and equipment is provided using the straight-line method over the estimated useful lives of the assets after taking into account a 5% residual value for both financial and income tax reporting purposes as follows:

Buildings	20 years
Communication Equipment	10 years

Motor vehicles	5 years
Furniture, Fixtures, and Equipment	5 years

Expenditures for renewals and betterments are capitalized while repairs and maintenance costs are normally charged to the statement of operations in the year in which they are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalized as an additional cost of the asset.

Upon sale or disposal of an asset, the historical cost and related accumulated depreciation or amortization of such asset are removed from their respective accounts and any gain or loss is recorded in the Statements of Operations.

The Company reviews the carrying value of property, plant, and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing these assessments 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 these assessments there was no impairment at December 31, 2009.

Intangibles and Capitalized Software- Intangibles and capitalized software consist of franchise rights on educational products, software and the transfer of minority interest in BHYHZ subsidiary for no consideration, that are amortized over the lives of the rights agreements, or their respective useful lives, which is three to eight years .

The Company evaluates the carrying value of intangible assets during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the intangible asset below its carrying amount. There were no impairments recorded during the years ended December 31, 2009 and 2008.

Long-Lived Assets - The Company reviews its long-lived assets for impairment when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets under certain circumstances are reported at the lower of carrying amount or fair value. Assets to be disposed of and assets not expected to provide any future service potential to the Company are recorded at the lower of carrying amount or fair value less cost to sell. To the extent carrying values exceed fair values, an impairment loss is recognized in operating results.

Foreign Currency - The Company’s principal country of operations is the PRC. The financial position and results of operations of the Company are recorded in Renminbi (“RMB”) as the functional currency. The results of operations denominated in foreign currency are translated at the average rate of exchange during the reporting period.

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

Tuition from courses is recognized ratably over the period 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 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.

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 December 31, 2009 and 2008 was $1,274,727 and $469,607, respectively.

The Company reviews its accounts receivables on a periodic basis and makes general and specific allowances when there is doubt as to the collectability of individual balances. In evaluating the collectability of individual receivable balances, the Company considers many factors, including the age of the balance, customer's historical payment history, its current credit-worthiness and current economic trends. Accounts are written off after exhaustive efforts at collection. If accounts receivable are to be provided for, or written off, they would be recognized in the consolidated statement of operations within operating expenses. At December 31, 2009 and 2008, the Company has not established an allowance for doubtful accounts, in addition the Company has not provided for, or written off, accounts receivable for the years ended December 31, 2009 and 2008.

Advertising - The Company expenses advertising costs for outdoor spots at the time they are aired and for all other advertising the first time the respective advertising takes place. These costs are included in selling expenses. The total advertising expenses incurred for the years ended December 31, 2009 and 2008 were $1,093,535 and $892,724, 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 years ended December 31, 2009 and 2008 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 benefit to be recognized in the financial statements. A tax position is measured at the largest amount of benefit where there is a greater than 50% likelihood of being realized upon ultimate settlement.

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

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of 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 benefits as of 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 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 at a rate of 15% of their taxable income. Preferential tax treatment may, however, be granted pursuant to any law or regulations from time to time promulgated by the State Council. ZHLD enjoyed a 100% exemption from enterprise income taxes during 2006 due to its classification as a “Wholly Owned Foreign Enterprise.” This exemption ended on December 31, 2006, at which time ZHLD qualified under the current tax structure for a 50% reduction in the statutory enterprise income tax rates for the three years ended December 31, 2007, 2008 and 2009. For the years ended December 31, 2008, 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. During the year ended December 31, 2009, the Company was assessed an additional PRC enterprise income tax, above their effective rate, due to tax regulations implemented by the PRC in the year ended December 31, 2009 relating to a prior period. ZHLD management, expects ZHLD to continue being qualified as a technology and software entity, and expects to receive a 50% reduction in their statutory PRC enterprise income tax rates. If such status is not achieved, ZHLD could be subject to increased tax expense in fiscal years subsequent to December 31, 2009. Furthermore, additional taxes can be assessed, beyond statutory rates enacted and

approved tax abatements received by the Company, or ZHLD. 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 and ZHLDBJ are taxed at the PRC statutory rate (25%), and have not accrued for taxes since inception, due to recurring losses 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 deferred tax assets or liabilities as of December 31, 2009and 2008. In addition, the Company has not recorded a deferred tax expense for the two years ended December 31, 2009 and 2008.

Value added tax

The Provisional Regulations of the PRC Concerning Value Added Tax promulgated by the State Council came into effect on January 1, 1994. Under these regulations and the Implementing Rules of the Provisional Regulations of the PRC Concerning Value Added Tax, value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

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

Software companies are eligible for a 14% VAT tax refund under PRC tax policy. The Company applied for and received VAT refunds of $0 and $536,876 during the years ended December 31, 2009 and 2008, respectively.

Related party – A related party is a company, or individual, in which a director or an officer has beneficial interests in and in which the Company has significant influence. As of December 31, 2009 and 2008, the Company has advanced $223,860 and $80,000 to WEI, an acquisition of the Company that has not been fully completed as of December 31, 2009, 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 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. In addition, the Company prior to the formation of ZHLDBJ advanced $62,006 to related party’s of this entity. ZHLDBJ was established on January 4, 2009, at which time these advances became inter-company advances and have been eliminated in consolidation.

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 December 31, 2009.

Cash and cash equivalents of approximately $65,035,300, include money market securities and commercial paper that are considered to be highly liquid and easily tradable as of December 31, 2009. 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.

- of a variable interest entity, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. The guidance is applicable for annual periods beginning after November 15, 2009 and interim periods therein and thereafter. The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations.

- In June 2009, the FASB issued authoritative guidance which eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor's interest in transferred financial assets. The guidance is applicable for annual periods beginning after November 15, 2009 and interim periods therein and thereafter. The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations.

- In August 2009, the FASB issued guidance on measuring liabilities at fair value. This guidance amends the fair value measurements and disclosures by providing additional guidance clarifying the measurement of liabilities at fair value. This new accounting guidance is effective for reporting period ending after December 15, 2009. The Company is evaluating this new guidance and the possible impact that the adoption of this new accounting guidance will have on their consolidated financial statements.

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Recent accounting pronouncements

Recent accounting pronouncements applicable to the Company are summarized below.

- Effective for interim and annual periods ending after September 15, 2009, the FASB Accounting Standards CodificationTM (the "Codification" or "ASC") is the single source of authoritative literature of U.S. generally accepted accounting principles ("GAAP"). The Codification consolidates all authoritative accounting literature into one internet-based research tool, which supersedes all pre-existing accounting and reporting standards, excluding separate rules and other interpretive guidance released by the SEC. New accounting guidance is now issued in the form of Accounting Standards Updates, which update the Codification. The Company adopted the Codification in the period ending September 30, 2009. The adoption of Codification did not result in any change the Company's significant accounting policies.

- In May 2009 the FASB issued standards that establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. These standards require the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether the date represents the date the financial statements were issued or were available to be issued. This standard was effective in the first interim period ending after June 15, 2009. The Company expects this standard to have an impact on disclosures in their consolidated financial statements, but the nature and magnitude of the specific effects will depend upon the nature, terms and value of the any subsequent events occurring after adoption.

- In June 2009, the FASB issued authoritative guidance which eliminates the exemption for qualifying special-purpose entities from consolidation requirements, contains new criteria for determining the primary beneficiary of a variable interest entity, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. The guidance is applicable for annual periods beginning after November 15, 2009 and interim periods therein and thereafter. The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations.

- In June 2009, the FASB issued authoritative guidance which eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor's interest in transferred financial assets. The guidance is applicable for annual periods beginning after November 15, 2009 and interim periods therein and thereafter. The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations.

- EITF Issue No. 07-5 (ASC 815), "Determining Whether an Instrument (or embedded Feature) is Indexed to an Entity's Own Stock" (EITF 07-5) was issued in June 2008 to clarify how to determine whether certain instruments or features were indexed to an entity's own stock under EITF Issue No. 01-6 (ASC 815), "The Meaning of "Indexed to a Company's Own Stock" (EITF 01-6) (ASC 815),. EITF 07-5(ASC 815), applies to any freestanding financial instrument (or embedded feature) that has all of the characteristics of a derivative as defined in FAS 133, for purposes of determining whether that instrument (or embedded feature) qualifies for the first part of the paragraph 11(a) scope exception. It is also applicable to any freestanding financial instrument (e.g., gross physically settled warrants) that is potentially settled in an entity's own stock, regardless of whether it has all of the characteristics of a derivative as defined in FAS 133 (ASC 815), for purposes of determining whether to apply EITF 00-19 (ASC 815). EITF 07-5(ASC 815) does not apply to share-based payment awards within the scope of FAS 123(R), Share-Based Payment (FAS 123(R) (ASC 718)). However, an equity-linked financial instrument issued to investors to establish a market-based measure of the fair value of employee stock options is not within the scope of FAS 123(R) and therefore is subject to EITF 07-5(ASC 815).

