

Jiangbo Pharmaceuticals, Inc.  
Form 10-Q  
February 19, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: December 31, 2009

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-53037

JIANGBO PHARMACEUTICALS, INC.  
(Exact name of small business issuer as specified in its charter)

Florida  
(State or other jurisdiction of incorporation or  
organization)

65-1130026  
(IRS Employer Identification No.)

25 Haibe Road, Laiyang Economic Development Zone  
Laiyang City, Yantai, Shandong Province, People's Republic of China 265200

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(Address of principal executive offices)

(0086) 535-7282997  
(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 Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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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 smaller reporting company)  
Smaller reporting company

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

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APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The total shares outstanding at February 18, 2010 was 12,031,373.

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JIANGBO PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(FORMERLY KNOWN AS GENESIS PHARMACEUTICAL ENTERPRISES, INC.)  
CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2009 AND JUNE 30, 2009

|  | December 31,<br>2009<br>(Unaudited) | June 30,<br>2009 |
|--|-------------------------------------|------------------|
| <b>ASSETS</b>  |                                     |                  |
| <b>CURRENT ASSETS:</b>   |                                     |                  |
| Cash and cash equivalents  | \$ 88,971,243                       | \$ 104,366,117   |
| Restricted cash  | 14,545,305                          | 7,325,000        |
| Investments  | 42,599                              | 879,228          |
| Accounts receivable, net of allowance for doubtful accounts of \$1,276,843 and \$694,370 as of December 31, 2009 and June 30, 2009, respectively | 19,729,985                          | 19,222,707       |
| Inventories  | 3,935,239                           | 3,277,194        |
| Other receivables  | 4,447                               | 167,012          |
| Other receivable - related parties   | 161,370                             | -                |
| Advances to suppliers  | 472,939                             | 236,496          |
| Financing costs - current  | 632,637                             | 680,303          |
| Total current assets   | 128,495,764                         | 136,154,057      |
| PLANT AND EQUIPMENT, net   | 13,661,593                          | 13,957,397       |
| <b>OTHER ASSETS:</b>   |                                     |                  |
| Restricted investments   | 129,306                             | 1,033,463        |
| Financing costs, net   | 131,278                             | 556,365          |
| Intangible assets, net   | 33,243,462                          | 17,041,181       |
| Total other assets   | 33,504,046                          | 18,631,009       |
| Total assets   | \$ 175,661,403                      | \$ 168,742,463   |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                     |                  |
| <b>CURRENT LIABILITIES:</b>  |                                     |                  |
| Accounts payable   | \$ 2,875,667                        | \$ 6,146,497     |
| Short term bank loans  | -                                   | 2,197,500        |
| Notes payable  | 14,545,305                          | 7,325,000        |
| Other payables   | 2,342,231                           | 2,152,063        |
| Refundable security deposits due to distributors   | 4,107,600                           | 4,102,000        |
| Other payables - related parties   | 332,689                             | 238,956          |
| Accrued liabilities  | 368,578                             | 1,356,898        |
| Liabilities assumed from reorganization  | 525,739                             | 1,565,036        |
| Taxes payable  | 3,608,665                           | 11,248,226       |
| Total current liabilities  | 28,706,474                          | 36,332,176       |
| <b>OTHER LIABILITIES:</b>  |                                     |                  |
| Derivative liabilities   | 33,996,855                          | -                |

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|   |            |            |
|---|------------|------------|
| Convertible debt, net of discount \$20,945,255 and \$28,493,089 as of December 31, 2009 and June 30, 2009, respectively | 8,694,745  | 6,346,911  |
| Total other liabilities   | 42,691,600 | 6,346,911  |
| Total liabilities   | 71,398,074 | 42,679,087 |

COMMITMENTS AND CONTINGENCIES

SHAREHOLDERS' EQUITY:

|  |                |                |
|--|----------------|----------------|
| Convertible preferred stock Series A (\$0.001 par value; 0 shares issued and outstanding as of December 31, 2009 and June 30, 2009, respectively)  | -              | -              |
| Common stock (\$0.001 par value, 22,500,000 and 15,000,000 shares authorized, 11,169,546 and 10,435,099 shares issued and outstanding as of December 31, 2009 and June 30, 2009, respectively) | 11,170         | 10,435         |
| Additional paid-in capital   | 23,805,104     | 48,397,794     |
| Capital contribution receivable  | (11,000)       | (11,000)       |
| Retained earnings - unrestricted   | 70,427,320     | 67,888,667     |
| Statutory reserves   | 3,253,878      | 3,253,878      |
| Accumulated other comprehensive income   | 6,776,857      | 6,523,602      |
| Total shareholders' equity   | 104,263,329    | 126,063,376    |
| Total liabilities and shareholders' equity   | \$ 175,661,403 | \$ 168,742,463 |

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

JIANGBO PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(FORMERLY KNOWN AS GENESIS PHARMACEUTICAL ENTERPRISES, INC.)  
CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME  
FOR THE THREE MONTHS AND SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008  
(UNAUDITED)

