

## China Education Alliance (CEU)

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"So far I've made three dollars selling lemonade and \$9 million selling stock in my company."

### Summary

In this report, we present compelling evidence that China Education Alliance (CEU) is fabricating its SEC financial statements. We believe that the company's revenue and profit are highly overstated in its SEC filings and that the company is mostly a hoax. Our evidence includes:

- The company's websites do not work, despite the fact that CEU is an online education provider and its websites are the company's main revenue-generating assets. We have recorded three videos [here](#), [here](#) and [here](#) which show that the main [www.edu-chn.com](http://www.edu-chn.com) and [www.pk1234567.com](http://www.pk1234567.com) websites have non-functioning payment methods and are full of broken links and HTML errors.
- The company's websites receive a fraction of the visitor traffic generated by comparable sites such as those operated by China Distance Education Holdings (DL), which reports lower revenue and lower margins than CEU despite having functioning websites, a larger number of web assets, operational payment schemes and no broken links on their sites.
- We hired an investigator to visit the company's training center in Harbin and found it to be barren of desks and teaching equipment. We provide a [video](#) where we present a slideshow of the empty building. We also explain why we are confident we visited the correct location.
- The company's local filings to the Chinese government show that the online business generated less than \$1 million in revenue in 2008. We provide SAIC filings from 2006, 2007 and 2008, including both original Chinese photocopies as well as English translations.
- The company's financials are not believable when compared to publicly traded comparable companies. The company reports higher margins and revenue growth when compared to DL, CEDU and CAST, despite having a non-functioning website and an empty training center.
- CEU has had 4 low quality, non-reputable auditors since going public in 2004. The company also raised capital in 2009 at an irrationally low valuation without providing a sensible rationale for why the capital was needed.

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## Introduction

It seems like every week another fraud is exposed in China. Time and again, channel checks and due diligence show that certain companies that have become publicly listed in the United States through reverse mergers are worth a small fraction of their current valuations. Six months ago, there were a few analysts and research firms pounding the table to get investors' attention, and they were criticized by long holders as conspiring to make a quick buck by destroying confidence in legitimate companies. What we're finding today is that analysts from all corners of the market are independently drawing the same conclusions. A number of Chinese companies, brought to market through reverse mergers, are stealing funds from U.S. investors through PIPE transactions and unnecessary public offerings. They sell shares at bargain basement prices while evidence accumulates that the companies' financial figures are highly inflated.

In this report, we examine China Education Alliance and provide strong evidence that the company is inflating its financial statements. China Education Alliance (CEU) is an online distributor of educational material with a website that fails to work and receives minimal online traffic, company facilities that are empty and unused, egregious shareholder dilution for no sensible purpose, AIC financial statements that don't match SEC filings, a history of small no-name auditors, and suspiciously unreasonable margins.

Today, CEU trades at a market capitalization of \$150 million and its shares are listed on the New York Stock Exchange. In actuality, the stock is worth little more than the \$20 million of cash it raised in its 2009 secondary offering, if indeed that cash still resides in the company's bank account.

We will provide evidence throughout this report that CEU is fabricating its SEC financial statements. Its actual revenue and net income is a small percentage of what it reports in its SEC filings.

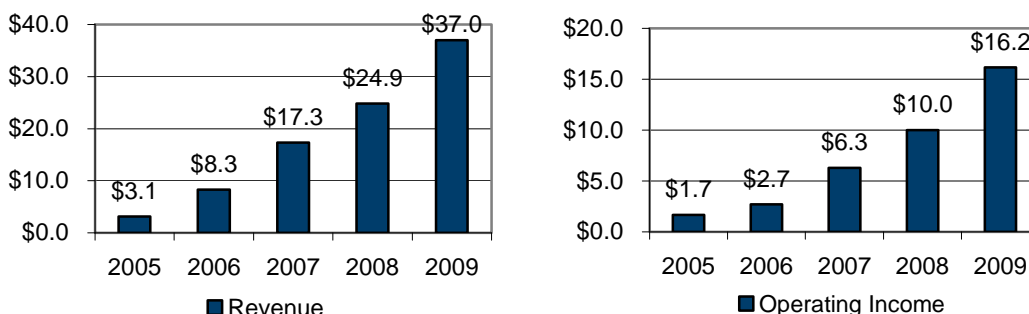
The company is mostly a hoax.

## The Company

China Education Alliance ("CEU" or the "Company") claims to be a distributor of "online educational resources through the Internet". Its main business is the operation of [www.edu-chn.com](http://www.edu-chn.com), which it claims is "a comprehensive education network platform which is based on network video technology and large data sources of elementary education resources". It also claims to provide on-site teaching services at a facility in Harbin and provide vocational services through the website [www.360ve.com](http://www.360ve.com). The complete list of websites owned by CEU, as determined by their annual report and a visit to their website, are (i) [www.edu-chn.com](http://www.edu-chn.com), (ii) [www.360ve.com](http://www.360ve.com), and (iii) [www.pk1234567.com](http://www.pk1234567.com).

The Company went public in December 2004 through a reverse merger with a U.S.-listed legal entity. Since 2004, the company has ostensibly grown revenue from \$3.1 million in 2005 to \$37.0 million in fiscal year 2009, and net income from \$1.7 million in 2005 to \$15.2 million in 2009.

Below is the company's historical revenue and operating income according to SEC filings.



We will provide evidence that the charts above are fiction.

## Website Usability

First and foremost, the website that comprises CEU's main business is non-functional in numerous ways. An online visitor who reads Chinese can determine this relatively quickly. In this section, we will explain the various ways in which the company's website does not work, but to better communicate the website's non-functional aspects, we have put together the following three videos:

[Video – Part 1](#): Core Website Has Non-Functioning Payment System

[Video – Part 2](#): Further Website Errors and Comparison with a Comparable Website

[Video – Part 3](#): More Broken Links, Irrelevant Content, and a Flaw with CEU's Business Model

We encourage readers to view all three videos, as they provide compelling evidence that the company's websites are not functional and merely a façade.

Our first video introduces the website and demonstrates that visitors **cannot purchase products from the company's website**, despite the fact that CEU is primarily a provider of online education.

Our second video examines the company's online educational game website [www.pk1234567.com](http://www.pk1234567.com) and demonstrates that **it neither works nor generates revenue through online payment because the payment options for the game are non-functional**. The second video also contrasts [www.edu-chn.com](http://www.edu-chn.com) with the properly functioning websites of China Distance Education Holdings (DL), and shows how visitors can in fact purchase products from DL's websites, whereas they cannot from CEU's websites.

Our third video shows numerous broken links and faulty html on the [edu-chn.com](http://edu-chn.com) website, as well as examples of inappropriate, irrelevant and outdated content. It also explores a fundamental flaw with CEU's business model: free test papers and examination material are readily available on the web, and it is unclear why students would pay for content, if in fact the site's payment options were to be functional.

Numerous attempts to purchase products online yielded no success. All payment methods on the company's websites led to error messages. We had multiple investigators call the phone

numbers on the websites to try to purchase products. The numbers either led to recorded messages during business hours or the callers were told that the cards “could only be purchased on site in Heilongjiang”. On several calls, the operators answering the phones were not able to provide any information on where these sites were located, although one operator said that cards are “sold at book stores around schools in Harbin”. The cards could not be purchased over the phone.

[Click here](#) for a report from one of our investigators who tried to purchase the company’s products online and over the phone. The investigator is a resident of Harbin.

