Cole Credit Property Trust II Inc
Form 10-Q
November 14, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from __________ to __________

Commission file number 000-51963

COLE CREDIT PROPERTY TRUST II, INC.

(Exact name of registrant as specified in its charter)

Maryland	**20-1676382**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*
2555 East Camelback Road, Suite 400 **Phoenix, Arizona, 85016**	**(602) 778-8700**
(Address of principal executive offices; zip code)	*(Registrant s telephone number, including area code)*

Not Applicable

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

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

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 þ No o

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ	Smaller reporting company o
		(Do not check if smaller reporting company)	

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

As of November 14, 2011, there were 209,634,299 shares of common stock, par value $0.01, of Cole Credit Property Trust II, Inc. outstanding.

COLE CREDIT PROPERTY TRUST II, INC.
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PART I
FINANCIAL INFORMATION

The accompanying condensed consolidated unaudited interim financial statements as of and for the three and nine months ended September 30, 2011 have been prepared by Cole Credit Property Trust II, Inc. (the Company, we, us or our) pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements, and should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The financial statements herein should also be read in conjunction with the notes to the financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in this Quarterly Report on Form 10-Q. The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the operating results expected for the full year. The information furnished in our accompanying condensed consolidated unaudited balance sheets and condensed consolidated unaudited statements of operations, stockholders equity, and cash flows reflects all adjustments that are, in our opinion, necessary for a fair presentation of the aforementioned financial statements. Such adjustments are of a normal recurring nature.

Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. We caution readers not to place undue reliance on forward-looking statements, which reflect our management s view only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results. The forward-looking statements should be read in light of the risk factors identified in the Item 1A Risk Factors section of the Company s Annual Report on Form 10-K.

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED BALANCE SHEETS
(in thousands except share and per share amounts)

	September 30, 2011	December 31, 2010
ASSETS		
Investment in real estate assets:		
Land	$ 860,950	$ 833,833
Buildings and improvements, less accumulated depreciation of $223,552 and $178,906, respectively	1,966,924	1,943,307
Real estate assets under direct financing leases, less unearned income of $13,827 and $15,284, respectively	36,236	36,946
Acquired intangible lease assets, less accumulated amortization of $120,493 and $97,387, respectively	330,008	340,606
Total investment in real estate assets, net	3,194,118	3,154,692
Investment in mortgage notes receivable, net	77,529	79,778
Total investment in real estate and mortgage assets, net	3,271,647	3,234,470
Cash and cash equivalents	54,584	45,791
Restricted cash	11,245	8,345
Marketable securities pledged as collateral		81,995
Investment in unconsolidated joint ventures	22,683	38,324
Rents and tenant receivables, less allowance for doubtful accounts of $429 and $646, respectively	53,111	45,616
Prepaid expenses and other assets	3,359	3,866
Deferred financing costs, less accumulated amortization of $16,310 and $13,599, respectively	24,427	26,928
Total assets	$ 3,441,056	$ 3,485,335
LIABILITIES AND STOCKHOLDERS EQUITY		
Notes payable and line of credit	$ 1,750,417	$ 1,673,243
Repurchase agreement		54,312
Accounts payable and accrued expenses	20,053	15,597
Due to affiliates	2,391	1,496
Acquired below market lease intangibles, less accumulated amortization of $40,138 and $32,095, respectively	133,378	140,797
Distributions payable	10,782	11,097
Deferred rental income, derivative and other liabilities	15,505	16,181
Total liabilities	1,932,526	1,912,723
Commitments and contingencies		
Redeemable common stock	14,474	12,237
STOCKHOLDERS EQUITY:		

Preferred stock, $0.01 par value; 10,000,000 shares authorized, none issued and outstanding				
Common stock, $0.01 par value; 240,000,000 shares authorized, 210,110,006 and 209,317,346 shares issued and outstanding, respectively		2,101		2,093
Capital in excess of par value		1,882,431		1,878,118
Accumulated distributions in excess of earnings		(385,899)		(332,547)
Accumulated other comprehensive (loss) income		(4,577)		12,711
Total stockholders equity		1,494,056		1,560,375
Total liabilities and stockholders equity	$	3,441,056	$	3,485,335