|   | For the Three Months Ended<br>December 31, |               | For the Six Months Ended<br>December 31, |               |
|---|--|---------------|--|---------------|
|   | 2009                                       | 2008          | 2009                                     | 2008          |
| <b>REVENUES:</b>                                    |  |               |  |               |
| Sales   | \$ 18,179,942                              | \$ 32,944,809 | \$ 42,563,996                            | \$ 60,265,493 |
| Sales – related parties                             | -  | -             | -  | 243,909       |
| Total revenues                                      | 18,179,942                                 | 32,944,809    | 42,563,996                               | 60,509,402    |
| <b>COST OF SALES</b>                                |  |               |  |               |
| Cost of sales                                       | 4,667,049                                  | 7,138,166     | 10,927,448                               | 12,851,210    |
| Cost of sales - related parties                     | -  | -             | -  | 54,493        |
| Total cost of sales                                 | 4,667,049                                  | 7,138,166     | 10,927,448                               | 12,905,703    |
| <b>GROSS PROFIT</b>                                 | 13,512,893                                 | 25,806,643    | 31,636,548                               | 47,603,699    |
| <b>RESEARCH AND DEVELOPMENT EXPENSE</b>             | 1,106,385                                  | 1,098,525     | 2,205,960                                | 2,196,450     |
| <b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b> | 5,259,213                                  | 13,282,421    | 9,601,019                                | 26,634,396    |
| <b>INCOME FROM OPERATIONS</b>                       | 7,147,295                                  | 11,425,697    | 19,829,569                               | 18,772,853    |
| <b>OTHER (INCOME) EXPENSE:</b>                      |  |               |  |               |
| Change in fair value of derivative liabilities      | (6,687,085)                                | -             | (1,865,992)                              | -             |
| Other income - related parties                      | (80,668)                                   | (92,774)      | (161,304)                                | (236,724)     |
| Non-operating (income) expense, net                 | 366,685                                    | 204,001       | 214,271                                  | 1,193,592     |
| Interest expense, net                               | 6,162,640                                  | 1,549,331     | 8,919,818                                | 2,902,125     |
| Loss from discontinued operations                   | 87,561                                     | 1,545,607     | 164,769                                  | 1,590,823     |
| Total other (income) expense, net                   | (150,867)                                  | 3,206,165     | 7,271,562                                | 5,449,816     |
| <b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>     | 7,298,162                                  | 8,219,532     | 12,558,007                               | 13,323,037    |
| <b>PROVISION FOR INCOME TAXES</b>                   | 1,970,021                                  | 2,820,346     | 5,078,191                                | 4,790,367     |
| <b>NET INCOME</b>                                   | 5,328,141                                  | 5,399,186     | 7,479,816                                | 8,532,670     |
| <b>OTHER COMPREHENSIVE INCOME:</b>                  |  |               |  |               |
| Unrealized holding gain (loss)                      | 32,827                                     | (384,650)     | 56,371                                   | (1,947,617)   |
| Foreign currency translation adjustment             | 44,704                                     | 248,823       | 196,884                                  | 579,464       |
| <b>COMPREHENSIVE INCOME</b>                         | \$ 5,405,672                               | \$ 5,263,359  | \$ 7,733,071                             | \$ 7,164,517  |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| BASIC WEIGHTED AVERAGE NUMBER OF SHARES   | 10,983,405 | 9,771,883  | 10,744,648 | 9,770,615  |
| BASIC EARNINGS PER SHARE                  | \$ 0.49    | \$ 0.55    | \$ 0.70    | \$ 0.87    |
| DILUTED WEIGHTED AVERAGE NUMBER OF SHARES | 15,065,301 | 14,148,317 | 14,829,605 | 14,173,463 |
| DILUTED EARNINGS (LOSS) PER SHARE         | \$ (1.06)  | \$ (1.87)  | \$ (0.89)  | \$ (1.61)  |

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



JIANGBO PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(FORMERLY KNOWN AS GENESIS PHARMACEUTICAL ENTERPRISES, INC.)  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

|  | Common Stock<br>Par Value \$0.001<br>Number<br>of shares | Common Stock<br>Amount | Additional<br>Paid-in<br>capital | Capital<br>contribution<br>receivable | Retained Earnings<br>Statutory<br>reserves | Unrestricted<br>earnings | Accumulated other<br>comprehensive<br>income | Totals         |
|--|--|------------------------|----------------------------------|---------------------------------------|--|--------------------------|--|----------------|
| BALANCE,<br>June 30, 2008  | 9,767,844  | \$ 9,769               | \$ 45,554,514                    | \$ (11,000)                           | \$ 3,253,878                               | \$ 39,008,403            | \$ 7,700,905                                 | \$ 95,516,469  |
| Shares issued<br>for adjustments<br>for 40:1 reverse<br>split                  | 1,104  | -                      |                                  |                                       |  |                          |  | -              |
| Cancellation of<br>common stock<br>for settlement<br>@ \$8 per share           | (2,500)  | (2)                    | (19,998)                         |                                       |  |                          |  | (20,000)       |
| Common stock<br>issued for<br>service @ \$8<br>per share                       | 2,500  | 2                      | 19,998                           |                                       |  |                          |  | 20,000         |
| Common stock<br>issued for<br>service @ \$9<br>per share                       | 2,500  | 2                      | 22,498                           |                                       |  |                          |  | 22,500         |
| Common stock<br>issued to<br>Hongrui @<br>\$4.035 per<br>share                 | 643,651  | 644                    | 2,596,488                        |                                       |  |                          |  | 2,597,132      |
| Conversion of<br>convertible<br>debt to stock                                  | 20,000   | 20                     | 159,980                          |                                       |  |                          |  | 160,000        |
| Stock based<br>compensation  |  |                        | 64,314                           |                                       |  |                          |  | 64,314         |
| Net income   |  |                        |                                  |                                       |  | 28,880,264               |  | 28,880,264     |
| Change in fair<br>value on<br>restricted<br>marketable<br>equity<br>securities |  |                        |                                  |                                       |  |                          | (1,514,230)                                  | (1,514,230)    |
| Foreign<br>currency<br>translation gain  |  |                        |                                  |                                       |  |                          | 336,927                                      | 336,927        |
|  | 10,435,099   | \$ 10,435              | \$ 48,397,794                    | \$ (11,000)                           | \$ 3,253,878                               | \$ 67,888,667            | \$ 6,523,602                                 | \$ 126,063,376 |

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BALANCE,  
June 30, 2009

Cumulative  
effect of  
reclassification  
of warrants

(34,971,570)

(4,941,163)

(39,912,733)

BALANCE,  
July 1, 2009 as  
adjusted

10,435,099

10,435

13,426,224

(11,000)

3,253,878

62,947,504

6,523,602

86,150,643

Common stock  
issued for  
services @  
\$9.91 per share

1,009

1

9,999

10,000

Common stock  
issued for  
interest  
payment @ \$8  
per share

83,438

84

984,540

984,624

Conversion of  
convertible  
debt to stock

650,000

650

5,199,350

5,200,000

Reclassification  
of derivative  
liabilities to  
APIC due to  
conversion of  
convertible  
debt