Seeing that it’s impossible to purchase access to CEU educational materials via the Internet or by phone, we became skeptical that CEU could have a strong enough presence locally in Harbin to generate the revenue reported to the SEC. We hired an investigator to visit bookstores near schools in Harbin to search for these debit cards. Our investigator visited fifteen locations, none of which carried CEU learning cards. Of the fifteen bookstores visited, only two sold learning cards, and neither was for [edu-chn.com](#). One was for a competitor we were not familiar with, [www.taiqiedu.com](#), and the other one was for websites of DL. The other thirteen bookstores did not sell learning cards at all. The addresses and a picture of each visited bookstore can be seen in the PDF linked to below. Our full set of pictures of the bookstores are available at [this Flickr account](#). As a result of our investigation, we do not believe that CEU has a strong enough presence either online or locally in Harbin to generate even a fraction of the revenue reported to the SEC.

[Click here](#) for the bookstore addresses and pictures.

To summarize, our investigators could not purchase learning cards on the Internet, over the phone, or in person. Even two independently operating investigators who live in Harbin could not purchase access to CEU course materials. The same is true for [pk1234567.com](#).

These additional errors were encountered while trying to navigate [edu-chn.com](#):

- The “Famed Instructors Test Paper Store” and the “Famous Schools’ Test Paper Store” could not be accessed due to an error screen.
- The online store ([www.edu-chn.com/wssc/index.htm](#)), which appears to sell merchandise unrelated to education, also does not work.
- The “Big Classroom of Famous Instructors” did not provide access to tutoring services. After viewing a profile, there is a link providing the company’s main phone line and a QQ messaging link that doesn’t work. The phone number supplied frequently goes unanswered during normal business hours from calls originated in China.
- Some free test material was available for download, but it frequently didn’t include answers to sample questions and/or was available on other sites free of formatting issues, leading us to believe that CEU is not the original creator of its free material.
- The websites featured irrelevant content – in our third video, we show that the website includes a personals ad by a 52-year old female seeking a husband.
- Web pages had stale content that have not been updated since late 2005.

We also question how CEU manages to generate any revenue of significance from selling test papers, given the amount of free content available on various other websites and forums that students and parents can easily access. An example was provided in the third video. For instance, [http://sj.smez.net](#) allows registered users to download and access an extensive

database of test papers for free. Parents and students should have little incentive to pay for such test papers from CEU.

We also compared the CEU websites to sites operated by comparable companies. We looked at China Distance Education Holding's [chinaacc.com](http://chinaacc.com) and [med66.com](http://med66.com), as well as ChinaEdu Corporation's [prcedu.com](http://prcedu.com) and [chinaedu.com](http://chinaedu.com). Please see our investigator's report on these comparable websites [here](#). Across the board, these comparable sites did require learning cards but had smooth purchasing processes with online payment available. Phoning the company was not necessary to acquire the learning cards, and there were no error screens. Most importantly, ***we were able to purchase material from every comparable website without a problem, whereas we could not purchase material from any CEU website or by phone.***

Additionally, the layout of every site we looked at was more intuitive to use than [edu-chn.com](http://edu-chn.com).

Despite all of the website shortcomings we detail in this section and in our video, CEU doesn't seem to be suffering financially, if investors are to believe the company's SEC filings. We're confident that those SEC filings are fiction.

In addition to the work that we did ourselves and show in our video, we hired several investigators to put together reports on China Education Alliance's websites, as well as comparable websites. They are here:

[Click here for Report on Learning Cards from Investigator 1](#)

[Click here for Website Report from Investigator 2](#)

[Click here for Comparable Websites Report from Investigator 2](#)

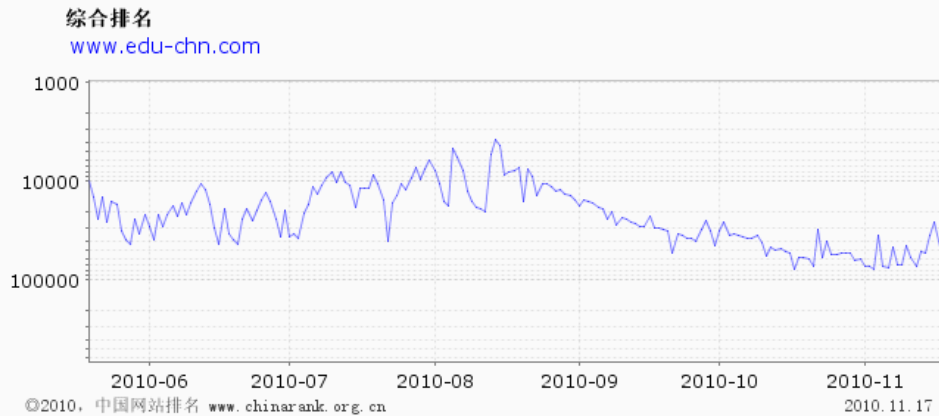
## Website Traffic

A variety of online services monitor visitor traffic to websites and make that information available to the general public. We examined traffic reports from the most popular of these services, [Alexa.com](http://Alexa.com), as well as one of the most useful traffic information resources in China, [chinarank.org.cn](http://chinarank.org.cn).

Both sites demonstrated low traffic to CEU's websites. When we compared CEU websites to websites operated by DL and CEDU, we found **CEU generates a tiny fraction of its competitors' traffic, yet reports similar revenue**. This is another sign of fraud, consistent with our other findings.

The first screenshot we will show presents the Chinarank data on [www.edu-chn.com](http://www.edu-chn.com). Chinarank's page is in Chinese, but we have pasted below a screenshot of Google's English translation of the Chinarank results:

www.edu-chn.com Website Ranking Half year t Latest Hot Report

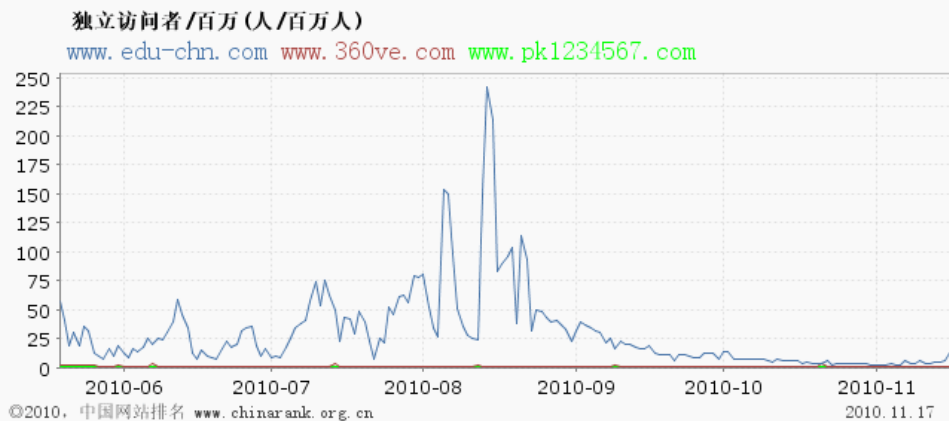


	Current	Average week	March Average
Ranking	45860	48825	38519
Unique visitors (people / million)	5	6	15
Average page views (pages / person)	1.5	1.2	1.5

We see that data exists for [edu-chn.com](http://edu-chn.com). We can also compare unique visitor data for this website to other CEU sites:

www.edu-chn.com Competitive Analysis

Ranking	Unique visitors (people / million)	Page views per	Range: week   January   March   June
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Comparison sites: www.edu-chn.com VS