- In January 2009, the FASB issued FSP EITF 99-20-1 (ASC 325), to amend the impairment guidance in EITF Issue No. 99-20 (ASC 325) in order to achieve more consistent determination of whether an other-than-temporary impairment (“OTTI”) has occurred. This FSP amended EITF 99-20 (ASC 325) to more closely align the OTTI guidance therein to the guidance in Statement No. 115 (ASC 320, 10-35-31). Retrospective application to a prior interim or annual period is prohibited. The guidance in this FSP was considered in the assessment of OTTI for various securities at December 31, 2008.

- On June 5, 2003, the United States Securities and Exchange Commission ("SEC") adopted final rules under Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404"), as amended by SEC Release No. 33-9072 on October 13, 2009. Commencing with its annual report for the year ending March 31, 2011, the Company will be required to include a report of management on its internal control over financial reporting. The internal control report must include a statement of:

Management's responsibility for establishing and maintaining adequate internal control over its financial reporting;
Management's assessment of the effectiveness of its internal control over financial reporting as of year- end; and
The framework used by management to evaluate the effectiveness of the Company's internal control over financial reporting.

Furthermore, it is required to file the auditor's attestation report separately on the Company's internal control over financial reporting on whether it believes that the Company has maintained, in all material respects, effective internal control over financial reporting.

- In August 2009, the FASB issued the FASB Accounting Standards Update No. 2009-04 "Accounting for Redeemable Equity Instruments - Amendment to Section 480-10-S99" which represents an update to section 480-10-S99, distinguishing liabilities from equity, per EITF Topic D-98, Classification and Measurement of Redeemable Securities. The Company does not expect the adoption of this update to have a material impact on its consolidated financial position, results of operations or cash flows.

- In August 2009, the FASB issued the FASB Accounting Standards Update No. 2009-05 "Fair Value Measurement and Disclosures Topic 820 – Measuring Liabilities at Fair Value", which provides amendments to subtopic 820-10, Fair Value Measurements and Disclosures – Overall, for the fair value measurement of liabilities. This update provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques: 1. A valuation technique that uses: a. The quoted price of the identical liability when traded as an asset b. Quoted prices for similar liabilities or similar liabilities when traded as assets. 2. Another valuation technique that is consistent with the principles of topic 820; two examples would be an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability. The amendments in this update also clarify that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The amendments in this update also clarify that both a quoted price in an active market for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. The Company does not expect the adoption of this update to have a material impact on its consolidated financial position, results of operations or cash flows.

- In September 2009, the FASB issued the FASB Accounting Standards Update No. 2009-08 "Earnings Per Share – Amendments to Section 260-10-S99",which represents technical corrections to topic 260-10-S99, Earnings per share, based on EITF Topic D-53, Computation of Earnings Per Share for a Period that includes a Redemption or an Induced Conversion of a Portion of a Class of Preferred Stock and EITF Topic D-42, The Effect of the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock. The Company does not expect the adoption of this update to have a material impact on its consolidated financial position, results of operations or cash flows.

- In September 2009, the FASB issued the FASB Accounting Standards Update No. 2009-09 “Accounting for Investments-Equity Method and Joint Ventures and Accounting for Equity-Based Payments to Non-Employees”. This update represents a correction to Section 323-10-S99-4, Accounting by an Investor for Stock-Based Compensation Granted to Employees of an Equity Method Investee. Additionally, it adds observer comment Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees to the Codification. The Company does not expect the adoption to have a material impact on its consolidated financial position, results of operations or cash flows.

- In September 2009, the FASB issued the FASB Accounting Standards Update No. 2009-12 “Fair Value Measurements and Disclosures Topic 820 – Investment in Certain Entities That Calculate Net Assets Value Per Share (or Its Equivalent)”, which provides amendments to Subtopic 820-10, Fair Value Measurements and Disclosures-Overall, for the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). The amendments in this update permit, as a practical expedient, a reporting entity to measure the fair value of an investment that is within the scope of the amendments in this update on the basis of the net asset value per share of the investment (or its equivalent) if the net asset value of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of Topic 946 as of the reporting entity’s measurement date, including measurement of all or substantially all of the underlying investments of the investee in accordance with Topic 820. The amendments in this update also require disclosures by major category of investment about the attributes of investments within the scope of the amendments in this update, such as the nature of any restrictions on the investor’s ability to redeem its investments at the measurement date, any unfunded commitments (for example, a contractual commitment by the investor to invest a specified amount of additional capital at a future date to fund investments that will be made by the investee), and the investment strategies of the investees. The major category of investment is required to be determined on the basis of the nature and risks of the investment in a manner consistent with the guidance for major security types in U.S. GAAP on investments in debt and equity securities in paragraph 320-10-50-1B. The disclosures are required for all investments within the scope of the amendments in this update regardless of whether the fair value of the investment is measured using the practical expedient. The Company does not expect the adoption to have a material impact on its consolidated financial position, results of operations or cash flows.

- In October 2009, the FASB issued guidance for amendments to FASB Emerging Issues Task Force on EITF Issue No. 09-1 “Accounting for Own-Share Lending Arrangements in Contemplation of a Convertible Debt Issuance or Other Financing” (Subtopic 470-20) “Subtopic”. This accounting standards update establishes the accounting and reporting guidance for arrangements under which own-share lending arrangements issued in contemplation of convertible debt issuance. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2009. Earlier adoption is not permitted. The Company does not expect the adoption to have a material impact on its consolidated financial position, results of operations or cash flows.

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 financial 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 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 December 31, 2009, The Company maintains cash in the US, in a financial institution insured by the FDIS that has approximately $14,636,000 in funds in excess of FDIC insured amounts.

For the years ended December 31, 2009 and 2008, no single customer accounted for 10% or more of revenues.

As of December 31, 2009 the Company had no insurance coverage of any kind. Accrual for losses is not recognized until such time as an uninsured loss has occurred. The Company has not accrued for any losses as of December 31, 2009.

Payments of dividends may be subject to some restrictions.

5. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	December 31,	
	2009	2008
Cash on Hand — China	$ 1,398	$ 417
Bank Deposits — China	49,898,143	22,705,067
Bank Deposits — US	15,135,791	712,614
	$ 65,035,332	$ 23,418,098

6. Advance to Related Parties

Advance to related parties consist of the following:

	December 31,	
	2009	2008
Advance to WEI	$ -	$ 80,000
Advance to ZHLDBJ	-	62,006
	$ -	$ 142,006

Advances were made to expand WEI's operations either inside or outside of the PRC. Due to the non-resolution of ongoing administrative and legal matters in connection with the acquisition of WEI, Company management has fully reserved these advances as of December 31, 2009, until such time as all administrative and legal matters regarding the WEI acquisition are 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. In addition, the Company prior to the formation of ZHLDBJ advanced $62,006 to related party's of this entity. ZHLDBJ was established on January 4, 2009,

at which time these advances became inter-company advances and have been eliminated in consolidation.

7. Accounts Receivables

Accounts Receivables are all unsecured and due upon demand:

	December 31, 2009	December 31, 2008
Mobi Advertising	$ 966,308	$ 467,450
Others	308,419	2,157
	$ 1,274,727	$ 469,607

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.

8. Prepaid Expenses

Prepaid Expenses consist of the following:

	December 31, 2009	December 31, 2008
Prepaid rent	$ 305,853	$ 312,343
Prepaid teachers and online material	294,622	456,137
Prepaid services and professional fees	81,441	66,529
Prepaid outdoor advertising	1,812,973	1,939,736
Prepaid printing fee	-	633,188
Other prepaid expenses	197,421	29,573
	$ 2,692,310	$ 3,437,506

9. Property and Equipment

Property and Equipment consist of the following:

	December 31, 2009	December 31, 2008
Buildings	$ 4,455,227	$ 3,562,826
Transportation vehicles	192,189	191,427
Communication equipment	3,148,972	2,664,840
Furniture and fixtures	2,030,114	1,567,032
	9,826,502	7,986,125
Depreciation	(3,236,520)	(2,224,856)
Net	$ 6,589,982	$ 5,761,269

For the year ended December 31, 2009 and 2008 depreciation expense totaled $1,011,664 and $910,490, respectively. Allocated in the years ended December 31, 2009 and 2008 depreciation expenses totaling $374,100 and $296,356, respectively, were included in cost of goods sold, the remainder of depreciation expense for the respective periods is included in operating expenses.