4,049,887

4,049,887

Stock based  
compensation

135,104

135,104

Net income

7,479,816

7,479,816

Change in fair  
value on  
restricted  
marketable  
equity  
securities

56,371

56,371

Foreign  
currency  
translation gain

196,884

196,884

BALANCE,  
December 31,  
2009

(Unaudited)

11,169,546

\$ 11,170

\$ 23,805,104

\$(11,000)

\$ 3,253,878

\$ 70,427,320

\$ 6,776,857

\$ 104,263,329

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



JIANGBO PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(FORMERLY KNOWN AS GENESIS PHARMACEUTICAL ENTERPRISES, INC.)  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008  
(Unaudited)

|  | 2009         | 2008         |
|--|--------------|--------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |              |              |
| Net income   | \$ 7,479,816 | \$ 8,532,670 |
| Loss from discontinued operations  | 164,769      | 1,590,823    |
| Income from continuing operations  | 7,644,585    | 10,123,493   |
| Adjustments to reconcile net income to net cash, net of acquisition, provided by operating activities: |              |              |
| Depreciation   | 391,435      | 289,749      |
| Amortization of intangible assets  | 803,234      | 147,120      |
| Amortization of deferred debt issuance costs   | 472,753      | 340,151      |
| Amortization of debt discount  | 7,547,834    | 1,646,235    |
| Loss from issuance of shares in lieu of interest   | 317,124      | -            |
| Bad debt expense   | 581,287      | 111,237      |
| Realized loss (gain) on marketable securities  | 406,551      | (115,128)    |
| Unrealized (gain) loss on marketable securities  | (265,747)    | 1,459,656    |
| Other non-cash settlement  | -            | (20,000)     |
| Change in fair value of derivative liabilities   | (1,865,992)  | -            |
| Stock-based compensation   | 135,104      | 38,028       |
| Changes in operating assets and liabilities  |              |              |
| Accounts receivable  | (1,062,126)  | (1,764,421)  |
| Accounts receivable - related parties  | -            | 488,580      |
| Inventories  | (653,303)    | (1,049,318)  |
| Other receivables  | 161,727      | (2,175,378)  |
| Other receivables - related parties  | (161,304)    | (236,724)    |
| Advances to suppliers and other assets   | (235,033)    | 1,608,131    |
| Accounts payable   | (3,277,854)  | 569,601      |
| Other payables   | 187,153      | 1,815,563    |
| Other payables - related parties   | 93,588       | 66,028       |
| Accrued liabilities  | (299,688)    | 153,587      |
| Liabilities assumed from reorganization  | (79,150)     | (903,600)    |
| Taxes payable  | (7,651,766)  | 13,821,621   |
| Net cash provided by operating activities  | 3,190,415    | 26,414,211   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |              |              |
| Proceeds from sale of marketable securities  | 531,333      | 117,614      |
| Purchase of equipment and building improvements  | (76,707)     | (128,179)    |
| Purchase of land use right   | (16,975,633) | -            |
| Net cash used in investing activities  | (16,521,007) | (10,565)     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |              |              |
| Change in restricted cash  | (7,207,356)  | 1,292,162    |
| Proceeds from bank loans   |              | 2,196,450    |
| Payments for bank loans  | (2,199,600)  | (2,782,170)  |

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|   |               |               |
|---|---------------|---------------|
| Proceeds from notes payable   | 14,539,356    | 704,328       |
| Principal payments on notes payable                                       | (7,332,000)   | -             |
| Net cash (used in) provided by financing activities                       | (2,199,600)   | 1,410,770     |
| EFFECTS OF EXCHANGE RATE CHANGE IN CASH                                   | 135,318       | 369,646       |
| (DECREASE) INCREASE IN CASH   | (15,394,874)  | 28,184,062    |
| CASH and CASH EQUIVALENTS, beginning                                      | 104,366,117   | 48,195,798    |
| CASH and CASH EQUIVALENTS, ending   | \$ 88,971,243 | \$ 76,379,860 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:                        |               |               |
| Cash paid for Interest  | \$ 390,861    | \$ 1,110,572  |
| Cash paid for Income taxes  | \$ 1,289,849  | \$ 128,329    |
| Non-cash investing and financing activities:                              |               |               |
| Common stock issued for interest payment                                  | \$ 667,500    | \$ -          |
| Common stock issued for convertible notes conversion, net of discount     | \$ 5,200,000  | \$ 160,000    |
| Derivative liability reclassified to equity upon conversion               | \$ 4,049,887  | \$ -          |
| Transfer of investments to settle liabilities assumed from reorganization | \$ 1,124,916  | \$ -          |

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

JIANGBO PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(FORMERLY KNOWN AS GENESIS PHARMACEUTICALS ENTERPRISES, INC.)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2009  
(UNAUDITED)

Note 1 – Organization and business

Jiangbo Pharmaceuticals, Inc. (the “Company” or “Jiangbo”) was originally incorporated in the state of Florida on August 15, 2001, under the name Genesis Technology Group, Inc.

Pursuant to a Certificate of Amendment to the Amended and Restated Articles of Incorporation filed with the state of Florida which took effect as of April 16, 2009, the Company's name was changed from "Genesis Pharmaceuticals Enterprises, Inc." to "Jiangbo Pharmaceuticals, Inc." (the "Corporate Name Change"). The Corporate Name Change was approved and authorized by the Board of Directors of the Company as well as the holders of a majority of the outstanding shares of the Company’s voting stock by written consent. As a result of the Corporate Name Change, the stock symbol changed to "JGBO" with the opening of trading on May 12, 2009, on the OTCBB.

Our primary operations consist of the business and operations of our direct and indirect subsidiaries and Variable Interest Entity (“VIE”), which produce and sell western pharmaceutical products in China and focuses on developing innovative medicines to address various medical needs for patients worldwide.

Note 2 - Summary of significant accounting policies

Basis of presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q. Accordingly, they do not include all the information and footnotes required by US Generally Accepted Accounting Principles (“GAAP”) for complete financial statements. In the opinion of management, the accompanying consolidated balance sheets, and related interim consolidated statements of income and other comprehensive income, stockholders’ equity, and cash flows, include all adjustments, consisting only of normal recurring items. However, these consolidated financial statements are not indicative of a full year of operations. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and footnotes for the year ended June 30, 2009 included in the Company’s Annual Report on Form 10-K.