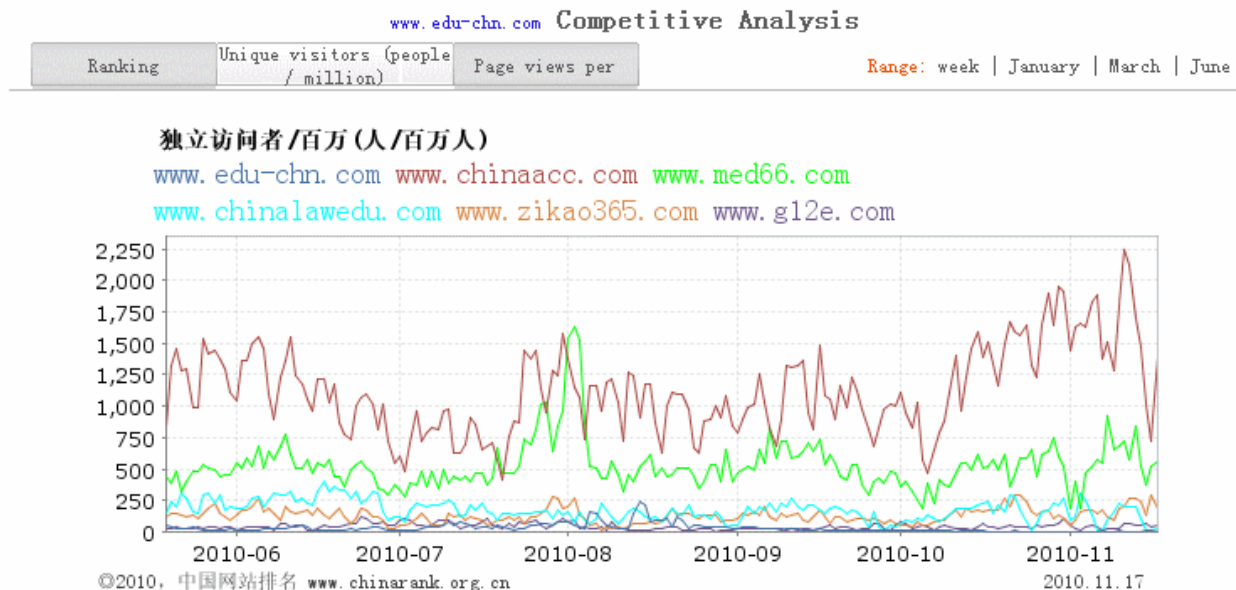
www.360ve.com VS www.pk1234567.com VS VS VS Submitted

Website	Current	7 Average	Average of 90 days
www.edu-chn.com	5	6	15
www.360ve.com	1	1	1
www.pk1234567.com	1	1	1



What we see above is that [edu-chn.com](http://edu-chn.com) is either the only site that receives traffic or the only site for which data exists. This is not encouraging. While management claims that [edu-chn.com](http://edu-chn.com) is the main web property, we would expect to see some traffic from the others.

Next, we can compare [edu-chn.com](http://edu-chn.com) to some of the sites run by competitors. We'll start with those for China Distance Education Holdings (DL):



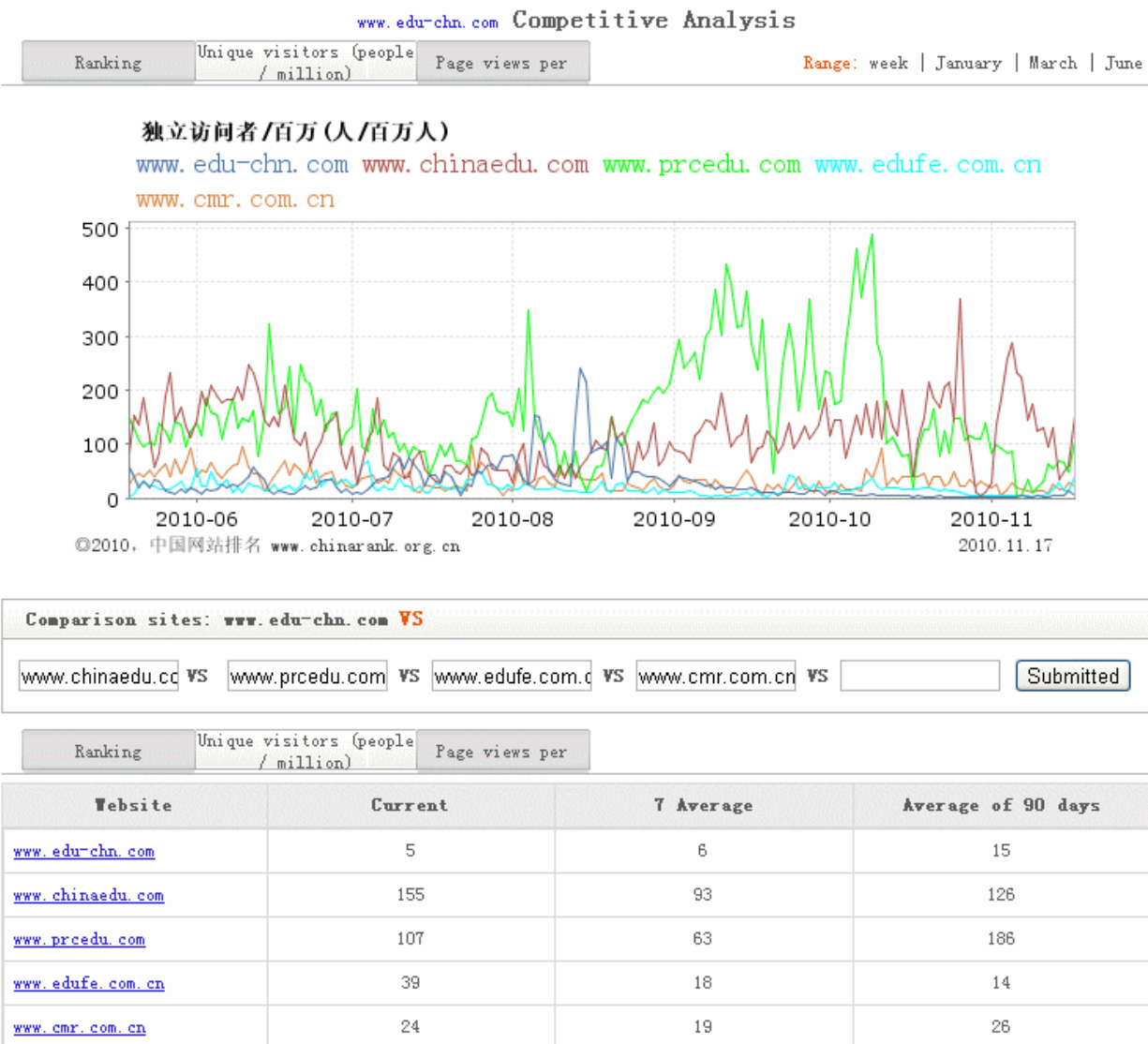
Comparison sites: www.edu-chn.com VS

http://www.chinaacc.com VS http://www.med66.com VS http://www.chinalawedu.com VS http://www.zikao365.com VS http://www.g12e.com Submitted

Website	Current	7 Average	Average of 90 days
www.edu-chn.com	5	6	15
www.chinaacc.com	1394	1523	1207
www.med66.com	563	586	513
www.chinalawedu.com	20	106	146
www.zikao365.com	187	224	137
www.g12e.com	53	55	35

Now things get interesting. In the above graph, we see [edu-chn.com](http://edu-chn.com) in dark blue, barely even registering on the chart. If we added all of the DL web properties together, the comparison would be even more appalling. **For reference, according to SEC filings, DL generated \$35 million of revenue in the last twelve months compared to \$44 million for CEU, despite CEU's websites generating less than one one-hundredth the traffic of DL's websites.** Based on these charts, we cannot understand how this is possible.