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

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF OPERATIONS
(in thousands except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Revenues:				
Rental and other property income	$ 63,613	$ 59,304	$ 187,449	$ 178,257
Tenant reimbursement income	3,568	3,590	12,261	10,716
Earned income from direct financing leases	486	498	1,457	1,569
Interest income on mortgage notes receivable	1,604	1,664	4,836	5,011
Interest income on marketable securities		1,928	2,459	5,721
Total revenue	69,271	66,984	208,462	201,274
Expenses:				
General and administrative expenses	2,237	1,740	6,180	5,633
Property operating expenses	5,346	5,233	16,813	15,497
Property and asset management expenses	4,238	3,970	12,700	12,347
Acquisition related expenses	382	1,226	2,700	1,851
Depreciation	15,077	14,131	44,646	42,175
Amortization	6,989	6,599	21,463	21,655
Impairment of real estate assets				4,500
Total operating expenses	34,269	32,899	104,502	103,658
Operating income	35,002	34,085	103,960	97,616
Other income (expense):				
Equity in income of unconsolidated joint ventures and other income	36	85	572	171
Gain on sale of marketable securities			15,587	
Gain on sale of unconsolidated joint venture interests	5,111		5,111	
Interest expense	(27,197)	(25,783)	(80,616)	(76,633)
Total other expense	(22,050)	(25,698)	(59,346)	(76,462)
Net income	$ 12,952	$ 8,387	$ 44,614	$ 21,154
Weighted average number of common shares outstanding:				
Basic	209,827,734	207,962,270	209,567,498	206,654,619

Diluted		209,827,734		207,962,270		209,567,498		206,655,254
Net income per common share:								
Basic and diluted	$	0.06	$	0.04	$	0.21	$	0.10
Distributions declared per common share	$	0.16	$	0.16	$	0.47	$	0.47

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

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED STATEMENT OF STOCKHOLDERS EQUITY
(in thousands, except share amounts)

	Common Stock Number of Shares	Par Value	Capital in Excess of Par Value	Accumulated Distributions in Excess of Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance, January 1, 2011	209,317,346	$ 2,093	$ 1,878,118	$ (332,547)	$ 12,711	$ 1,560,375
Issuance of common stock	5,408,465	54	44,885			44,939
Distributions to investors				(97,966)		(97,966)
Redemptions of common stock	(4,615,805)	(46)	(38,335)			(38,381)
Redeemable common stock			(2,237)			(2,237)
Comprehensive income:						
Net income				44,614		44,614
Unrealized loss on marketable securities					(1,713)	(1,713)
Reclassification of previous unrealized gain on marketable securities into net income					(14,654)	(14,654)
Unrealized loss on interest rate swaps					(921)	(921)
Total comprehensive income						27,326
Balance, September 30, 2011	210,110,006	$ 2,101	$ 1,882,431	$ (385,899)	$ (4,577)	$ 1,494,056

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

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net income	$ 44,614	$ 21,154
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	44,646	42,175
Amortization of intangible lease assets and below market lease intangibles, net	16,626	15,282
Amortization of deferred financing costs	5,106	5,050
Amortization of premiums on mortgage notes receivable	527	512
Accretion of discount on marketable securities	(846)	(1,900)
Amortization of fair value adjustments of mortgage notes payable assumed	1,397	1,370
Bad debt recovery	(73)	(106)
Stock compensation expense		7
Impairment of real estate assets		4,500
Equity in income of unconsolidated joint ventures	(407)	(74)
Return on investment from unconsolidated joint ventures	452	2,120
Property condemnation and easement gain	(92)	
Gain on sale of marketable securities	(15,587)	
Gain on sale of unconsolidated joint venture interests	(5,111)	
Changes in assets and liabilities:		
Rents and tenant receivables	(7,422)	(8,659)
Prepaid expenses and other assets	507	673
Accounts payable and accrued expenses	4,756	(504)
Due to affiliates, deferred rental income and other liabilities	(1,629)	(3,207)
Net cash provided by operating activities	87,464	78,393
Cash flows from investing activities:		
Investment in real estate and related assets and other capital expenditures	(109,175)	(69,853)
Proceeds from sale of marketable securities	82,061	
Proceeds from sale of unconsolidated joint venture interests	19,100	
Principal repayments from mortgage notes receivable and real estate assets under direct financing leases	2,432	2,061
Return of investment from unconsolidated joint ventures	1,989	
Refund of property escrow deposits	1,340	
Payment of property escrow deposits	(1,340)	
Proceeds from easement of real estate assets	247	5
Change in restricted cash	(2,900)	415
Net cash used in investing activities	(6,246)	(67,372)
Cash flows from financing activities:		