Principles of consolidation

The accompanying consolidated financial statements include the accounts of the following entities, and all significant intercompany transactions and balances have been eliminated in consolidation:

| Consolidated entity name:                              | Percentage of ownership  |
|--|--------------------------|
| Karmoya International Ltd.                             | 100%                     |
| Union Well International Ltd.                          | 100%                     |
| Genesis Jiangbo (Laiyang) Biotech Technology Co., Ltd. | 100%                     |
| Laiyang Jiangbo Pharmaceuticals Co., Ltd.              | Variable Interest Entity |

The Financial Accounting Standards Board's ("FASB") accounting standards address whether certain types of entities, referred to as VIE's, should be consolidated in a company's consolidated financial statements. In accordance with the provisions of the accounting standard, the Company has determined that Laiyang Jiangbo is a VIE and that the Company is the primary beneficiary, and accordingly, the financial statements of Laiyang Jiangbo are consolidated into the financial statements of the Company.

#### Reverse stock split

In July 2008, the board of directors of the Company approved a 40-to-1 reverse stock split, effective September 4, 2008, and a new trading symbol "GNPH" also became effective on that day. The accompanying consolidated financial statements have been retroactively adjusted to reflect the reverse stock split. All share representations are on a post-split basis. In April, 2009, in connection with the Company's name change, the Company's trading symbol changed to "JGBO."

#### Foreign currency translation

The reporting currency of the Company is the U.S. dollar. The functional currency of the Company is the local currency, the Chinese Renminbi ("RMB"). In accordance with the FASB's accounting standard governing foreign currency translation, results of operations and cash flows are translated at average exchange rates during the period, assets and liabilities are translated at the unified exchange rates as quoted by the People's Bank of China at the end of the period, and equity is translated at historical exchange rates. As a result, amounts related to assets and liabilities reported on the consolidated statements of cash flows will not necessarily agree with changes in the corresponding balances on the consolidated balance sheets. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred.

Asset and liability accounts at December 31, 2009, were translated at 6.82 RMB to \$1.00 as compared to 6.83 RMB to \$1.00 at June 30, 2009. Equity accounts were stated at their historical rates. The average translation rates applied to statements of income for the six months ended December 31, 2009 and 2008 were 6.82 RMB and 6.83 RMB to \$1.00, respectively.

#### Use of estimates

The preparation of financial statements in conformity with US 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 date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The significant estimates made in the preparation of the Company's consolidated financial statements relate to the assessment of the carrying values of accounts receivable and related allowance for doubtful accounts, allowance for obsolete inventory, sales returns, accrual for estimated advertising costs, fair value of warrants and beneficial conversion features related to the convertible notes, fair value of derivative liability and fair value of options granted to employees. Actual results could be materially different from these estimates upon which the carrying values were based.

#### Revenue recognition

Product sales are generally recognized when title to the product has transferred to customers in accordance with the terms of the sale. In general, the Company records revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured.

The Company is generally not contractually obligated to accept returns. However, on a case by case negotiated basis, the Company permits customers to return their products. Therefore, revenue is recorded net of an allowance for estimated returns. Such reserves are based upon management's evaluation of historical experience and estimated costs. The amount of the reserves ultimately required could differ materially in the near term from amounts included in the accompanying consolidated statements of income.





## Financial instruments

The accounting standard governing financial instruments adopted on July 1, 2008, defines financial instruments and requires fair value disclosures about those instruments. It defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosure requirements for fair value measures. Investments, receivables, payables, short term loans and convertible debt all qualify as financial instruments. Management concluded the receivables, payables and short term loans approximate their fair values because of the short period of time between the origination of such instruments and their expected realization and, if applicable, their stated rates of interest are equivalent to rates currently available.

The three levels of valuation hierarchy are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company analyzes all financial instruments with features of both liabilities and equity under the FASB's accounting standard for such instruments. Under this standard, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Depending on the product and the terms of the transaction, the fair value of notes payable and derivative liabilities were modeled using a series of techniques, including closed-form analytic formula, such as the Black-Scholes option-pricing model.

Effective July 1, 2009, as a new accounting standard took effect, the Company's two convertible notes with principal amounts totaling \$34,840,000 and 2,275,000 warrants previously treated as equity pursuant to the derivative treatment exemption are no longer afforded equity treatment because the strike price of the warrants is denominated in US dollar, a currency other than the Company's functional currency, the Chinese Renminbi. As a result, those financial instruments are not considered indexed to the Company's own stock, and as such, all future changes in the fair value of these convertible notes and warrants will be recognized currently in earnings until such time as the convertible notes and warrants are converted, exercised or expired.

As such, effective July 1, 2009, the Company reclassified the fair value of the conversion features on the convertible notes and warrants from equity to liability, as if these conversion features on the convertible notes and warrants were treated as a derivative liability since their initial issuance dates. On July 1, 2009, the Company reclassified approximately \$35 million from additional paid-in capital and approximately \$4.9 million from beginning retained earnings to warrant liabilities, as a cumulative effect adjustment, to recognize the fair value of the conversion features on the convertible notes and warrants. For the six months ended December 31, 2009, \$5.2 million of convertible notes were converted. As of December 31, 2009, the Company has \$29,640,000 convertible notes and 2,275,000 warrants outstanding. The fair value of the conversion features on the convertible notes was approximately \$19.7 million and the fair value of the warrants was approximately \$14.3 million. The Company recognized \$1.9 million gain from the change in fair value of the conversion features on the convertible notes and warrants for the six months ended December 31, 2009.