CEU compares similarly to the multiple web properties owned by ChinaEdu Corporation (CEDU):



Again, edu-chn.com is in dark blue, and it's barely perceptible along the bottom of the chart. CEDU generated \$58 million of revenue in the last twelve months.

Data offered by Alexa is no better than that offered by [chinarank.org.cn](http://chinarank.org.cn). While the data is different, the picture it paints is equally damning. For starters, we'll look at the data provided by Alexa for the three main CEU websites. Again, we see that only [edu-chn.com](http://edu-chn.com) generates any meaningful volume.

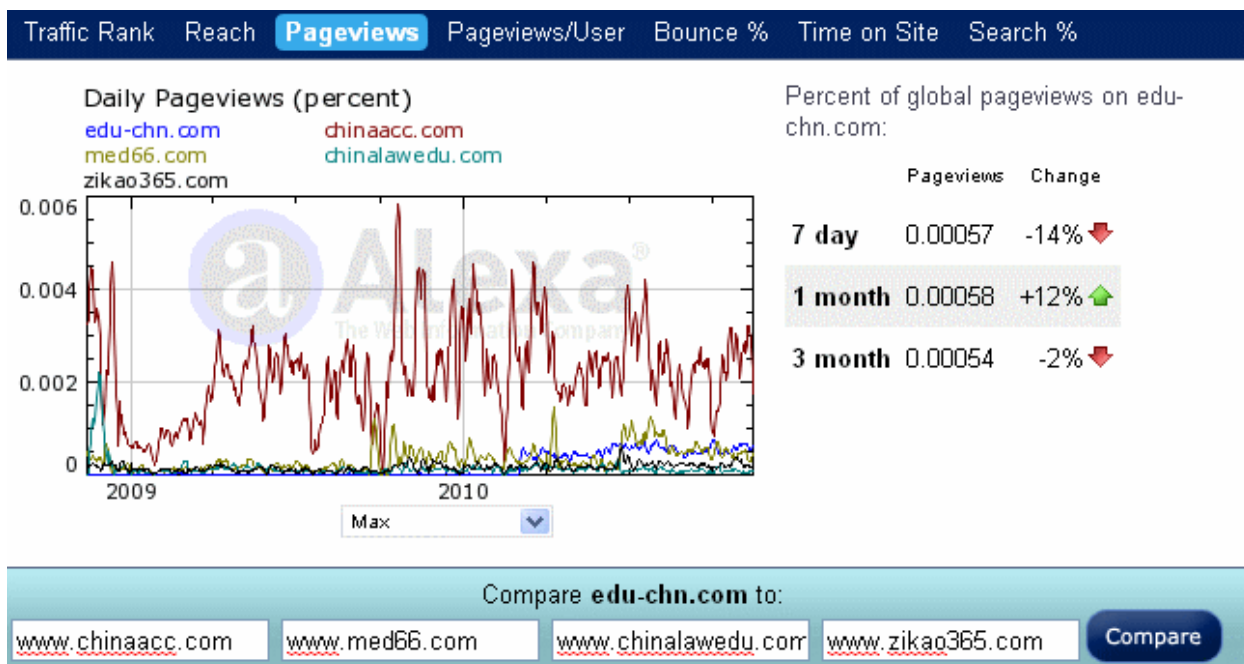




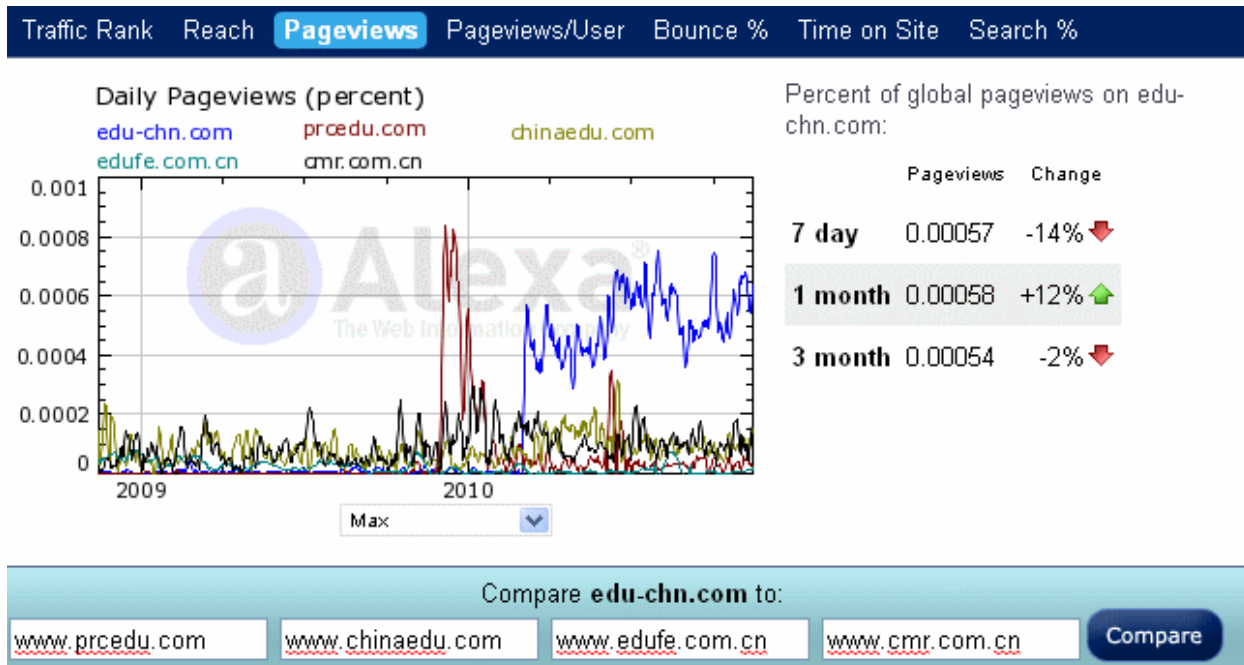
[Pk1234567.com](http://Pk1234567.com) and [360ve.com](http://360ve.com) hardly register on the chart. Also surprising is the growth pattern of [edu-chn.com](http://edu-chn.com). In the chart, we see a large jump in traffic in the first quarter of 2010. Yet [edu-chn.com](http://edu-chn.com) was supposedly operational well before 2010. Alexa data is frequently criticized for being easily manipulated. If one believes that Alexa data is easily manipulated, this looks like an egregious example of it. It's not as if [edu-chn.com](http://edu-chn.com) had been unranked prior to 2010, and then appeared on the chart because it was newly recognized by the database. We can see blips on the "Daily Pageviews" chart throughout 2009. Its 2009 traffic was clearly being recorded by Alexa.

We would not be surprised if CEU management began employing data manipulation practices in early 2010 after investors began inquiring about CEU's suspiciously low web traffic figures.