Redemptions of common stock	(38,381)	(11,350)
Distributions to investors	(53,342)	(50,479)
Offering costs on issuance of common stock		(2)
Proceeds from notes payable, line of credit and repurchase agreement	203,796	303,029
Repayment of notes payable, line of credit and repurchase agreement	(182,331)	(229,387)
Refund of loan deposits		2,145
Payment of loan deposits		(2,145)
Deferred financing costs paid	(2,167)	(2,561)
Net cash (used in) provided by financing activities	(72,425)	9,250
Net increase in cash and cash equivalents	8,793	20,271
Cash and cash equivalents, beginning of period	45,791	28,417
Cash and cash equivalents, end of period	$ 54,584	$ 48,688

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

COLE CREDIT PROPERTY TRUST II, INC.
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS
September 30, 2011

NOTE 1 ORGANIZATION AND BUSINESS

Cole Credit Property Trust II, Inc. (the Company) is a Maryland corporation formed on September 29, 2004, that has elected to be taxed, and currently qualifies, as a real estate investment trust (REIT) for federal income tax purposes. Substantially all of the Company s business is conducted through Cole Operating Partnership II, LP (Cole OP II), a Delaware limited partnership. The Company is the sole general partner of and owns a 99.99% partnership interest in Cole OP II. Cole REIT Advisors II, LLC (Cole Advisors II), the affiliate advisor to the Company, is the sole limited partner and owner of an insignificant non-controlling partnership interest of less than 0.01% of Cole OP II.

As of September 30, 2011, the Company owned 751 properties comprising 21.1 million rentable square feet of single and multi-tenant retail and commercial space located in 45 states and the U.S. Virgin Islands. As of September 30, 2011, the rentable space at these properties was 96% leased. As of September 30, 2011, the Company also owned 69 mortgage notes receivable secured by 43 restaurant properties and 26 single-tenant retail properties, each of which is subject to a net lease. Through an unconsolidated joint venture, the Company had a non-controlling majority interest in a 386,000 square foot multi-tenant retail building in Independence, Missouri as of September 30, 2011.

The Company ceased offering shares of common stock in its initial primary offering (the Initial Offering) on May 22, 2007, and ceased offering shares of common stock in its follow-on offering (the Follow-on Offering) on January 2, 2009. The Company continues to issue shares of common stock under its dividend reinvestment plan (the DRIP Offering , and collectively with the Initial Offering and the Follow-on Offering, the Offerings). As of September 30, 2011, the Company had issued approximately 223.5 million shares of common stock in its Offerings for aggregate gross proceeds of $2.2 billion (including proceeds from the issuance of shares pursuant to the DRIP Offering of $254.6 million), before share redemptions of $120.6 million. As of September 30, 2011, the Company had incurred an aggregate of $188.3 million in offering costs, selling commissions, and dealer manager fees in the Offerings.

The Company s stock is not currently listed on a national securities exchange. The Company may seek to list its common stock for trading on a national securities exchange only if a majority of its independent directors believes listing would be in the best interest of its stockholders. The Company disclosed in its prospectus a targeted liquidity event by May 22, 2017 and in the event it does not obtain listing prior to such date, its charter requires that it either (1) seek stockholder approval of an extension or elimination of this listing deadline; or (2) seek stockholder approval to adopt a plan of liquidation. If neither proposal is approved, the Company may continue to operate as before. On June 28, 2011, the Company disclosed that its sponsor, Cole Real Estate Investments, is actively exploring options to successfully exit the Company s portfolio within the next 12 months, and that the potential exit strategies it is evaluating include, but are not limited to, a sale of the portfolio or a listing of the portfolio on a public stock exchange. Such targeted date has not yet occurred, and the Company has not had a liquidity event.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

The condensed consolidated unaudited financial statements of the Company have been prepared in accordance with the rules and regulations of the SEC, including the instructions to Form 10-Q and Article 10 of Regulation S-X, and do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the statements for the interim periods presented include all adjustments, which are of a normal and recurring nature, necessary to present a fair presentation of the results for such periods. Results for these interim periods are not necessarily indicative of full year results. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company s audited consolidated financial statements as of and for the year ended December 31, 2010, and related notes thereto set forth in the Company s Annual Report on Form 10-K.