These common stock purchase warrants do not trade in an active securities market, and as such, the Company estimates the fair value of the conversion features on the convertible notes and warrants using the Black-Scholes option pricing model using the following assumptions:

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|  | December 31, 2009     |                       |                         |                     | July 1, 2009          |                       |                         |                     |
|--|-----------------------|-----------------------|-------------------------|---------------------|-----------------------|-----------------------|-------------------------|---------------------|
|  | Annual dividend yield | Expected term (years) | Risk-free interest rate | Expected volatility | Annual dividend yield | Expected term (years) | Risk-free interest rate | Expected volatility |
| Conversion feature on the \$5 million convertible notes  | -                     | 0.85                  | 0.47%                   | 64.00%              | -                     | 1.35                  | 1.11%                   | 95.8%               |
| Conversion feature on the \$30 million convertible notes | -                     | 1.42                  | 1.14%                   | 88.43%              | -                     | 1.92                  | 1.11%                   | 102%                |
| 400,000 warrants issued in November 2007                 | -                     | 0.85                  | 0.47%                   | 64.00%              | -                     | 1.35                  | 1.11%                   | 95.8%               |
| 1,875,000 warrants issued in May 2008                    | -                     | 3.42                  | 2.31%                   | 86.91%              | -                     | 3.92                  | 2.54%                   | 97.51%              |

Expected volatility is based primarily on historical volatility. Historical volatility was computed using weekly pricing observations for recent periods that correspond to the term of the warrants. The Company's management believes this method produces an estimate that is representative of the expectations of future volatility over the expected term of these warrants. The Company has no reason to believe future volatility over the expected remaining life of these warrants will likely differ materially from historical volatility. The expected life is based on the remaining term of the warrants. The risk-free interest rate is based on U.S. Treasury securities according to the remaining term of the financial instruments.

The following table sets forth by level within the fair value hierarchy the financial assets and liabilities that were accounted for at fair value on a recurring basis.

|   | Carrying Value at<br>December 31,<br>2009 | Fair Value Measurements at December 31,<br>2009,<br>Using Fair Value Hierarchy |             |                      |
|---|---|--|-------------|----------------------|
|   |   | Level 1  | Level 2     | Level 3              |
| Investments   | \$ 42,599                                 | \$ 42,599  | \$ -        | \$ -                 |
| Investments, restricted                                       | 129,306                                   | 129,306  | -           | -                    |
| Conversion options - \$4M Convertible Debt<br>(November 2007) | 2,010,359                                 | -  | -           | 2,010,359            |
| Conversion options - \$25.6M Convertible Debt<br>(May 2008)   | 17,708,382                                | -  | -           | 17,708,382           |
| 400,000 warrants issued in November 2007                      | 1,608,287                                 | -  | -           | 1,608,287            |
| 1,875,000 warrants issued in May 2008                         | 12,669,826                                | -  | -           | 12,669,826           |
| \$4M Convertible Debt (November 2007)                         | 4,192,195                                 | -  | -           | 4,192,195            |
| \$25.6M Convertible Debt (May 2008)                           | 26,558,365                                | -  | -           | 26,558,365           |
| <b>Total</b>  | <b>\$ 64,919,319</b>                      | <b>\$ 171,905</b>  | <b>\$ -</b> | <b>\$ 64,747,414</b> |

The Company did not identify any other non-recurring assets and liabilities that are required to be presented on the consolidated balance sheets at fair value in accordance with the relevant accounting standards.

An accounting standard became effective for the Company on July 1, 2008 which provides the Company with the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis with the difference between the carrying value before election of the fair value option and the fair value recorded upon election as an adjustment to beginning retained earnings. The Company chose not to elect the fair value option.

#### Stock-based compensation

The Company records stock-based compensation expense pursuant to the governing accounting standard which requires companies to measure compensation cost for stock-based employee compensation plans at fair value at the grant date and recognize the expense over the employee's requisite service period. The Company estimates the fair value of the awards using the Black-Scholes option pricing model. Under this accounting standard, the Company's expected volatility assumption is based on the historical volatility of Company's stock or the expected volatility of similar entities. The expected life assumption is primarily based on historical exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.



Stock-based compensation expense is recognized based on awards expected to vest, and there were no estimated forfeitures as the Company has a short history of issuing options.

The Company uses the Black-Scholes option-pricing model which was developed for use in estimating the fair value of options. Option-pricing models require the input of highly complex and subjective variables including the expected life of options granted and the Company's expected stock price volatility over a period equal to or greater than the expected life of the options. Because changes in the subjective assumptions can materially affect the estimated value of the Company's employee stock options, it is management's opinion that the Black-Scholes option-pricing model may not provide an accurate measure of the fair value of the Company's employee stock options. Although the fair value of employee stock options is determined in accordance with the accounting standards using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

#### Comprehensive income

FASB's accounting standard regarding comprehensive income establishes standards for reporting and display of comprehensive income and its components in financial statements. It requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The accompanying consolidated financial statements include the provisions of this accounting standard.

#### Cash and cash equivalents

Cash and cash equivalents include cash on hand and demand deposits in accounts maintained with state-owned banks within the PRC. The Company considers all highly liquid instruments with original maturities of three months or less, and money market accounts to be cash and cash equivalents.

The Company maintains cash deposits in financial institutions that exceed the amounts insured by the U.S. government. Balances at financial institutions or state-owned banks within the PRC are not covered by insurance. Non-performance by these institutions could expose the Company to losses for amounts in excess of insured balances. As of December 31, 2009 and June 30, 2009, the Company's bank balances, including restricted cash balances, exceeded government-insured limits by approximately \$103,516,548 and \$111,684,000, respectively.

#### Restricted cash

Restricted cash represents amounts set aside by the Company in accordance with the Company's debt agreements with certain financial institutions. These cash amounts are designated for the purpose of paying down the principal amounts owed to the financial institutions, and these amounts are held at the same financial institutions with which the Company has debt agreements. Due to the short-term nature of the Company's debt obligations to these banks, the corresponding restricted cash balances have been classified as current in the consolidated balance sheets.

#### Investment and restricted investments

Investments are comprised of marketable equity securities of publicly traded companies and are stated at fair value based on the quoted price of these securities. These investments are classified as trading securities based on the Company's intent and ability to sell them within the year. Restricted investments are marketable equity securities of publicly traded companies that were acquired through the reverse merger and contained certain SEC Rule 144 restrictions on the securities. These securities are classified as available-for-sale and are reflected as restricted and noncurrent, as the Company intends to hold them beyond one year. Restricted investments are carried at fair value based on the trade price of these securities.