As of December 31, 2009 the Company does not have any land use rights agreements with the PRC for the office buildings owned by the Company. The Government owns the land where the Company's buildings are located and provides to the Company its usage for free.

In the PRC land use rights are the legal rights for an entity to use lands for a fixed period of time. The PRC adopts 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").

10. Intangibles and Capitalized Software

Intangibles and capitalized software of the Company consist of franchise rights, software and the transfer of minority interest in the BHYHZ subsidiary for no consideration.

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.

BHYHZ Intangible

In connection with the organization of BHYHZ, the Company transferred to an unrelated non-profit organization, a quasi-governmental entity for no consideration a 30% ownership interest in the contributed capital of BHYHZ. The value of the transferred ownership is reflected as an intangible asset, related to their customer base, that is being amortized over four years. At December 31, 2009, the intangible asset relating to this transaction was $43,696 net of amortization of $21,848. The minority ownership interest share of operating losses of BHYHZ is being absorbed by the Company as the minority interest holdings have no basis in their investment. The minority losses absorbed by the Company for the year ended December 31, 2009 and 2008 were $83,325 and $90,963, respectively.

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Intangibles and Capitalized Software consist of the following:

	December 31,			
		2009		2008
ACCP training course	$	790,975	$	787,838
BENET training course		58,591		58,358
Usage rights — Job Seekers		439,430		437,688
Usage rights—Learner		292,954		291,792
Other softwares		578,668		511,500
Minority interest in BHYHZ subsidiary		43,696		43,696
		2,204,314		2,130,872
Less: accumulated amortization		(1,466,553)		(891,800)
Intangibles, net	$	737,761	$	1,239,072

For the year ended December 31, 2009 and 2008, amortization expenses totaled $574,753, and $668,134, respectively, and were recorded in cost of goods sold and operating expenses.

Future amortization of intangible and capitalized software assets is as follows:

Year Ended December 31,		
2010	$	337,566
2011		204,615
2012		53,529
2013		32,242
2014		32,242
2015		32,242
2016		27,955
2017		17,370
	$	737,761

11. Deferred revenue

Deferred revenue includes subscriber prepayments and education fee prepayments. Subscriber prepayments represent deferred revenue for the purchase of debit cards used to pay for the online downloading of education materials. The Company recognizes revenue when the card is used to download material. During the period between the purchase and use of debit cards, the unused portion of the debit card is treated as deferred revenue to the Company. Education fee prepayments represent payments for tuition for the Company's training schools, which are amortized over the term of the course. As of December 31, 2009 and 2008, the Company had deferred revenue of $1,008,884 and $1,227,806, respectively.

12. Stockholders’ Equity

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 RedChip 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 RedChip Companies Inc. for its services according toa 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.

The Company recorded the following equity transactions during the year ended December 31, 2008:

- On June 27, 2008, the Company issued 400,000 common shares with a market value of $2.33 per share to Mr. Yuli Guo, to acquire 70% of WEI.

- During the year ended December 31, 2008 warrants for the purchase of 1,482,801 shares of common stock were exercised for proceeds of $2,667,559.

- During the year ended December 31, 2008 a total of 1,800,000 Series A Preferred Shares were converted into 600,000 shares of common stock valued at $667,800.

- On March 17, 2008, the Company’s board of directors approved the repurchase of up to 1,000,000 shares of the Company’s common stock from time to time in the open market at prevailing market prices. As of December 31, 2008 no shares have been repurchased.

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 years ended December 31, 2009 and 2008, dilutive shares include shares attributable to convertible preferred stock, exercisable warrants and exercisable option.

The following reconciles the components of the EPS computation.

	Years Ended December 31, 2009	2008
Net income available to common shareholders	$ 15,206,772	$ 10,009,499
Weighted average shares outstanding - basic	24,081,002	21,549,381
Effect of dilutive securities	1,541,604	3,113,449
Weighted average shares outstanding - diluted	25,622,606	24,662,830
Earnings per share - basic	$ 0.63	$ 0.46
Earnings per share - diluted	$ 0.59	$ 0.41

14. Statutory Reserves

The Company is required to make appropriations to reserve funds, comprising the statutory surplus reserve, statutory public welfare fund and discretionary surplus reserve, based on after-tax net income determined in accordance with generally accepted accounting principles of the People's Republic of China (the "PRC GAAP"). Appropriation to the statutory surplus reserve should be at least 10% of the after tax net income determined in accordance with the PRC GAAP until the reserve is equal to 50% of the entities' registered capital or members' equity. Appropriations to the statutory public welfare fund are at a minimum of 5% of the after tax net income determined in accordance with PRC GAAP. Commencing on January 1, 2006, the new PRC regulations waived the requirement for appropriating retained earnings to the statutory public welfare fund. The public welfare fund no longer requires the Company to contribute, but the Company can't dissolve it. As of December 31, 2007, the Company appropriated 50% of its registered capital to statutory reserve for Heilongjian Zhonghe Education Training Center, and has not contributed additional funds to this subsidiary statutory surplus reserve, as they are in compliance with all applicable PRC rules. The Company's other subsidiary has not reached their maximum contribution required for their statutory reserve; accordingly contributions were made for the year ended December 31, 2008. For the year ended December 31, 2009 and 2008, statutory reserves activity is as follows:

	Harbin Zhong He Li Da Education Technology, Inc	Heilongjiang Zhonghe Education Training Center	Beijing Hua Yu Hui Zhong Technology Development Co., Ltd	Total
Balance – January 1, 2008	$ 870,018	$ 281,867	$ -	$ 1,151,885
Allocations to Statutory reserves	838,353	-	-	838,353
Balance – December 31, 2008	1,708,371	281,867	-	1,990,238
Allocations to Statutory reserves	1,025,905	-	-	1,025,905

Balance – December 31, 2009	$ 2,734,276	$ 281,867	$ -	$ 3,016,143

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15. 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 may have a material adverse affect on the Company's financial condition and operations.

16. Warrants and Options

Warrants

Years Ended December 31, 2009 and 2008:

- The Company did not grant any warrants during the year ended December 31, 2009 and 2008.

Warrant activity for the years ended December 31, 2009 and 2008 is as follows:

	Shares underlying warrants	Weighted average Exercise Price
Outstanding as of January 1, 2008	5,130,210	$ 2.03
Granted	-	-
Exercised	(1,482,801)	1.80
Expired or cancelled	-	-
Outstanding as of December 31, 2008	3,647,409	$ 2.12
Granted	-	-
Exercised	(3,497,825)	1.84
Expired or cancelled	(50,000)	1.29
Outstanding as of December 31, 2009	99,584	$ 3.00

The following table summarizes information about stock warrants outstanding and exercisable as of December 31, 2009.

Exercise Price	Outstanding December 31, 2009	Weighted Average Remaining Life in Years	Number exercisable
$ 3.00	99,584	3.34	99,584

The remaining warrants, for 99,584 shares, have already been exercised in January 2010.The Company has no warrants left as of the date of this report issuance on March 15, 2009.

Options:

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 commons 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 commons 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 year, a dividend rate of 0.0%, and a weighted expected volatility of 151.88%. The Company recorded $418,984 in compensation expenses, net of related tax effects, related to these option grant for the year ended December 31, 2009.

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 commons 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 $52,467 in compensation expenses, net of related tax effects, related to this option grant for the year ended December 31, 2009.

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 commons 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%. The Company recorded $12,210 in compensation expenses, net of related tax effects, related to this option grant for the year ended December 31, 2009.

In June 2008 pursuant to the terms of an employment agreement with the prior CFO of the Company, the Company granted an option for 10,000 shares of the Company's common stock at an exercise price of $3.05, the then market price on the date of grant. These options have a one year life and expire on the first anniversary of the date of grant. The options vest monthly in installments of approximately 833 shares per month. The Company recorded expense over the vesting period in connection with these options granted.

The fair value of the June 2008 granted option was estimated on the date of grant using the Blacks-Scholes valuation model and the following assumptions: a risk free interest rate of 2.17%, a weighted expected life of 0.75 year, a dividend rate of 0.0%, and a weighted expected volatility of 86.53%. The Company recorded $3,794 and $5,326 in compensation expenses, net of related tax effects, related to this option grant for the year ended December 31, 2009 and 2008, respectively. The option has expired and forfeited as of December 31, 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 December 31, 2009 there are 294,000 options with a weighted average exercise price of $3.28 and a weighted average remaining life of 2.5 years, that remain outstanding and continue to be remeasured at the intrinsic value over their remaining vesting period ranging from 6 months to1.75 years. Compensation expense in any given period is calculated as the difference between total earned compensation at the end of the period, less total earned compensation at the beginning of the period. Compensation earned is calculated on a straight line basis over the requisite service period for any given option award. A total of approximately $203,000 in compensation expense remains unearned as of December 31, 2009. The intrinsic value for exercisable options as of December 31, 2009 is approximately $441,000.