The accompanying condensed consolidated unaudited financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

The Company is required to continually evaluate its variable interest entity (VIE) relationships and consolidate investments in these entities when it is determined to be the primary beneficiary of their operations. A VIE is broadly defined as an entity where either (i) the equity investors as a group, if any, lack the power through voting or similar rights to direct the activities of an entity that most significantly impact the entity s economic performance or (ii) the equity investment at risk is insufficient to finance that entity s activities without additional subordinated financial support.

COLE CREDIT PROPERTY TRUST II, INC.
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
September 30, 2011

A variable interest holder is considered to be the primary beneficiary of a VIE if it has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and has the obligation to absorb losses of, or the right to receive benefits from, the entity that could potentially be significant to the VIE. The Company qualitatively assesses whether it is (or is not) the primary beneficiary of a VIE. Consideration of various factors include, but are not limited to, the Company s ability to direct the activities that most significantly impact the entity s economic performance, its form of ownership interest, its representation on the entity s governing body, the size and seniority of its investment, its ability and the rights of other investors to participate in policy making decisions and to replace the manager of and/or liquidate the entity.

The Company continually evaluates the need to consolidate joint ventures based on standards set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810, *Consolidation* (ASC 810). In determining whether the Company has a controlling interest in a joint venture and the requirement to consolidate the accounts of that entity, management considers factors such as ownership interest, power to make decisions and contractual and substantive participating rights of the partners/members as well as whether the entity is a variable interest entity for which the Company is the primary beneficiary.

Valuation of Real Estate and Related Assets

The Company continually monitors events and changes in circumstances that could indicate that the carrying amounts of its real estate and related intangible assets may not be recoverable. Impairment indicators that the Company considers include, but are not limited to, bankruptcy or other credit concerns of a property s major tenant, such as a history of late payments, rental concessions, and other factors, a significant decrease in a property s revenues due to lease terminations, vacancies, co-tenancy clauses, reduced lease rates or other circumstances. When indicators of impairment are present, the Company assesses the recoverability of the assets by determining whether the carrying value of the assets will be recovered through the undiscounted future operating cash flows expected from the Company s use of the assets and the eventual disposition of such assets. In the event that such expected undiscounted future cash flows do not exceed the carrying value, the Company will adjust the real estate and related intangible assets to their respective fair values and recognize an impairment loss.

The Company continues to monitor certain properties for which it has identified impairment indicators. As of September 30, 2011, the Company had seven properties with an aggregate book value of $54.1 million for which it had assessed the recoverability of the carrying values. For each of these properties, the undiscounted future operating cash flows expected from the use of these properties and their eventual disposition continued to exceed the carrying value of these assets and their related intangible assets as of September 30, 2011. Should the conditions related to any of these, or any of the Company s other properties change, the underlying assumptions used to determine the expected undiscounted future operating cash flows may change and adversely affect the recoverability of the carrying values related to such properties. No impairment losses were recorded during the three and nine months ended September 30, 2011. The Company recorded an impairment loss on one property of $4.5 million during the nine months ended September 30, 2010.

Projections of expected future cash flows require the Company to use estimates such as current market rental rates on vacant properties, future market rental income amounts subsequent to the expiration of current lease agreements, property operating expenses, terminal capitalization and discount rates, the expected number of months it takes to re-lease the property, required tenant improvements and the number of years the property will be held for investment. The use of alternative assumptions in the future cash flow analysis could result in a different determination of the property s future cash flows and a different conclusion regarding the existence of an impairment, the extent of such loss, if any, as well as the carrying value of the real estate and related intangible assets.

Restricted Cash and Escrows

Restricted cash of $11.2 million and $8.3 million as of September 30, 2011 and December 31, 2010, respectively, held by lenders in escrow accounts for tenant and capital improvements, leasing commissions, repairs and maintenance and other lender reserves for certain properties, in accordance with the respective lender s loan agreement.

COLE CREDIT PROPERTY TRUST II, INC.
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
September 30, 2011

Concentration of Credit Risk

As of September 30, 2011, the Company had cash on deposit, including restricted cash, in five financial institutions, four of which had deposits in excess of federally insured levels totaling $18.5 million; however, the Company has not experienced any losses in such accounts. The Company limits significant cash holdings to accounts held by financial institutions with high credit standing; therefore, the Company believes it is not exposed to any significant credit risk on its cash deposits.