The following is a summary of the components of the gain/loss on investments and restricted investments for the three and six months ended December 31, 2009 and 2008:

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|   | For the Three Months Ended<br>December 31, |          | For the Six Months Ended<br>December 31, |              |
|---|--|----------|--|--------------|
|   | 2009                                       | 2008     | 2009                                     | 2008         |
| Realized (gain) loss on trading securities  | \$ 425,616                                 | \$ 9,395 | \$ 406,551                               | \$ (115,128) |
| Unrealized (gain) loss on trading securities  | (14,743)                                   | 415,573  | (265,747)                                | 1,459,656    |
| Unrealized (gain) loss on restricted investments –<br>available-for-sale securities | (32,827)                                   | 384,650  | (56,371)                                 | 1,947,617    |

All unrealized gains and losses related to available-for-sale securities have been properly reflected as a component of accumulated other comprehensive income.

#### Accounts receivable

During the normal course of business, the Company extends credit to its customers without requiring collateral or other security interests. Management reviews its accounts receivables at each reporting period to provide for an allowance against accounts receivable for an amount that could become uncollectible. This review process may involve the identification of payment problems with specific customers. The Company estimates this allowance based on the aging of the accounts receivable, historical collection experience, and other relevant factors, such as changes in the economy and the imposition of regulatory requirements that can have an impact on the industry. These factors continuously change, and can have an impact on collections and the Company's estimation process. These impacts may be material.

Certain accounts receivable amounts are charged off against allowances after unsuccessful collection efforts. Subsequent cash recoveries are recognized as income in the period when they occur.

The activities in the allowance for doubtful accounts are as follows for the periods ended December 31, 2009 and June 30, 2009:

|   | December 31, |               |
|---|--------------|---------------|
|   | 2009         | June 30, 2009 |
|   | (Unaudited)  |               |
| Beginning allowance for doubtful accounts | \$ 694,370   | \$ 155,662    |
| Bad debt additions                        | 581,287      | 538,068       |
| Foreign currency translation adjustments  | 1,186        | 640           |
| Ending allowance for doubtful accounts    | \$ 1,276,843 | \$ 694,370    |

#### Inventories

Inventories, consisting of raw materials, work-in-process, packing materials and finished goods related to the Company's products, are stated at the lower of cost or market utilizing the weighted average method. The Company reviews its inventory periodically for possible obsolete goods or to determine if any reserves are necessary. As of December 31, 2009 and June 30, 2009, the Company determined that no reserves were necessary.

#### Advance to suppliers

Advances to suppliers represent partial payments or deposits for future inventory and equipment purchases. These advances to suppliers are non-interest bearing and unsecured. From time to time, vendors require a certain amount of money to be deposited with them as a guarantee that the Company will receive their purchase on a timely basis.





### Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Additions and improvements to plant and equipment accounts are recorded at cost. When assets are retired or disposed of, the cost and accumulated depreciation are removed from the accounts, and any resulting gains or losses are included in the results of operations in the year of disposition. Maintenance, repairs, and minor renewals are charged directly to expense as incurred. Major additions and betterments to plant and equipment accounts are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of the assets are as follows:

|                                    | Useful Life  |
|------------------------------------|--------------|
| Building and building improvements | 5 – 40 Years |
| Manufacturing equipment            | 5 – 20 Years |
| Office equipment and furniture     | 5 – 10 Years |
| Vehicles                           | 5 Years      |

### Intangible assets

All land in the PRC is owned by the PRC government and cannot be sold to any individual or company. The Company has recorded the amounts paid to the PRC government to acquire long-term interests to utilize land underlying the Company's facilities as land use rights. This type of arrangement is common for the use of land in the PRC. Land use rights are amortized on the straight-line method over the terms of the land use rights, which range from 20 to 50 years. The Company acquired land use rights in August 2004, October 2007 and November 2009 in the amounts of approximately \$879,000, \$8,871,000 and \$17,000,000, respectively, which are included in intangible assets.

Patents and licenses include purchased technological know-how, secret formulas, manufacturing processes, technical and procedural manuals, and the certificate of drugs production and is amortized using the straight-line method over the expected useful economic life of 5 years, which reflects the period over which those formulas, manufacturing processes, technical and procedural manuals are kept secret to the Company as agreed between the Company and the selling parties.

The estimated useful lives of intangible assets are as follows:

|  | Useful Life |
|--|-------------|
| Land use rights                                  | 50 Years    |
| Patents  | 5 Years     |
| Licenses   | 5 Years     |
| Customer list and customer relationships         | 3 Years     |
| Trade secrets - formulas and know how technology | 5 Years     |

### Impairment of long-lived assets

Long-lived assets of the Company are reviewed periodically or more often if circumstances dictate, to determine whether their carrying values have become impaired. The Company considers assets to be impaired if the carrying values exceed the future projected cash flows from related operations. The Company also re-evaluates the periods of depreciation to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of December 31, 2009, the Company expects these assets to be fully recoverable.

### Beneficial conversion feature of convertible notes

In accordance with accounting standards governing the beneficial conversion feature of convertible notes, the Company has determined that the convertible notes contained a beneficial conversion feature because on November 6, 2007, the effective conversion price of the \$5,000,000 convertible note was \$5.81 when the market value per share was \$16.00, and on May 30, 2008, the effective conversion price of the \$30,000,000 convertible note was \$5.1 when the market value per share was \$12.00. Total value of beneficial conversion feature of \$2,904,092 for the November 6, 2007 convertible note and \$19,111,323 for the May 30, 2008 convertible debt was discounted from the carrying value of the convertible notes. The beneficial conversation feature is amortized using the effective interest method over the term of the note. As of December 31, 2009 and June 30, 2009, a total of \$13,216,956 and \$17,955,637, respectively, remained unamortized for the beneficial conversion feature.

## Income taxes

The Company accounts for income taxes in accordance with the accounting standard for income taxes. Deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Under this accounting standard, the effect on deferred income taxes of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized if it is more likely than not that some portion, or all of, a deferred tax asset will not be realized. As of December 31, 2009 and June 30, 2009, the Company did not have any net deferred tax assets or liabilities.