Stock option activity for the year ended December 31, 2009 is summarized as follows:

	Shares underlying options	Weighted average Exercise Price
Outstanding as of January 1, 2008	-	$ -
Granted	10,000	3.05
Exercised	-	-
Expired / cancelled / forfeited	-	-
Outstanding as of December 31, 2008	10,000	$ 3.05
Granted	456,000	3.33
Exercised	-	-
Expired / cancelled / forfeited	(10,000)	3.05
Outstanding as of December 31, 2009	456,000	$ 3.33

The following table summarizes the Company’s stock options outstanding at December 31, 2009.

Exercise Price	Outstanding December 31, 2009	Weighted Average Remaining Life in Years	Number exercisable
$ 3.19	300,000	2.47	100,000
$ 2.90	116,000	2.47	42,000
$ 5.59	30,000	2.73	10,000
$ 5.40	10,000	0.87	10,000
	456,000	2.44	162,000

17. Income Taxes

On September 15, 2004, the Company executed a Plan of Exchange with ZHLD, subsequently ZHLD applied to be as a foreign invested company immediately after the merger, and a business license was approved for such qualification on April 8, 2005. According to PRC taxation policy, there is a 100% income tax exemption or holiday for 2 years and a 50% tax exemption or holiday for 3 years applicable to a foreign invested company, advanced technology company or software development company. Because ZHLD falls within these categories, it enjoys this income tax exemption or holiday from April 8, 2005, the date it obtained approval as a wholly owned foreign enterprise. The Company received a 100% tax holiday for the year ended December 31, 2006, and then 50% reduction of the prevailing tax rate until the fiscal year ending December 31, 2009, subject to changes in tax rates implemented in 2007 that go into effect commencing January 1, 2008 which will have the effect of increasing the enterprise tax rate by 2% per year until it reaches and effective tax rate of 25%. For the years ended December 31, 2008, 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. During the year ended December 31, 2009, the Company was assessed an additional PRC enterprise income tax, above their effective rate, due to tax regulations implemented by the PRC in the year ended December 31, 2009 relating to a prior period. ZHLD management, expects ZHLD to continue being qualified as a technology and software entity, and expects to receive a 50% reduction in their statutory PRC enterprise income tax rates. If such status is not achieved, ZHLD could be subject to increased tax expense in fiscal years subsequent to December 31, 2009. Furthermore, additional taxes can be assessed, beyond statutory rates enacted and approved tax abatements received by the Company, or ZHLD. 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 and ZHLDBJ are taxed at the PRC statutory rate (25%), and have not accrued for taxes since inception, due to recurring losses incurred since inception.

The components of income (loss) before income tax consist of approximately following:

	Years Ended December 31,	
	2009	2008
U.S. Operations	$ (1,916,000)	$ (782,000)
Chinese Operations	18,328,000	11,370,000
	$ 16,412,000	$ 10,588,000

The components of the provision for income taxes are approximately as follows:

	Years Ended December 31,	
	2009	2008
Federal, State and Local	$ -	$ -
Peoples Republic of China –Federal and Local	1,295,000	668,000
	$ 1,295,000	$ 668,000

The table below approximately summarizes the reconciliation of the Company's income tax provision computed at the statutory U.S. Federal rate and the actual tax provision:

	Years Ended December 31,	
	2009	2008
Income tax provision at Federal statutory rate	$ 5,745,000	$ 3,705,000
State income taxes, net of Federal benefit	755,000	487,000
Permanent differences	600,000	93,000
U.S. tax rate in excess of foreign tax rate	(2,676,000)	(1,603,000)
Abatement of foreign income taxes	(3,487,000)	(2,231,000)
Additional tax assessment for PRC income taxes – assessed in current period related to prior period	131,000	-
Increase in valuation allowance	227,000	217,000
Tax provision	$ 1,295,000	$ 668,000

The Company has a U.S net operating loss carryforward of approximately $2,200,000 as of December 31, 2009 which will begin to expire in 2025. Under IRC section 382, certain of these loss carryforward amounts may be limited due to the more than 50% change in ownership which took place during 2005. The deferred tax asset of approximately $875,000 associated with these net operating loss carryforwards was fully reserved as of December 31, 2009.

Had the tax exemption not been in place for the partial year ended December 31, 2009 and 2008, the Company estimates the following proforma financial statement impact.

	Years Ended December 31,	
	2009 (Proforma)	2008 (Proforma)
Net income before tax provision	$ 16,412,000	$ 10,588,000
Less Tax provision not exempted	1,295,000	668,000
Less Tax provision exempted	3,287,000	1,516,000
Net income	11,830,000	8,404,000
Less: net loss attributable to noncontrolling interests	(90,000)	(91,000)
Net income – attributable to the Company	$ 11,920,000	$ 8,495,000

18. Operating Risk

(a) Country risk

Currently, the Company's revenues are mainly derived from sale of educational products and services in the PRC. The Company hopes to expand its operations in the PRC, 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.

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(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 PRC 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 PRC is in a period of growth and is openly promoting business development in order to bring more business into the PRC. Additionally, the PRC allows a PRC 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 PRC could be affected.

(e) Key personnel risk

The Company's future success depends on the continued services of executive management in 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.

19. Subsequent Events

In accordance with ASC 855, "Subsequent Events" the Company evaluated subsequent events after the balance sheet date of December 31, 2009 through March 15, 2010, which is the date the financial statements were issued.

On January 27, 2010, the stock of China Education Alliance, Inc was approved and began trading on the NYSE under the symbol: CEU. Prior to that the stock was traded on NYSE Amex.

On Febrary 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 People's Republic of China, Beijing New Shifan Education & Technology ("New Shifan"), with registered capital of RMB 1.95 million. Further, New Shifan has acquired all the assets and operations of Beijing Shifan Culture Communication Co., Ltd. ("Beijing Shifan") for RMB 6 million. Beijing Shifan, focused on the advancement of science and mathematics education, publishes 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 currently 23 provinces and cities and more than 100,000 students participating in the contest, and the winners of the contest qualify for enrollment in some of the top universities in the

People's Republic of China. The acquisition has very 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 percent equity interest in New Shifan, while ZHLD owns 65 percent interest.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

See Item 9A(T) below.

Item 9A(T). Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed by the Company in the reports filed under the Securities Exchange Act, is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls are also designed with the objective of ensuring that this information is accumulated and communicated to the Company's management, including the Company's chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(b) under the Exchange Act, the Company carried out an evaluation with the participation of the Company’s management, including Xiqun Yu, the Company’s chief executive officer, and Zibing Pan, the Company’s chief financial officer, of the effectiveness of the Company’s disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the fiscal year ended December 31, 2009. Based upon that evaluation, the Company’s chief executive officer and chief financial officer concluded that the Company’s disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that the Company files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Our chief executive officer and chief financial officer also concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports required to be filed or submitted under the Exchange Act is accumulated and communicated to the our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

Management’s Report on Internal Control over Financial Reporting

The Company’s management is responsible for establishing and maintaining adequate internal control over our financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act. The Company’s management is also required to assess and report on the effectiveness of the Company’s internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 (“Section 404”). Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of the Company’s financial reporting for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that: (i) pertain to maintaining records that in reasonable detail accurately and fairly reflect the Company’s transactions; (ii) provide reasonable assurance that transactions are recorded as necessary for preparation of the Company’s financial statements and that receipts and expenditures of company assets are made in accordance with management authorization; and (iii) provide reasonable assurance that unauthorized acquisition, use or disposition of company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The Company’s management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. This evaluation was conducted by Xiqun Yu, the Company’s chief executive officer, and Zibing Pan, the Company’s chief financial officer. Based on its assessment, the Company’s management believes that, as of December 31, 2009, the Company’s internal control over

financial reporting is effective based on those criteria.

This annual report does not include an attestation report of the Company's registered accounting firm regarding internal control over financial reporting. The management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission.

Changes in Internal Control over Financial Reporting

No changes in the Company's internal control over financial reporting have come to management's attention during the Company's last fiscal quarter that have materially affected, or are likely to materially affect, the Company's internal control over financial reporting.

Limitations on Controls

Management does not expect that the Company's disclosure controls and procedures or the Company's internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and the Company's chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures are effective at that reasonable assurance level.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The following are our officers and directors as of the date of this prospectus. All our officers and directors are residents of the PRC and, therefore, it may be difficult for investors to effect service of process within the U.S. upon them or to enforce judgments against them obtained from the U.S. courts.