Investment in Unconsolidated Joint Ventures

Investment in unconsolidated joint ventures as of September 30, 2011 consisted of the Company s non-controlling majority interest in a joint venture that owns a multi-tenant property in Independence, Missouri. As of December 31, 2010, investment in unconsolidated joint ventures also consisted of a non-controlling majority interest in a joint venture that owned and operated a ten-property storage facility portfolio, which was sold on September 30, 2011, as discussed in Note 5 to these condensed consolidated unaudited financial statements. Consolidation of these investments is not required as the entities do not meet the requirements for consolidation, as defined in ASC 810. Both the Company and the joint venture partner must approve decisions about the entity s activities that significantly influence the economic performance of the entity. As of September 30, 2011, the aggregate carrying value of assets held within the unconsolidated joint venture were $60.4 million and the face value of the non-recourse mortgage note payable was $34.1 million. As of December 31, 2010, the aggregate carrying value of assets held within the unconsolidated joint ventures was $148.6 million and the face value of the non-recourse mortgage notes payable was $111.6 million.

The Company accounts for unconsolidated joint ventures using the equity method of accounting per guidance established under ASC 323, *Investments Equity Method and Joint Ventures* (ASC 323). The equity method of accounting requires investments to be initially recorded at cost and subsequently adjusted for the Company s share of equity in the joint venture s earnings and distributions. The Company evaluates the carrying amount of its investments for impairment in accordance with ASC 323. The unconsolidated joint ventures are evaluated for potential impairment if the carrying amount of the investment exceeds its fair value. To determine whether impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until the carrying value is fully recovered. The evaluation of an investment in a joint venture for potential impairment requires the Company s management to exercise significant judgment and to make certain assumptions. The use of different judgments and assumptions could result in different conclusions. No impairment losses were recorded related to the unconsolidated joint ventures for the three and nine months ended September 30, 2011 or 2010. The Company recognizes gains on the sale of interests in joint ventures to the extent the economic substance of the transaction is a sale.

Redeemable Common Stock

The Company s share redemption program provides that the Company will not redeem in excess of 3% of the weighted average number of shares outstanding during the prior calendar year (including shares requested for redemption upon the death of a stockholder), and the cash available for redemptions (including those upon death or qualifying disability) is limited to the net proceeds from the sale of shares pursuant to the DRIP Offering. In addition, the Company will redeem shares on a quarterly basis, at the rate of one-fourth of 3% of the weighted average number of shares outstanding during the prior calendar year (including shares requested for redemption upon the death of a stockholder). Funding for redemptions for each quarter (including those upon death or qualifying disability of a stockholder) will also be limited to the net proceeds the Company receives from the sale of shares during such quarter from the DRIP Offering. As of September 30, 2011 and December 31, 2010, the Company had redeemed approximately 13.4 million and approximately 8.8 million shares of common stock, respectively, for an aggregate price of $120.6 million and $82.2 million, respectively. Redeemable common stock is recorded at the greater of the carrying amount or redemption value each reporting period. Changes in the value from period to period are recorded as an adjustment to capital in excess of par value.

The redemption price per share is dependent on the length of time the shares are held and the estimated share value. For purposes of establishing the redemption price per share, estimated share value means the most recently disclosed estimated value of the Company s shares of common stock, as determined by the Company s board of directors, including a majority of the Company s independent directors (the Estimated Share Value). As of September 30, 2011, the Estimated Share Value was $9.35 per share, as determined by the Company s board of directors on July 27, 2011 and disclosed in the Company s Form 8-K filed on such date.

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COLE CREDIT PROPERTY TRUST II, INC.
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
September 30, 2011

NOTE 3 FAIR VALUE MEASUREMENTS

ASC 820, *Fair Value Measurements and Disclosures* (ASC 820) defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. ASC 820 emphasizes that fair value is intended to be a market-based measurement, as opposed to a transaction-specific measurement.

Fair value is defined by ASC 820 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. Depending on the nature of the asset or liability, various techniques and assumptions can be used to estimate the fair value. Assets and liabilities are measured using inputs from three levels of the fair value hierarchy, as follows:

Level 1 Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. An active market is defined as a market in which transactions for the assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active (markets with few transactions), inputs other than quoted prices that are observable for the asset or liability (i.e. interest rates, yield curves, etc.), and inputs that are derived principa