The accounting standards clarify the accounting and disclosure for uncertain tax positions and prescribe a recognition threshold and measurement attribute for recognition and measurement of a tax position taken or expected to be taken in a tax return. The accounting standards also provide guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Under this accounting standard, evaluation of a tax position is 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 that position. The second step is to measure a 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 that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions 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 financial reporting period in which the threshold is no longer met.

The Company's operations are subject to income and transaction taxes in the United States and in the PRC jurisdictions. Significant estimates and judgments are required in determining the Company's worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations, and as a result the ultimate amount of tax liability may be uncertain. However, the Company does not anticipate any events that would lead to changes to these uncertainties.

## Value added tax

The Company is subject to value added tax ("VAT") for manufacturing products and business tax for services provided. The applicable VAT rate is 17% for products sold in the PRC. The amount of VAT liability is determined by applying the applicable tax rate to the invoiced amount of goods sold (output VAT) less VAT paid on purchases made with the relevant supporting invoices (input VAT). Under the commercial practice of the PRC, the Company pays VAT based on tax invoices issued. The tax invoices may be issued subsequent to the date on which revenue is recognized, and there may be a considerable delay between the date on which the revenue is recognized and the date on which the tax invoice is issued. In the event that the PRC tax authorities dispute the date on which revenue is recognized for tax purposes, the PRC tax office has the right to assess a penalty, which can range from zero to five times the amount of the taxes which are determined to be late or deficient, and will be charged to operations in the period if and when a determination is made by the taxing authorities that a penalty is due.

VAT on sales and VAT on purchases amounted to approximately \$3,090,000 and \$894,000 for the three months ended December 31, 2009, respectively, and approximately \$5,603,000 and \$781,000 for the three months ended December 31, 2008, respectively. VAT on sales and VAT on purchases amounted to approximately \$7,236,000 and \$1,738,000, respectively, for the six months ended December 31, 2009, respectively, and approximately \$10,287,000 and \$1,155,000, respectively, for the six months ended December 31, 2008. Sales and purchases are recorded net of

VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

### Shipping and handling

Shipping and handling costs related to costs of goods sold are included in selling, general and administrative expenses. Shipping and handling costs amounted to approximately \$113,000 and \$130,000, respectively, for the three months ended December 31, 2009, and 2008, respectively. Shipping and handling costs amounted to approximately \$264,000 and \$252,000 for the six months ended December 31, 2009, and 2008, respectively.

### Advertising

Expenses incurred in the advertising of the Company and the Company's products are charged to operations. Advertising expenses amounted to approximately \$2,190,431 and \$24,000 for the three months ended December 31, 2009 and 2008, respectively. Advertising expenses amounted to approximately \$3,257,000 and \$928,000 for the six months ended December 31, 2009 and 2008, respectively.

### Research and development

Research and development costs are expensed as incurred. These costs primarily consist of cost of materials used and salaries paid for the development of the Company's products, and fees paid to third parties to assist in such efforts.

### Recent accounting pronouncements

In April 2009, the FASB issued an accounting standard for accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. It amends and clarifies a previously issued accounting standard in regards to the initial recognition and measurement, subsequent measurement and accounting, and disclosures of assets and liabilities arising from contingencies in a business combination. The accounting standard applies to all assets acquired and liabilities assumed in a business combination that arise from contingencies. The accounting standard will be effective for the first annual reporting period beginning on or after December 15, 2008. The accounting standard will apply prospectively to business combinations for which the acquisition date is after fiscal years beginning on or after December 15, 2008. The adoption of the accounting standard did not have a material impact on the Company's results of operations or financial condition.

In April 2009, the FASB issued an accounting standard to make the other-than-temporary impairments guidance more operational and to improve the presentation of other-than-temporary impairments in the financial statements. This standard will replace the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired debt security until recovery with a requirement that management assert it does not have the intent to sell the security, and it is more likely than not it will not have to sell the security before recovery of its cost basis. This standard provides increased disclosure about the credit and noncredit components of impaired debt securities that are not expected to be sold and also requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. Although this standard does not result in a change in the carrying amount of debt securities, it does require that the portion of an other-than-temporary impairment not related to a credit loss for a held-to-maturity security be recognized in a new category of other comprehensive income and be amortized over the remaining life of the debt security as an increase in the carrying value of the security. This standard became effective for interim and annual periods ending after June 15, 2009. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued an accounting standard that requires disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this accounting standard, fair values for these assets and liabilities were only disclosed annually. This standard applies to all financial instruments within its scope and requires all entities to disclose the

method(s) and significant assumptions used to estimate the fair value of financial instruments. This standard does not require disclosures for earlier periods presented for comparative purposes at initial adoption, but in periods after the initial adoption, this standard requires comparative disclosures only for periods ending after initial adoption. The adoption of this standard did not have a material impact on the disclosures related to its consolidated financial statements.

In June 2009, the FASB issued an accounting standard amending the accounting and disclosure requirements for transfers of financial assets. This accounting standard requires greater transparency and additional disclosures for transfers of financial assets and the entity's continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, it eliminates the concept of a qualifying special-purpose entity ("QSPE"). This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2009. The Company believes the adoption of this ASU will not have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB also issued an accounting standard amending the accounting and disclosure requirements for the consolidation of variable interest entities ("VIEs"). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this accounting standard. Further, this accounting standard requires a company to perform a qualitative analysis when determining whether or not it must consolidate a VIE. It also requires a company to continuously reassess whether it must consolidate a VIE. Additionally, it requires enhanced disclosures about a company's involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the company's financial statements. Finally, a company will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2009. The Company has not completed their assessment of the impact that this pronouncement will have on the Company's financial condition, results of operations or cash flows.

In June 2009, the FASB issued an accounting standard which establishes the FASB Accounting Standards Codification™ (the "Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. The Codification is effective for interim and annual periods ending after September 15, 2009, and as of the effective date, all existing accounting standard documents will be superseded. Pursuant to the provisions of the Codification, the Company updated references to GAAP in the Company's consolidated financial statements. The Codification did not change GAAP and therefore did not impact the Company's consolidated financial statements other than the change in references.