The following table sets forth certain information concerning our directors and executive officers:

Name	Age	Position
Xiqun Yu	42	Chairman of the board, chief executive officer, president and director
Zibing Pan	41	Chief financial officer
James Hsu 1	57	Director
Ansheng Huang 2,3	63	Director
Liansheng Zhang 1,2,3	68	Director
Yizhao Zhang1,2,3	40	Director

1 Member of the audit committee.
2 Member of the compensation committee.
3 Member of the nominating committee

Mr. Xiqun Yu has been our chairman and chief executive officer since the organization of our subsidiaries in 2001. He has more than 18 years of experience in senior management with several Northern PRC-based enterprises. He was responsible for marketing, strategic planning and designing for many of these corporations. Mr. Yu previously serves

ad the chief executive officer of RETONG.COM, and chairman of Harbin Zhonghelida Technology Corporation, Heilongjiang Retong Advertising Co., Ltd. and Heilongjiang Wantong Telecommunication Project Co., Ltd. Mr. Yu is a member of the Council of China Harbin Advertising Association and is a Director of the China Internet Network Association. Mr. Yu received a degree in Business Administration from the Harbin University of Science and Technology in 1989.

Mr. Zibing Pan was appointed our Chief Financial Officer on August 20, 2009. Mr. Pan is a Certified Public Accountant, certified by the Oklahoma State Board of Accountancy and member of American Institute of Certified Public Accountant (AICPA) and Oklahoma Society of Certified Public Accountants (OSCPA). Mr. Pan graduated with a Master of Business Administration from the University of Central Oklahoma in 1999. He obtained his Bachelor of Arts from Anhui University, China in 1988. Prior to joining to the Company, Mr. Pan was an audit manager with EideBailly CPAs & Business Advisors ("EideBailly") at Oklahoma City office. From September 1998 to September 2005, Mr. Pan was a statistical analyst and economist with the State of Oklahoma. From 1994 to1996, Mr. Pan worked as a loan project officer for Asian Development Bank (ADB) Loan Management Office in Anhui, China. He managed various ADB loan projects and assisted communication and translation between ADB and Chinese government. From 1988 to 1994, Mr. Pan was an associate professor at Anhui University, China, teaching English language.

Mr. James Hsu has been a director since October 2007. Mr. Hsu has been the president of Global Education Initiatives, Inc., a company which develops higher education collaboration programs between the U.S., Taiwan and the PRC, since 1997. He has also been the chief executive officer of Greater New York Home Care Systems, Inc., a company which provides infusion and other health care services to patients in their homes, since 1998. He is a founder of HeritageEast, a company which promotes cultural exchange between the U.S. and the PRC, and YYnet Communications, a company which specializes in information system services. He received a B.A. in Economics from Taiwan University, M.A in Management Science from Yale University and Ph.D. in Industrial and Operations Engineering from the University of Michigan.

Mr. Ansheng Huang has been a director since October 2007. Mr. Huang has been the training director of Vocational Education Equipment Commission at the National Association of Vocation Education of China since 1996. From 1991 through 2006, Mr. Huang was the division director of technology development at the China Education Instruction and Equipment Corporation of the PRCMinistry of Education. Mr. Huang graduated from the Department of Beijing Institute of Education with a Bachelor's Degree in Physics.

Mr. Lianzheng Zhang has been a director since October 2007. Mr. Zhang currently serves as Pluralism Director at the Heilongjiang provincial Base of Research and Experiment in Polymer Science & Technology since July 1990. Mr. Zhang has also been appointed as a People's Representative during the 9th (1998) and 10th (2003) National People's Congress of the PRCfor his extraordinary achievement in Polymer Science and Technology. Mr. Zhang received a Bachelor's Degree in Organic Chemistry from the Heilongjiang University and Master's Degree in Polymer Chemistry at the Jillin University. Mr. Zhang was also a visiting scholar at the University of Bradford.

Mr. Yizhao Zhang is currently the chief financial officer of Universal Travel Group (NYSE: UTA). He is also an independent director of China Green Agriculture Inc. (NYSE: CGA), Kaisa Holdings Group (HK: 1638) and China Carbon Graphite, Inc. (OTC BB: CHGI), respectively. Mr. Zhang has over 13 years of experience in accounting and internal control, corporate finance, and portfolio management. Previously, Mr. Zhang held senior positions in Energoup Holdings Corporation(OTC BB: ENHD), Shengtai Pharmaceutical Inc. (OTC BB: SGTI), China Natural Resources Incorporation (NASDAQ CM: CHNR) and Chinawe Asset Management Corporation (OTC BB: CHWE). Mr. Zhang also had experiences in portfolio management and asset trading in Guangdong South Financial Services Corporation from 1993 to 1999. He is a certified public accountant of the state of Delaware, and a member of the American Institute of Certified Public Accountants (AICPA). Mr. Zhang graduated with a bachelor's degree in economics from Fudan University, Shanghai in 1992 and received an MBA degree with financial analysis and accounting concentrations from the State University of New York at Buffalo in 2003.

The directors will serve until our next annual meeting, or until their successors are duly elected and qualified. The officers serve at the pleasure of the Board.

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Save as otherwise reported above, none of our directors hold directorships in other reporting companies.

There are no family relationships among our directors or officers.

To our knowledge, during the last ten years, none of our directors and executive officers (including those of our subsidiaries) has:

- Had a bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time.
- Been convicted in a criminal proceeding or been subject to a pending criminal proceeding, excluding traffic violations and other minor offenses.
- Been subject to any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities or banking activities.
- Been found by a court of competent jurisdiction (in a civil action), the SEC, or the Commodities Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended or vacated.
- Been the subject to, or a party to, any sanction or order, not subsequently reverse, suspended or vacated, of any self-regulatory organization, any registered entity, or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

Committees of the Board of Directors

Our board of directors has three committees, the audit committee, the compensation committee and the nominating committee. The audit committee and compensation committee was established in October 2007, and the nominating committee was establish in October 2007. Prior to October 2007, our entire board of directors acted as the audit and compensation committee for the purpose of overseeing the accounting and financial reporting processes, and audits of ourfinancial statements.

The members of the audit committee are YizhaoZhang (Chairman), James Hsu and Liansheng Zhang. The members of the compensation committee are Liansheng Zhang (Chairman), Yizhao Zhang and Ansheng Huang. The nominating committee similarly comprises of Liansheng Zhang (Chairman), Yizhao Zhang and Ansheng Huang.

Audit Committee and Audit Committee Financial Expert

Our board of directors established an audit committee in October 2007. The audit committee is responsible for (i) recommending independent accountants to the Board, (ii) reviewing our financial statements with management and the independent accountants, (iii) making an appraisal of our audit effort and the effectiveness of our financial policies and practices and (iv) consulting with management and our independent accountants with regard to the adequacy of internal accounting controls. Our audit committee members are YizhaoZhang (Chairman), James Hsu and Liansheng Zhang.

Our board of directors has determined that it has an "audit committee financial expert" as defined by Item 401(h) of Regulation S-K as promulgated by the Securities and Exchange Commission. Our audit committee financial expert is Yizhao Zhang. The directors who serve on the audit committee are "independent" directors based on the definition of

independence in the listing standards of the New York Stock Exchange. Our Board of Directors has adopted a written charter for the Audit Committee. The Charter is available on our website at http://www.chinaeducationalliance.com/Governance.jsp.

Compensation Committee

Our board of directors established a compensation committee in October 2007.

The compensation committee of the board of directors is responsible for (i) determining the general compensation policies, (ii) establishing compensation plans, (iii) determining senior management compensation and (iv) administering our stock option plans. The members of the compensation committee currently are Liansheng Zhang (Chairman), Yizhao Zhang and Ansheng Huang. The members of our compensation committee or their affiliates did not provide additional service to the Company or its affiliates in an amount in excess of $120,000 during the Company's fiscal year ended December 31, 2009.

Our board of directors has adopted a written compensation committee charter. The charter is available on our website at http://www.chinaeducationalliance.com/Governance.jsp. The directors who serve on the compensation committee are "independent" directors based on the definition of independence in the listing standards of the New York Stock Exchange.

Nominating Committee

Our board of directors established a nominating committee in June 2009.

The purpose of the nominating committee of the board of directors is to assist the board of directors in identifying and recruiting qualified individuals to become board members and select director nominees to be presented for board and/or stockholder approval. The nominating committee will be involved evaluating the desirability of and recommending to the board any changes in the size and composition of the board, evaluation of and successor planning for the chief executive officer and other executive officers. The qualifications of any candidate for director will be subject to the same extensive general and specific criteria applicable to director candidates generally. The members of the nominating committee currently are Liansheng Zhang (Chairman), Yizhao Zhang and Ansheng Huang.