Despite potential manipulation, [edu-chn.com](http://edu-chn.com) again looks like a 2<sup>nd</sup> tier property when compared to DL. The chart below demonstrates that CEU is generating far less traffic than the combined DL web properties:



The [edu-chn.com](http://edu-chn.com) website compares more favorably against CEDU's websites in periods after the first quarter of 2010. But again, we believe that the company's Alexa traffic for 2010 has been artificially inflated through various traffic-inflation methods. In prior periods, CEU's website shows far less traffic than CEDU's sites.



## The Training Facility

The Heilongjiang Zhonghe Education Training Center is located at Building 39, High & New Technology Developing Zone, Sidao Street, Qianshan Road, Nangang District, Harbin, Postcode: 150080. This information can be found in [exhibit 10.4 in the 10KSB filed in 2006](#).

The company has not moved its location since 2006. Here is disclosure from its [2006](#), [2007](#), [2008](#) and [2009](#) 10Ks about the training center. As we can see, the company has described the training center as having “17 modern classrooms that has a capacity for 1,200 students” since its inception, and refers to it by the name “Heilongjiang Zhonghe Education Training Center”. Throughout SEC filings and in MD&A, the company consistently refers to a single training center that began operations in 2006.

According to documents filed with the SEC, in 2009 this 36,600 square foot facility generated \$12.1 million of revenue at a 78.8% gross margin. Management, however, has claimed in conferences that this facility is only responsible for approximately 60% of segment revenue, with the other 40% coming from smaller satellite facilities. These claims conflict with disclosures in SEC filings, but even if we assume that only 60% of the segment’s revenue comes from the Heilongjiang Zhonghe Education Training Center, that’s gross income of \$156 per square foot. Average rent for Class A office space in Manhattan is \$71 per square foot per year. This amazing profitability is something we needed to understand better, so we hired an investigator to visit the school. We found that if CEU is able to generate \$156 per square foot, they apparently don’t even need furniture to do it.

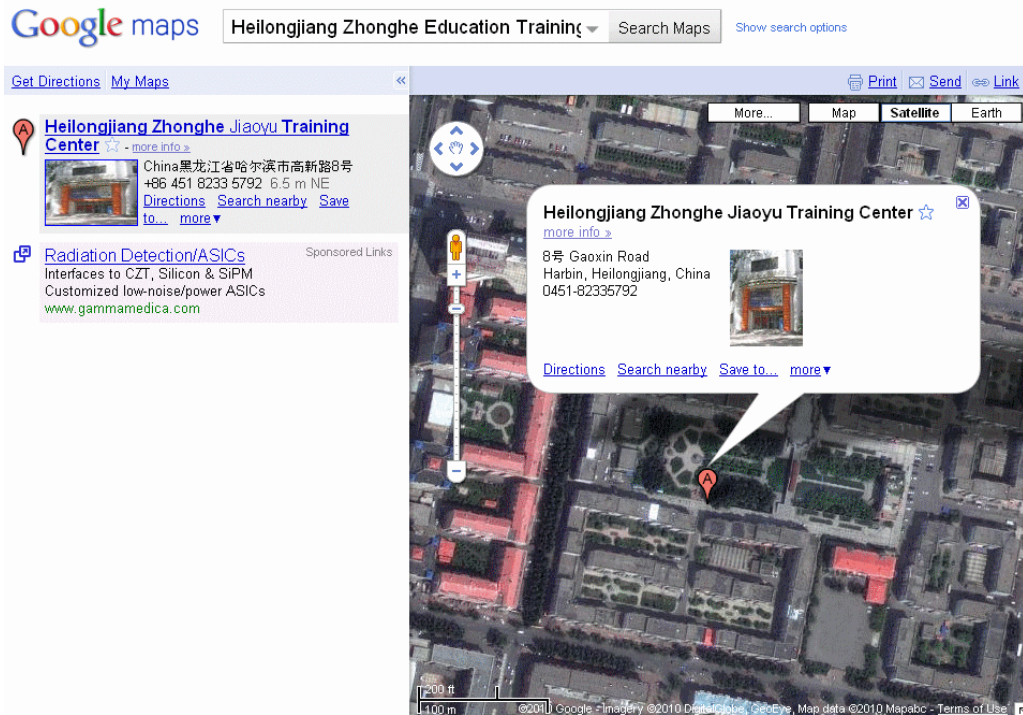
Our investigator took more than 45 photos, as well as video footage. ***What we found was a vacant, unfurnished building, with little sign of use.*** We have created a video that features our investigator’s photos and video footage, as well as general evidence for why the company’s training center is a façade.

[Click here for our video on the training facility](#)

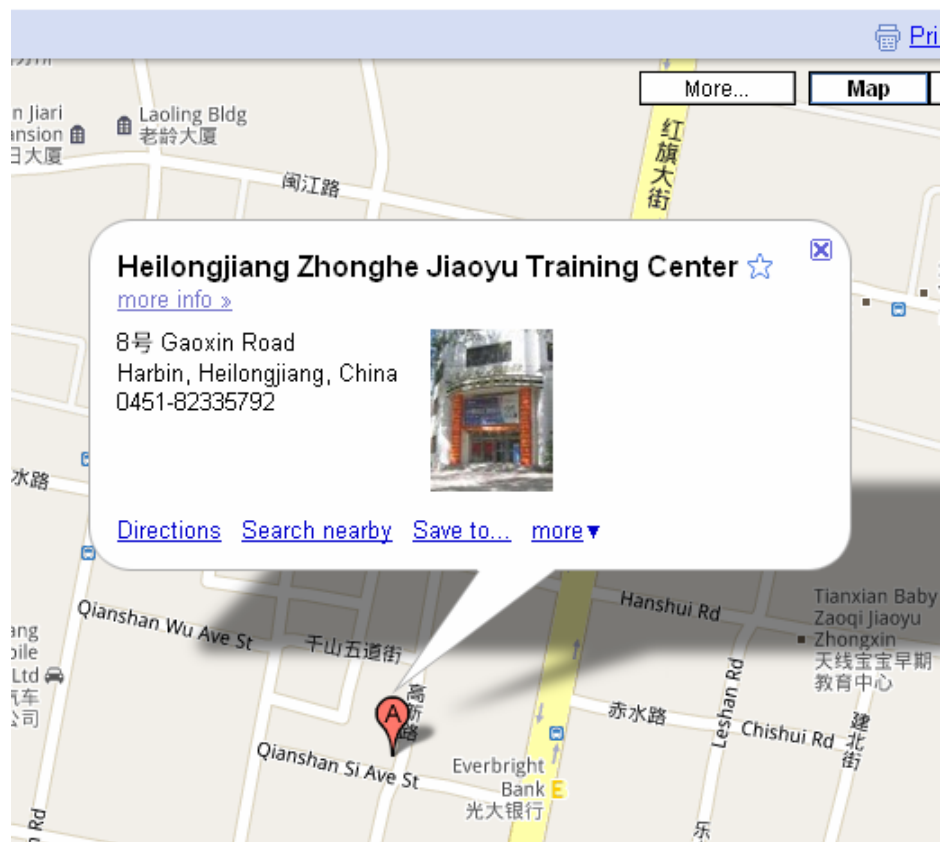
The building is located inside an industrial park in Harbin. We have listed the English address above, and when translated into Chinese, it’s:

哈尔滨，南岗区，千山路，四道街，高新技术开发区，39号楼，邮政编码150080

A [Google Maps search](#) for “Heilongjiang Zhonghe Education Training Center” directs us to the page shown below:



The above location is from Google Satellite. Here is a Google Maps depiction showing the relevant cross streets of the training center.