The directors who serve on the nominating committee are "independent" directors based on the definition of independence in the listing standards of the New York Stock Exchange. The nominating committee has a written charter. The charter is available on our website at http://www.chinaeducationalliance.com/Governance.jsp. The nominating committee will consider qualified director candidates recommended by stockholders if such recommendations for director are submitted in writing to our Secretary at 58 Heng Shan Road, Kun Lun Shopping Mall,Harbin, The People's Republic of China 150090, provided such recommendation has been made in accordance with the relevant by-laws.

At this time, no additional specific procedures to propose a candidate for consideration by the nominating committee, nor any minimum criteria for consideration of a proposed nomination to the board, have been adopted.

Code of Ethics

We have adopted a code of ethics to apply to our principal executive officer, principal financial officer, principal accounting officer and controller, or persons performing similar functions. The Code of Ethics is currently available on our website.

The board and its committees held the following number of meetings during the fiscal year of 2009:

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Board of Directors	0
Audit Committee	0
Compensation Committee	0
Nominating Committee	0

The meetings include meetings that were held by means of a conference telephone call, but do not include actions taken by unanimous written consent, which amounting to 9.

Each director attended at least 75% of the total number of meetings of the board and those committees on which he served during the year.

Our non-management directors did not meet in executive session during 2009.

Board Leadership Structure and Role in Risk Oversight

Xiqun Yu is our chairman and chief executive officer. We have four independent directors. We do not have a lead independent director. Our Board has three standing committees, each of which is comprised solely of independent directors with a committee chair. The Board believes that the Company's chief executive officer is best situated to serve as Chairman of the Board because he is the director most familiar with our business and industry and the director most capable of identifying strategic priorities and executing our business strategy. In addition, having a single leader eliminates the potential for confusion and provides clear leadership for the Company. We believe that this leadership structure has served the Company well.

Our Board of Directors has overall responsibility for risk oversight. The Board has delegated responsibility for the oversight of specific risks to Board committees as follows:

- The Audit Committee oversees the Company's risk policies and processes relating to the financial statements and financial reporting processes, as well as key credit risks, liquidity risks, market risks and compliance, and the guidelines, policies and processes for monitoring and mitigating those risks.

- The Nominating Committee oversees risks related to the company's governance structure and processes.

Our Board of Directors is responsible to approve all related party transactions according to our Code of Ethics. We have not adopted written policies and procedures specifically for related person transactions.

Limitations on Liability

Article VIII of our Bylaws limits the liability of our directors, officers and employees to the fullest extent permitted by North Carolina law. Consequently, our directors and officers may not be personally liable for monetary damages regarding their duties as directors.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our executive officers and directors and persons who own more than 10% of a registered class of our equity securities to file with the SEC initial statements of beneficial ownership, reports of changes in ownership and annual reports concerning their ownership of our common stock and other equity securities, on Form 3, 4 and 5 respectively. Executive officers, directors and greater than 10% shareholders are required by the SEC regulations to furnish our company with copies of all Section 16(a) reports they file.

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Based solely on our review of the copies of such reports received by us and on written representations by our officers and directors regarding their compliance with the applicable reporting requirements under Section 16(a) of the Exchange Act, we believe that, with respect to the fiscal year ended December 31, 2009, our officers and directors, and all of the persons known to us to own more than 10% of our common stock, filed all required reports on a timely basis except Zibing Pan was late for one Form 3 filing.

Item 11. Executive Compensation.

The following table sets forth information with respect to the compensation of each of the named executive officers for services provided in all capacities to China Education Alliance, Inc. and its subsidiaries in the fiscal years ended December 31, 2009 and 2008 in their capacity as such officers. Mr. Xiqun Yu, our chief executive officer and also one of our directors, receives no additional compensation for his services in his capacity as director. No other executive officer orformer executive officer received more than $100,000 in compensation in the fiscal years reported below.

Name and Principal Position	Fiscal Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Xiqun Yu Chief	2009	21,000	—	—	313,000	—	—	—	334,000
Executive Officer (principal executive officer)	2008	21,000	—	—	—	—	—	—	21,000
Zibing Pan Chief Financial	2009	38,000	—	—	52,000	—	—	—	90,000
Officer (principal financial officer)(1)	2008	—	—	—	—	—	—	—	—
Susan Liu Former Chief	2009	50,000	—	—	4,000	—	—	—	54,000
Financial Officer(2)	2008	39,000	—	—	5,000	—	—	—	44,000
Chunqing Wang Former	2009	—	—	—	—	—	—	—	—

Chief Financial Officer (3)	2008	5,000	—	—	—	—	—	—	5,000

(1) Mr. Zibing Pan joined us as our Chief Financial Officer on August 20, 2009
(2) Ms. Susan Liu joined us as our Chief Financial Officer on June 2, 2008 and resigned on August 20, 2009.
(3) Mr. Chunqing Wang resigned as our Chief Financial Officer on June 2, 2008.

Outstanding Equity Awards at 2009 Fiscal Year End

As of December 31, 2009, no options were exercised, and options to purchase 456,000 shares of the Company’s common stock were outstanding.

Employment Agreements

We do not currently provide any contingent or deferred forms of compensation arrangements, annuities, or retirement benefits to our executive officers or directors. We had entered into a five year employment agreement with of our Chief Executive Officer and our ex-Chief Financial Officer, Chunqing Wang, each of which terminate on August 9, 2009. Under the terms of the employment agreement, our Chief Executive Officer is paid $15,000 per annum and our Chief Financial Officer was paid $10,000 per annum. Pursuant to the employment agreements, the executives are also entitled to a working clothes subsidiary, insurance, medical benefits, unemployment insurance and other benefits pursuant to our standard policies.

On June 2, 2008, we appointed Susan Liu as our Chief Financial Officer pursuant to an employment agreement dated June 2, 2008. Ms. Liu's compensation as our Chief Financial Officer is set forth in an employment agreement between Ms. Liu and us dated June 2, 2008. Under that agreement, Ms. Liu was to receive compensation consisting of the following: (i) a monthly salary of CA$6,000, (ii) an annual bonus equivalent to one month's salary, payable in December of each year, based on the monthly salary in effect on November 30 of that year, (iii) such benefits as are available to our other employees, and (iv) options to purchase a total of 10,000 shares of our common stock, such options to vest monthly in equal installments commencing from June 2, 2008 through June 1, 2009. Susan Liu resigned on August 20, 2009.

On August 20, 2009, we appointed Zibing Pan as our new Chief Financial Officer pursuant to an employment agreement between Mr. Pan and us dated August 20, 2009. Under that agreement, Mr. Pan is to receive an annual salary of $100,000, and an additional $300 per month towards the payment of his medical, health and dental benefits, disability, accident and life insurance. Additionally, Mr. Pan will be granted an option to purchase 30,000 shares of common stock of Company annually at an exercise price equivalent to the closing price per share of common stock on the date of the grant, which option shall vest in one-third installments over three years. As an incentive to Mr. Pan, on completion of two full years of service to the Company, the Company shall award him an additional option to purchase 40,000 shares of the Company's common stock at an exercise price equivalent to the closing price per share of common stock on the date of the grant, which option shall vest in one-third installments over three years.

Compensation Discussion and Analysis

We strive to provide our named executive officers (as defined in Item 402 of Regulation S-K) with a competitive base salary that is in line with their roles and responsibilities when compared to peer companies of comparable size in similar locations.

It is not uncommon for PRC private companies in the PRC to have base salaries as the sole form of compensation. The base salary level is established and reviewed based on the level of responsibilities, the experience and tenure of the individual and the current and potential contributions of the individual. The base salary is compared to the list of similar positions within comparable peer companies and consideration is given to the executive's relative experience in his or her position. Base salaries are reviewed periodically and at the time of promotion or other changes in responsibilities.

We plan to implement a more comprehensive compensation program, which takes into account other elements of compensation, including, without limitation, short and long term compensation, cash and non-cash, and other equity-based compensation such as stock options. We expect that this compensation program will be comparable to the programs of our peer companies and aimed to retain and attract talented individuals.

Board Compensation

On June 17, 2009, the Board of Directors of the Company appointed Mr. Yizhao Zhang as independent director of the Company. Mr. Zhang’s compensation as director of the Company is set forth in an appointment letter with the Company dated June 17, 2009. He will be paid a monthly fee of $1,000. He will also be granted options to purchase a total of 30,000 shares of common stock of the Company, par value $0.001 per year of service at a price to be determined by the Compensation Committee and the Board of Directors. The first set of options shall vest on the first anniversary of its grant and may be exercised until three years from the date of grant provided that Mr. Zhang is still a director of or otherwise engaged by the Company at the date of vesting.

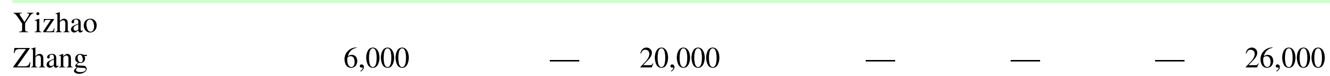
On June 18, 2009, the Company granted Liansheng Zhang 10,000 shares of common stock of the Company. This option was issued pursuant to the Company's 2009 Incentive Stock Plan and an Incentive Stock Option Agreement dated as of June 18, 2009. The option shall become exercisable during the term of the Liansheng Zhang's employment in three equal annual installments of 3,333 shares of common stock each (save for the last installment of 3,334 shares), the first installment to be exercisable on the date of this option (the "Initial Vesting Date"), with additional installments becoming exercisable on each of the first and second anniversaries following the Initial Vesting Date. Mr. Zhang also received $5,000 inj fees in fiscal year 2009.

On November 15, 2009, James Hsu was granted an option by the Company pursuant to the Company's 2009 Incentive Stock Option Plan and an Incentive Stock Option Agreement dated as of November 15, 2009. The option shall become vested and exercisable as of November 15,2009 to purchase 10,000 shares of common stock at the exercise price of $5.40 per share during the term of the James Hsu’s employment with the Company and shall expire one year from November 15, 2009. Mr. Hsu also received $10,000 in fees in fiscal year 2009.

Mr. Ansheng Huang received $14,000 in fees in fiscal year 2009.

The following table sets forth the compensation received by our directors in fiscal year 2009 in their capacity of directors:

Name and Principal Position	Fee earned or paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non-equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Xiqun Yu	—	—	313,000	—	— —	— —	313,000
James Hsu	10,000	—	12,210	—	— —	— —	22,210
Ansheng Huang	14,000	—	—	—	—	—	14,000
Liansheng Zhang	5,000	—	3,500	—	—	—	8,500



Yizhao Zhang	6,000	—	20,000	—	—	—	26,000

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The following table sets forth certain information with respect to the beneficial ownership of our voting securities by (i) any person or group owning more than 5% of any class of voting securities, (ii) each director, (iii) our chief executive officer and (iv) all executive officers and directors as a group as of March 8, 2010.

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Name and Address	Number of Shares Beneficially Owned (1)	Percentage of Outstanding Shares (1)
Executive Officers and Directors		
Xiqun Yu (1) 58 Heng Shan Rd. Kun Lun Shopping Mall Harbin, PRC 150090	12,783,335(2)	40.39%
Zibing Pan 58 Heng Shan Rd. Kun Lun Shopping Mall Harbin, PRC150090	10,000(3)	*
James Hsu 58 Heng Shan Rd. Kun Lun Shopping Mall Harbin, PRC150090	10,000(4)	*
Ansheng Huang 58 Heng Shan Rd. Kun Lun Shopping Mall Harbin, PRC150090	0	0%
Liansheng Zhang 58 Heng Shan Rd. Kun Lun Shopping Mall Harbin, PRC150090	3,333(5)	*
Yizhao Zhang 45 Old MillstoneDrive, NIT 6 East Windsor, NJ08520	0(6)	0%
Officers and Directors as a group (six individuals)	12,806,668	40.43%

*Represents less than 1%

(1) In determining beneficial ownership of our common stock as of a given date, the number of shares shown includes shares of common stock which may be acquired on exercise of warrants or options or conversion of convertible securities within 60 days of that date. In determining the percent of common stock owned by a person or entity on March 8, 2010, (a) the numerator is the number of shares of the class beneficially owned by such person or entity, including shares which may be acquired within 60 days on exercise of warrants or options and conversion of convertible securities, and (b) the denominator is the sum of (i) the total shares of common stock outstanding on March 8, 2010 (31,651,251), and (ii) the total number of shares that the beneficial owner may acquire upon conversion of the preferred and on exercise of the warrants and options. Unless otherwise stated, each beneficial owner has sole power to vote and dispose of its shares.

(2) The shares beneficially owned by Xiqun Yu include (a) 12,683,335 shares of common stock directly owned by Xiqun Yu, and (b) an option granted by the Company on June 18, 2009, to purchase 300,000 shares of the Company's common stock in three equal installments, the first being vested on the date of the grant, and additional installments being vested on the first and second anniversaries of the date of the grant.

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(3) Pursuant to an Incentive Stock Option Agreement between Zibing Pan and the Company, on September 24, 2009, Zibing Pan was granted an option to purchase 30,000 shares of common stock of Company annually at an exercise price equivalent to the closing price per share of common stock on the date of the grant, which option shall vest in one-third installments over three years, the first installment to be exercisable on the date of this option, with additional installments becoming exercisable on each of the first and second anniversaries following the date of the grant.

(4) James Hsu was granted an option by the Company pursuant to the Company's 2009 Incentive Stock Option Plan and an Incentive Stock Option Agreement dated as of November 15, 2009. The option shall become vested and exercisable as of November 15,2009 to purchase 10,000 shares of common stock at the exercise price of $5.40 per share during the term of the James Hsu’s employment with the Company and shall expire one year from November 15, 2009.

(5) Liansheng Zhang was granted an option to purchase 10,000 shares of the common stock of the Company on June 18, 2009. The option shall become exercisable during the term of the Liansheng Zhang's employment in three equal annual installments of 3,333 shares of common stock each (save for the last installment of 3,334 shares), the first installment to be exercisable on the date of this option, with additional installments becoming exercisable on each of the first and second anniversaries following the date of the option.

(6) Yizhao Zhang was granted an option to purchase 30,000 shares of the common stock of the Company pursuant to the 2009 Incentive Stock Plan on June 18, 2009. The option shall vest on the first anniversary of the date of the grant and may be exercised until three years from the date of the grant of the option.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

One of our executive officers rents, in his name, two properties in Beijing, PRC on our behalf. Our executive officer leases from Beijing Yi De Zhi Bang Technology Limited office space located at Anleli Road A, 4th Floor, Building B, No. 69, Chongwen District, Beijing, PRC. The rent for this facility is RMB 480,000 per year (approximately US$68,943). The lease has a one year term, from October 1, 2008 through September 30, 2009. The lease has been renewed to be valid till September 30, 2010.

As of December 31, 2009 and December 31, 2008 the Company has outstanding advances made to its subsidiary World Exchanges, Inc (WEI) of $223,860 and $80,000, respectively, accounted for as advances to related parties.

Independent Directors

Our Board of Directors is currently comprised of a majority of independent directors, as such term is defined by the rules of the New York Stock Exchange, and such independent directors are Yizhao Zhang, James Hsu, Ansheng Huang and Liansheng Zhang.

Item 14. Principal Accounting Fees and Services.

We were billed by Sherb & Co., LLP, an independent public accounting firm, for the following professional services they performed for us during the fiscal years ended December 31, 2009 and 2008 as set forth in the table below.

	Fiscal year ended December 31,	
	2009	2008
Audit fees	$ 103,000	$ 88,000
Audit-related fees	$ —	$ —

Tax fees	$	1,800	$	3,800
All other fees	$	—	$	—

PART IV

Item 15. Exhibits, Financial Statement Schedules.