As we can see, the location of the listed center is on Qianshan Road, matching what the company reported in its SEC filings. Note that Google Maps is providing the specific address of the building, while the SEC disclosure referred to the building's location within the industrial park.

Below is an enlarged picture of the building's front in Google Maps, which matches pictures taken by our investigator (but which was clearly taken at a different time):





Compare this to the building front taken by our investigator:



It is the same building. We're confident that we have the correct location, and would welcome the company to provide us another "Building 39, High & New Technology Developing Zone, Sidao Street, Qianshan Road, Nangang District, Harbin, Postcode 150080".



Here is an on-site map of the High & New Technology Developing Zone:



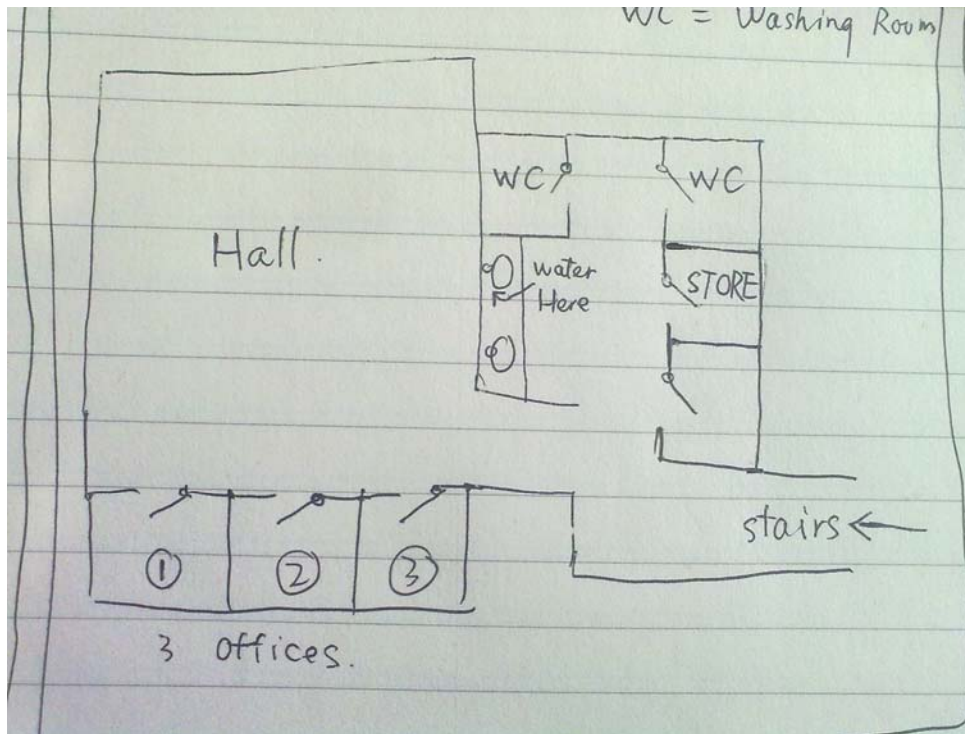
The title of the map is 哈尔滨高新区南岗集中区平面图, which translates to “Layout of High & New Technology Developing Zone, Nangang District, Harbin”. We have circled building #39.

Here is a closeup of the address:



The address sign says: 哈高新开发区, 39号楼. In English, that translates to “Harbin High & New Technology Zone, Building No. 39”.

The building appears to be six stories, based on views of the building from the outside. The floor plans are similar for all the floors, and this is our investigator’s rendition of the layout for each floor.



Some of the space is occupied by offices, though most of the space is completely empty. In our [video](#), you can see just how empty the building is. Our full set of pictures is available on Flickr at this [link](#).

Floor 1:



Floor 2:





Floor 3:



Floor 4:



Floor 5:



Floor 6:



As our pictures and video demonstrate, the Heilongjiang Zhonghe Education Training Center is an empty, unfurnished and unused building. The company has not made any disclosures that it has moved into a new facility, and its most recent quarterly report implies that the training center is fully operating. In conferences and investor discussions, the chief financial officer has stated that the training center remains at the same location as the one originally set up in 2005. He has said that it is highly profitable and operating at full capacity. We believe this to be false.

## Financial Comparison

Given the faulty website and the empty training facility, it remains impossible for us to understand how this business generates the same revenue, better margins, and higher earnings than its competitors with functional websites, national scopes, and utilized training facilities. We compared CEU to DL, CEDU, and ChinaCast Education Corporation (CAST). We chose not to look at New Oriental Education & Technology Group (EDU) because we believe it is a fundamentally different business with a larger scale, but we do note that it has much lower margins than CEU. We also include the numbers for the Princeton Review (REVU), a popular US test-prep company with which US investors should be familiar. Its use as a comparison company may be limited, but we will let readers weigh the evidence on their own.

We'll start by showing readers the numbers as of June 30, 2010, and then we'll discuss some of the differences between CEU and its competitors.

*(units: \$US in millions)*

Company	CEU	DL	CEDU	CAST	REVU
<b>Revenue</b>	\$ 40.1	\$ 33.6	\$ 54.7	\$ 60.7	\$ 186.6
<b>Gross Margin</b>	82.0%	53.1%	62.7%	54.5%	62.8%
<b>EBIT Margin</b>	44.1%	4.4%	23.6%	36.8%	-13.3%

CEU – Manages the websites discussed above, with a supposed regional focus in Harbin, the greater Heilongjiang area, and the surrounding provinces. The distribution of online materials accounted for \$22 million of revenue in 2009 at a 79% gross margin. A 36,600 square foot facility with 17 classrooms also contributed \$12 million of revenue at a 79% gross margin.

DL – Manages a total of 14 websites “each dedicated to a specific industry, profession, or subject area, and accessible from our portal website”. In 2009, DL reported 1,071,000 enrollments. This compares to the 600,000 students CEU reportedly served as per its August 2010 investor presentation. Online education courses accounted for 74.0% of revenues in 2009, with the rest coming from the sales of books and reference materials and, to a lesser extent, offline courses.

CEDU – Manages online degree programs (80% of revenue), online tutoring (6%), private schools (9%), and an international curriculum (5%). The business model revolves around partnering with universities to provide online degrees, recruitment services, and student services. The online tutoring program for K-12 students is proclaimed to be China's largest, with 500 branches in 30 provinces, but only 50,000 paying students. The private schools include two completed facilities enrolling a combined 4,900 students. Given that CEDU's private schools generate revenue of \$4.9 million, it is difficult to understand how the Harbin training facility with 17 classrooms run by CEU could generate \$12.1 million. This is particularly the case in light of our visit to the training facility, which was barren of desks and furniture.



CAST – A post-secondary education company managing three private universities with 30,000 students and 6.5 million square feet of space generating \$32 million of revenue. It also provides e-learning services to 141,000 students, a teacher training program, and a vocational network generating \$29 million of revenue.

REVV – Most U.S. citizens are likely familiar with the Princeton Review. REVV also owns Penn Foster which provides online degree, diploma, and certificate programs to 207,000 students in vocational, college, and high school programs. The traditional Princeton Review is only responsible for \$111 million of revenue. Knowing how popular these courses are in the U.S., and knowing how much they cost, we have a lot of trouble believing that a non-functional K-12 website targeting students in a handful of Chinese provinces could generate \$22 million. We also have trouble believing the growth numbers.

## The AIC Filings

CEU's locally filed financial statements in China do not match its SEC financial statements. These local financial statements, which CEU must file with the Harbin branch of the Administration for Industry and Commerce ("AIC"), show that the online business generated revenue of less than \$1 million in 2008. This corroborates our belief that CEU is mostly a hoax. We believe that the company is providing accurate financial statements to its own government, but is providing fraudulent numbers to U.S. investors and the U.S. Securities and Exchange Commission. 2008 was the most recent year for which we could access filings, as of our last inquiry on November 15.

Below are photocopies of the company's AIC filings for 2008, 2007 and 2006 for CEU's main operational subsidiary, Harbin Zhong He Li Da Education Technology, Inc. We provide filings in their original Chinese, as well as English translations of those filings.

AIC Reports:

[2008 AIC Filings in Original Chinese](#)  
[2008 AIC Filings in English Translation](#)  
[2007 AIC Filings in Original Chinese](#)  
[2007 AIC Filings in English Translation](#)  
[2006 AIC Filings in Original Chinese](#)  
[2006 AIC Filings in English Translation](#)

For those new to the U.S.-listed Chinese reverse merger space, all Chinese companies are required to file financial statements with the Chinese government. Specifically, they must file financial statements with their local branch of the State Administration for Industry and Commerce ("SAIC"). The SAIC is the Chinese government body that regulates industry and commerce in China. Its provisions are executed by local county branches.

Information filed with AIC branches includes organizational bylaws/minutes; capital infusion/withdrawal data; the approved business description; information on business licenses; land use rights; property leases; applications to form companies, with personal information on the applying shareholders; the legal representatives; tax data; and annual financial statements.

Below, we have pasted the organizational structure for CEU as of 12-31-09. The same organizational structure can be found in the company's 2009 10K [here](#), and we have rearranged it so it can be legibly shown below in our report.



Chinese GAAP does not consolidate subsidiaries, and it is therefore important for us to explain why we only use the AIC filings of Harbin Zhong He Li Da Education Technology, Inc. (“ZHLD”) to demonstrate that the company’s AIC filings show a business far smaller than what SEC financials indicate.

Harbin Zhong He Li Da Education Technology, Inc. generates more than 65% of CEU’s revenue and gross profit according to SEC filings. The Heilongjiang Zhonghe Education Training Center generates 30% of revenue and gross profit according to SEC filings. The remaining subsidiaries generate minimal revenue and can be ignored. We provide reasons below:

<b><u>Name of Subsidiaries</u></b>	<b><u>Rationale for Why Subsidiar(ies) Are Not Material</u></b>
<i>World Exchange Inc. and Beijing Wei Shi Yi Tong Education Technology Co. Inc.</i>	These two subsidiaries have not been consolidated into 2009 SEC financial statements because the acquisition was cancelled on September 20, 2010 and 400,000 shares were returned to CEU for cancellation.
<i>Beijing Hua Yu Hui Zhong Technology Development Co., Ltd (BHYHZ).</i>	Formed on September 30, 2006 and then transferred in part (30%) to the National Vocational Education Association of China for no consideration. It provides information regarding vocation training schools. The language in SEC filings describing this segment implies that it is not yet fully established – the company says that “we are in the process of introducing new services...” and “the core business for our vocation education will be in three main areas...”
<i>Harbin New Discovery Media Co.</i>	This is a joint venture entered into with the Harbin Daily Newspaper Group on April 18, 2008, in which ZHLD contributed \$430k and the newspaper group contributed \$445k. This segment publishes a scientific newspaper. It's likely too small to generate meaningful revenue for CEU.
<i>Zhong He Li Da (Beijing) Management Consultant Co., Ltd.</i>	This is a joint venture entered into with Mr. Guang Li on January 4, 2009, in which ZHLD contributed \$62,107 and Li contributed \$10,960. According to SEC filings, this subsidiary “will be involved in the vocational training business, [and] in particular, in running the ‘Million Managers Training Program’.” It's likely not yet a material revenue contributor.
<i>Beijing New Shifan Education &amp; Technology</i>	Incorporated in February 2010, this subsidiary acquired assets of another company for RMB 6 million (approx. \$900k). It publishes a magazine and manages a nationwide contest.

Interestingly, the only website which we found to be reasonably functional, [www.360ve.com](http://www.360ve.com), is admittedly not generating any earnings.

We can conclude that the main revenue-generating subsidiaries are (i) Harbin Zhong He Li Da Education Technology, Inc. and (ii) Heilongjiang Zhonghe Education Training Center. The training center presumably generates the training center-related revenue and profit, while Harbin Zhong He Li Da Education Technology, Inc. generates the remaining revenue and profit.

According to [SEC filings](#), the “Online Education” segment generated \$22.2 million at 79.4% gross margins; “Training Center” generated \$12.1 million of revenue in 2009 at 78.8% gross margins; and “Advertising Revenue” accounted for \$2.6 million at 92.0% gross margins. For 2008, “Online Education” generated \$16.7 million at 82.9% gross margins; “Training Center” generated \$5.6 million of revenue at 65.4% gross margins; and “Advertising Revenue” accounted for \$2.6 million at 93.0% gross margins.

Therefore, we should expect the 2008 AIC filings of Harbin Zhong He Li Da Education Technology, Inc. to show at least \$16 million of revenue and \$13 million of gross profit.

What we find is quite different. We have provided the original and translated AIC filings at the beginning of this section. A comparison of SEC and AIC financial figures is below:

<b><u>A Comparison of SEC and SAIC Filings for China Education Alliance</u></b>			
<i>(Units are in dollars, using average annual RMB/USD exchange rates)</i>			
<b>From SEC Filings</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Revenue (excluding training center)	\$6,620,519	\$13,623,707	\$19,298,048
Gross Profit (excluding training center)	\$4,854,077	\$11,229,762	\$16,255,950
Total Revenue	\$8,324,473	\$17,323,534	\$24,851,017
Total Gross Profit	\$5,760,583	\$13,782,225	\$19,886,078
Total Net Income	\$2,624,660	\$3,104,907	\$9,918,536
Total Assets	\$9,277,646	\$20,310,653	\$35,741,915
<b>From AIC Filings</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Revenue	\$54,500	\$23,598	\$612,869
Gross Profit	-\$7,959	-\$106,712	\$495,235
Income from Operations	-\$107,131	-\$423,788	-\$69,010
Net Income	-\$144,572	-\$415,926	\$17,340
Total Assets	\$1,447,938	\$2,256,720	\$4,038,409

We believe that the AIC filings, which represent the financial information that management submits annually to its own government, demonstrate the real revenue at the main operational subsidiary of China Education Alliance. This real revenue for 2008 was less than \$1 million.

## Interest Income

As distorted as the income statement is, the balance sheet is just as bad. It presents another red flag that emerges in many fraudulent U.S.-listed Chinese companies. Despite large purported cash balances, frauds routinely report miniscule interest income. From December 31, 2009 to June 30, 2010, CEU grew its cash balance from \$65 million to \$76 million. However, over the same six month period, CEU only generated interest income of \$97,535. Annualized, that's interest income of only 0.28%. Over the 12 months ended June 30, 2010, CEU had an average cash balance of \$53 million, from which the company earned just \$180,000, or 0.34%.

We are faced with two scenarios: management either eagerly diluted shareholders only to hold the newly raised cash in non-interest bearing accounts, or is fabricating the \$76 million balance. We're confident that the second scenario is true. The \$76 million of cash reported in the company's SEC filings is fiction.