Exhibit No.	Description
3.1	Articles of Incorporation filed December 2, 1996 in the State of North Carolina are incorporated herein by reference to Exhibit 3.1 to the Form SB-2 Registration Statement of China Education Alliance, Inc. (File No. 333-101167) filed on November 13, 2002.
3.2	Articles of Amendment Business Corporation dated May 23, 2002 are incorporated herein by reference to Exhibit 3.2 to the Form SB-2 Registration Statement of China Education Alliance, Inc. (File No. 333-101167) filed on November 13, 2002.
3.3	Articles of Amendment Business Corporation filed November 17, 2004, changing the name of the Company from ABC Realty Co. to China Education Alliance, Inc. is incorporated herein by reference to Exhibit 3.3 filed with the Company's Form 10-KSB annual report for its fiscal year ended December 31, 2005.
3.4	Articles of Share Exchange of China Education Alliance, Inc. filed with the Department of The Secretary of State of the State of North Carolina on December 30, 2004 are incorporated herein by reference to Exhibit 3.1 filed with China Education Alliance, Inc.'s Form 10-QSB quarterly report for its quarter ended September 30, 2007 filed with the SEC on November 14, 2007.
3.5	Articles of Amendment to Articles of Incorporation filed with the Department of The Secretary of State of the State of North Carolina on October 4, 2007 are incorporated herein by reference to Exhibit 3.2 filed with China Education Alliance, Inc.'s Form 10-QSB quarterly report for its quarter ended September 30, 2007 filed with the SEC on November 14, 2007.
3.6	ByLaws of China Education Alliance, Inc. are incorporated herein by reference to Exhibit 3.3 to the Form SB-2/A Registration Statement of China Education Alliance, Inc. filed on February 7, 2003 (File No. 333-101167).
10.1	Stock Transaction Agreement between and among China Education Alliance, Inc. and the former owners of Harbin Zhonghelida Educational Technology Co., Ltd., a wholly owned subsidiary of China Education Alliance, Inc. is incorporated herein by reference to Exhibit 10.3 to China Education Alliance, Inc.'s Form 10-KSB for the year ended December 31, 2005 filed with the SEC on April 17, 2006.
10.2	Organization Constitution of Heilongjiang Zhonge Education Training Center dated June 15, 2005, a wholly owned subsidiary of the Company is incorporated herein by reference to Exhibit 10.4 to China Education Alliance, Inc.'s Form 10-KSB for the year ended December 31, 2005 filed with the SEC on April 17, 2006.
10.3	Business licenses of Harbin Zhonghelinda Educational Technology Company Limited, a wholly owned subsidiary of China Education Alliance, Inc. is incorporated herein by reference to Exhibit 10.5 to China Education Alliance, Inc.'s Form 10-KSB for the year ended December 31, 2005 and filed with the SEC on April 17, 2006.

10.4 Product Commission Process Contract dated March 2, 2006, with Tianjin Huishi Printing Products Co., Ltd. is incorporated herein by reference to Exhibit 10.6 to China Education Alliance, Inc.'s Form 10-KSB for the fiscal year ended December 31, 2005 filed with the SEC on April 17, 2006.

10.5 Consulting Agreement with Conceptual Management Limited dated March 20, 2006 is incorporated herein by reference to Exhibit 10.8 to China Education Alliance, Inc.'s Form 10-KSB for the fiscal year ended December 31, 2005 filed with the SEC on April 17, 2006.

10.6 Form of Secured Promissory Note dated September 29, 2006, by China Education Alliance, Inc. is hereby incorporated herein by reference to Exhibit 10.1 to the Form 8-K current report of China Education Alliance, Inc. filed with the SEC on November 1, 2006.

10.7 Stock Pledge Agreement dated September 29, 2006, between Xiqun Yu and SBI Advisors, LLC, as Agent is hereby incorporated herein by reference to Exhibit 10.2 to the Form 8-K current report of China Education Alliance, Inc. filed with the SEC on November 1, 2006.

10.8 Guarantee Agreement dated as of September 29, 2006, among Harbin Zhong He Li Da Jiao Yu KeJi You Xian Gong Si, Heilongjiang Zhonghe Education Training Center, Harbin Zhonghelida Educational Technology Company Limited, Xinqun Yu, and SBI Advisors, LLC, as Agent is hereby incorporated herein by reference to Exhibit 10.3 to the Form 8-K current report of China Education Alliance, Inc.filed with the SEC on November 1, 2006.

10.9 Investor Relations Agreement dated November 1, 2006, between China Education Alliance, Inc. and Taylor Rafferty Associates, Inc. is incorporated herein by reference to Exhibit 10.3 to the Form 10-QSB quarterly report of the Company for the period ended June 30, 2006.

10.10 Purchase Contract dated December 28, 2006, between Harbin Zhonghelida Education &Technology Co., Ltd. and Harbin Nangang Compass Computer Training School is incorporated herein by reference to Exhibit 10.11 to China Education Alliance, Inc.'s Form 10-KSB for the fiscal year ended December 31, 2006 filed with the SEC on April 2, 2007.

10.11 Securities Purchase Agreement dated as of May 8, 2007, among China Education Alliance, Inc., Barron Partners, LP and the other investors named therein is hereby incorporated herein by reference to Exhibit 99.1 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on May 15, 2007.

10.12 3% Convertible Note issued to Barron Partners, LP is hereby incorporated herein by reference to Exhibit 99.2 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on May 15, 2007

10.13 3% Convertible Note issued to Eos Holdings is hereby incorporated herein by reference to Exhibit 99.3 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on May 15, 2007.

10.14 3% Convertible Note issued to Hua-Mei 21st Century Partners, LP is hereby incorporated herein by reference to Exhibit 99.4 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on May 15, 2007.

10.15 Registration Rights Agreement, dated May 8, 2007, among China Education Alliance, Inc. , Barron Partners, LP and the other investors named therein is hereby incorporated herein by reference to Exhibit 99.5 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on May 15, 2007.

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10.16 Closing Escrow Agreement, dated May 8, 2007, among China Education Alliance, Inc. , Barron Partners, LP, the other investors named therein and the escrow agent named therein is hereby incorporated herein by reference to Exhibit 99.6 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on May 15, 2007.

10.17 Letter agreement dated May 8, 2007 between China Education Alliance, Inc. and SBI Advisors LLC, and related payment letter is hereby incorporated herein by reference to Exhibit 99.7 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on May 15, 2007.

10.18 Amendment dated as of May 23, 2007 to the Securities Purchase Agreement dated May 8, 2007, among China Education Alliance, Inc. , Barron Partners, LP and the other investors named therein is hereby incorporated herein by reference to Exhibit 99.1 to the Form 8-K of China Education Alliance, Inc. y filed with the SEC on June 7, 2007.

10.19 3% Convertible Note issued to Barron Partners, LP is hereby incorporated herein by reference to Exhibit 99.2 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on June 7, 2007.

10.20 Closing Escrow Agreement, dated May, 2007, among China Education Alliance, Inc. , Barron Partners, LP, the other investors named therein and the escrow agent named therein is hereby incorporated herein by reference to Exhibit 99.3 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on June 7, 2007.

10.21 Letter Agreement dated November 30, 2007, among China Education Alliance, Inc. , Barron Partners, LP and the other investors named therein is incorporated herein by reference to Exhibit 10.22 to the Form SB-2/A Registration Statement of China Education Alliance, Inc. (File No. 333-146023) filed with the SEC on December 7, 2007.

10.22 Extracts of Office Rental Agreement dated January 28, 2006 by and between Vocational Education Organization Service Centre and Beijing Hua Yu HuiZhong Technology Development Co., Limited is incorporated herein by reference to Exhibit 10.22 to the Form 10-KSB of China Education Alliance, Inc. filed with the SEC on March 31, 2008.

10.23 House Lease Contract dated January 29, 2006 by and between Beijing Yi De Zhi Bang Technology Limited and Beijing Huayuhuizhong Technology Development Co., Ltd. is incorporated herein by reference to Exhibit 10.24 to the Form 10-KSB of China Education Alliance, Inc. filed with the SEC on March 31, 2008.

10.24 Employment Contract between Zhonghelida Education Technology Co., Ltd and Xiqun Yu dated August 9, 2004 is incorporated herein by reference to Exhibit 10.27 to the Form 10-KSB of China Education Alliance, Inc. filed with the SEC on March 31, 2008.

10.25 Employment Contract between Zhonghelida Education Technology Co., Ltd and Chunqing Wang dated August 9, 2004 is incorporated herein by reference to Exhibit 10.28 to the Form 10-KSB of China Education Alliance, Inc. filed with the SEC on March 31, 2008.

10.26 Underwriting Agreement dated as of September 29, 2009 by and between the Registrant and Rodman & Renshaw, LLC, is incorporated herein by reference to Exhibit 10.1 to the Form 8-K of China Education Alliance, Inc. filed with the SEC on September 30, 2009.

21.1 List of Subsidiaries.

23.1	Consent of Independent Registered Public Accounting Firm (Sherb & Co., LLP).
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	CHINA EDUCATION ALLIANCE, INC.	
Date: March 15, 2010	By:	/s/ Xiqun Yu Xiqun Yu President and Chief Executive Officer
Date: March 15, 2010	By:	/s/ Zibing Pan Zibing Pan Chief Financial Officer (Principal Financial Officer)

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Xiqun Yu Xiqun Yu	President, Chief Executive Officer Chairman of the Board of Directors and Director (Principal Executive Officer)	March 15, 2010
/s/ Zibing Pan Zibing Pan	Chief Financial Officer (Principal Financial and Accounting Officer)	March 15, 2010
/s/ James Hsu James Hsu	Director	March 15, 2010
Ansheng Huang	Director	March 15, 2010
/s/ Liansheng Zhang Liansheng Zhang	Director	March 15, 2010
/s/ Yizhao Zhang Yizhao Zhang	Director	March 15, 2010

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