Comparing the CEU cash yield to comparable companies' makes the problem a little more obvious:

Company	CEU	DL	CEDU	CAST	REU
Cash & Equivalents	\$ 74.7	\$ 46.8	\$ 49.1	\$ 156.9	\$ 12.1
Interest Yield	0.2%	0.9%	1.4%	0.9%	0.1%

In the table above, we used the cash balance as of June 30, 2010 and the interest income during the twelve months ended June 30, 2010.

## Low Quality Auditors & High Auditor / CFO Turnover

Low quality auditors and high auditor turnover are telltale signs of trouble. Repeated changes in auditors should be looked at with suspicion, especially considering all of the other red flags that we have identified in this report.

Here is a chart documenting the company's history of auditors:

Date	Name	Comments
2009-Present:	Sherb & Co.	Last PCAOB audit was in 2007 and showed 6 partners, 17 staff members, and 73 issuer clients
2006-2008:	Murrell, Hall, McIntosh & Co.	Last PCAOB audit was in 2006 and showed 9 partners, 45 staff members, and 16 issuer clients
2005:	e-Fang Accountancy Corp.	Last PCAOB audit was in 2010 and showed 2 partners, 3 staff members, and no issuer clients
2004:	Jimmy C.H. Cheung & Co.	Last PCAOB audit was in 2009 and showed 1 partner, 26 staff members, and 8 issuer clients

None of the above auditors are considered [top 100 accounting firms](#), and all are small, non-reputable firms. CEU's longest auditor relationship lasted 3 years. Why would management need a new accounting firm of subpar quality every few years?

Below is a table outlining the company's history of chief financial officers:

Date	Name	Comments
August 2009 - Present.	Zibing Pan	Previous experience as audit manager at EideBaily. Pan is a CPA and has an MBA from the University of Central Oklahoma.
June 2008 - August 2009:	Susan Liu	Previous experience as CFO at Entech Environmental (now SkyPeople Fruit Juice, trades at 5x earnings) for less than a year and Hendrx Corp (shares traded over \$5 in 2005, now at less than \$0.01) for less than a year.
2004 - June 2008:	Chunqing Wang	Served as CFO of Harbin Tian Run Group from 1990 through 2004. Was previously a planning department head at the Harbin Bureau of Finance. Graduate in industrial accounting from the Harbin College of Economic Carde Management.

The qualifications of the current and past chief financial officers do not give investors any further comfort. Another troubling sign is the turnover subsequent to 2008, when the first non-Harbin, or outsider, chief financial officer was hired.

## Stock Offering

Fraudsters don't perpetuate a fraud for fun – they keep the machine running to steal cash in share offerings. This is how frauds make money. At the end of 2008, CEU supposedly had \$23 million of cash on its balance sheet. Despite generating \$15 million of net income and \$19 million operating cash flow in 2009, the company decided to raise an additional \$18 million by issuing new shares and an additional \$6 million from exercising warrants. The commitment was made on September 29, 2009, to sell 3,162,055 shares at \$5.50 per share. The Company received \$5.17 per share, after underwriting fees. Compared to earnings per share of \$0.63 in 2009, this represented a P/E of 8.2x. The transaction increased the basic share count by 11.7%. On May 12, management stated "We expect 30 percent revenue growth for the full year 2010". This means management raised capital via a secondary offering at a forward 2010 earnings multiple of 6.3x earnings.

Selling shares could be reasonable if management needed the cash to profitably grow the business. But they have neither utilized this capital nor explained how they will do so. The newly raised cash sits in a bank (supposedly), earning minimal interest. As of today, less than \$1 million has been spent on a single acquisition, and \$3 million has been allocated for 6 new learning centers in Beijing.



The icing on the cake is that on October 27, 2010, CEU [released an amendment](#) to its annual report. One of the key changes was made to the “Liquidity and Capital Resources” section, which has been changed to read as follows (emphasis added):

During the next five years, we may incur substantial expenditure for acquisitions and the setup of new schools and training centers in new markets. During this five year expansion period we may require additional funding for the expansion purpose. At this time we are unable to accurately project the funding needs beyond the next twelve months since long-term needs depend on the availability and the scale of acquisitions we might make. The anticipated cost for the future expansion may also associate with the development of a nation-wide advertising campaign, which is estimated to be approximately additional 5% of our total revenue. **If additional funds are needed in the future we anticipate obtaining such funds through the sale of equity.**

To repeat: this is how frauds steal money from foreign investors and this is why management continues to perpetuate the fraud.

## Promotion Sickness

As a final point, we would like to highlight CEU's aggressive marketing campaign in 2010, as disclosed by press releases from the company denoting conferences that CEU has attended in the past year. This is not evidence for fraud, but worth looking at for anyone who is interested in understanding how these frauds operate. Since the start of 2010, CEU has participated in the following conferences:

- [November 2010](#) – New York - Brean Murray, Carret & Co. 2010 China Growth Conference
- [September 2010](#) – New York - Rodman & Renshaw Annual Investment Conference
- [July 2010](#) – San Francisco - Global Hunter Securities China Conference
- [May 2010](#) – New York - Piper Jaffray China Growth Conference
- [April 2010](#) – RedChip Small-Cap Equities Virtual Conference
- [March 2010](#) – California - 22<sup>nd</sup> Annual OC Growth Stock Conference
- [March 2010](#) – Beijing - Rodman & Renshaw China Investment Conference
- [January 2010](#) – New York - Cowen & Company 8<sup>th</sup> Annual Consumer Conference

With a tour like this, there can be little doubt that management is doing all they can to “get the story out”. Any institutional asset manager, hedge fund, or investor interested in this space has undoubtedly been exposed to CEU. Yet the stock still trades at less than 10x earnings. It is no coincidence that many institutional investors have decided against investing in CEU's stock. They merely need to hire a Chinese speaker for one hour to investigate the company's website in order to recognize that the company is a fraud.

## Conclusion

It is difficult to believe that this company is valued at \$150 million. It is an even sadder state of affairs that the company is listed on the New York Stock Exchange. There are dozens of red flags, any one of which should scare investors away. To recap, here are glaring issues:

- 1) The company's main revenue-generating website does not have a functioning payment system. Its online and mobile payment methods lead to error screens. One cannot purchase their products by calling them over the phone. Our investigators could not find their learning cards at any Harbin bookstores, despite visiting 15 locations.
- 2) The company's sites feature a multitude of error screens, broken links, faulty HTML, irrelevant content and outdated material.
- 3) The website receives minimal traffic. Data sources show either little volume or suspicious traffic growth, or both.
- 4) Comparable online education websites in China have properly functioning payment systems, no broken links, and a cleaner and more intuitive layout. Yet investors are to believe that CEU's faulty website with a geographic scope limited to Harbin is generating the same revenue and better margins than functioning websites with a national scope.
- 5) The training facility is supposedly generating outsize profits and margins, despite the fact that it is empty and unfurnished.
- 6) AIC financial statements filed in China for the online business (ie. excluding the training center segment) showed revenue of less than \$1 million in 2008. We believe that companies report accurate financial figures to their own government, whereas they report fabricated financial figures to the U.S. government and U.S. investors.
- 7) The company generates suspiciously low interest income off of its ostensibly large cash balance. We believe that most of this cash does not exist.
- 8) The company has had 4 low-quality auditors in the past 6 years. In contrast, the comparable Chinese education providers DL, CEDU and CAST all have top-4 auditors.
- 9) The company raised cash at a discount to its stock price at the time of its equity offering and has done nothing with that cash. It already supposedly had \$38 million of cash on its balance sheet prior to its unnecessary capital raise.