In August 2009, the FASB issued an Accounting Standards Update ("ASU") regarding measuring liabilities at fair value. This ASU provides additional guidance clarifying the measurement of liabilities at fair value in circumstances in which a quoted price in an active market for the identical liability is not available; under those circumstances, a reporting entity is required to measure fair value using one or more of valuation techniques, as defined. This ASU is effective for the first reporting period, including interim periods, beginning after the issuance of this ASU. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued an ASU regarding accounting for own-share lending arrangements in contemplation of convertible debt issuance or other financing. This ASU requires that at the date of issuance of the shares in a share-lending arrangement entered into in contemplation of a convertible debt offering or other financing, the shares issued shall be measured at fair value and be recognized as an issuance cost, with an offset to additional paid-in capital. Further, loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the basic and diluted earnings-per-share calculation. This ASU is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The Company is currently evaluating the impact of this ASU on its consolidated financial statements.



In December 2009, FASB issued ASU No. 2009-16, Accounting for Transfers of Financial Assets. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140. The amendments in this Accounting Standards Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In December, 2009, FASB issued ASU No. 2009-17, Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Accounting Standards Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 regarding accounting and reporting for decreases in ownership of a subsidiary. Under this guidance, an entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation of a subsidiary, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. In contrast, an entity is required to account for a decrease in its ownership interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. This ASU clarifies the scope of the decrease in ownership provisions, and expands the disclosures about the deconsolidation of a subsidiary or de-recognition of a group of assets. This ASU is effective for beginning in the first interim or annual reporting period ending on or after December 31, 2009. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-01- Accounting for Distributions to Shareholders with Components of Stock and Cash. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification. The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51.” If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarify existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

### Note 3 - Earnings per share

The FASB's accounting standard for earnings per share requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

All shares and per share amounts used in the Company's financial statements and notes thereto have been retroactively restated to reflect the 40-to-1 reverse stock split, which occurred on September 4, 2008.

The following is a reconciliation of the basic and diluted earnings per share computations for the three months ended December 31, 2009 and 2008:

#### Basic earnings per share

|   | 2009         | 2008         |
|---|--------------|--------------|
| Net income for basic and diluted earnings per share | \$ 5,328,141 | \$ 5,399,186 |
| Weighted average shares used in basic computation   | 10,983,405   | 9,771,883    |
| Earnings per share:                                 |              |              |
| Basic   | \$ 0.49      | \$ 0.55      |

#### Diluted earnings (loss) per share

|   | 2009         | 2008         |
|---|--------------|--------------|
| Net income for basic earnings per share | \$ 5,328,141 | \$ 5,399,186 |
| Add: Interest expense                   | 469,885      | 536,666      |

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|   |              |              |
|---|--------------|--------------|
| Subtract: Loan issuance cost                        | (763,914)    | (1,576,792)  |
| Subtract: Debt discount if converted                | (20,945,255) | (30,853,722) |
| Net income for diluted EPS                          | (15,911,143) | (26,494,662) |
| Weighted average shares used in basic computation   | 10,983,405   | 9,771,883    |
| Diluted effect of stock options and warrants        | 376,896      | 21,434       |
| Diluted effect of \$4,000,000 convertible notes     | 500,000      | 625,000      |
| Diluted effect of \$25,600,000 convertible notes    | 3,205,000    | 3,730,000    |
| Weighted average shares used in diluted computation | 15,065,301   | 14,148,317   |
| Loss per share-Diluted                              | \$ (1.06)    | (1.87)       |

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The following is a reconciliation of the basic and diluted earnings per share computations for the six months ended December 31, 2009 and 2008:

Basic earnings per share

|   | 2009         | 2008         |
|---|--------------|--------------|
| Net income for basic earnings per share           | \$ 7,479,816 | \$ 8,532,670 |
| Weighted average shares used in basic computation | 10,744,648   | 9,770,615    |
| Earnings per share – Basic                        | \$ 0.70      | \$ 0.87      |

Diluted earnings (loss) per share

|   | 2009         | 2008         |
|---|--------------|--------------|
| Net income for basic earnings per share             | \$ 7,479,816 | \$ 8,532,670 |
| Add: Interest expense                               | 990,715      | 1,073,332    |
| Subtract: Loan issuance cost                        | (763,914)    | (1,576,792)  |
| Subtract: Debt discount if converted                | (20,945,255) | (30,856,722) |
| Net income for diluted EPS                          | (13,238,638) | (22,827,512) |
| Weighted average shares used in basic computation   | 10,744,648   | 9,770,615    |
| Diluted effect of stock options and warrants        | 379,957      | 47,848       |
| Diluted effect of \$ 4,000,000 convertible notes    | 500,000      | 625,000      |
| Diluted effect of \$25,600,000 convertible notes    | 3,205,000    | 3,730,000    |
| Weighted average shares used in diluted computation | 14,829,605   | 14,173,463   |
| Loss per share-Diluted                              | \$ (0.89)    | \$ (1.61)    |

For the three and six months ended December 31, 2009, 7,500 vested stock options with an average exercise price of \$17.93 were not included in the diluted earnings per share calculation because of the anti-dilutive effect. For the three months and six months ended December 31, 2008, 2,000 stock options and 1,875,000 warrants with an average exercise price of \$12.00 and \$10.00, respectively, were not included in the diluted earnings per share calculation because of the anti-dilutive effect.

Note 4 - Inventories

Inventories consisted of the following:

|                   | December 31, 2009<br>(Unaudited) | June 30, 2009 |
|-------------------|----------------------------------|---------------|
| Raw materials     | \$ 2,045,408                     | \$ 1,539,602  |
| Work-in-process   | -                                | 55,992        |
| Packing materials | 740,660                          | 483,297       |
| Finished goods    | 1,149,171                        | 1,198,303     |
| Total             | \$ 3,935,239                     | \$ 3,277,194  |



## Note 5 - Plant and equipment

Plant and equipment consisted of the following:

|                                     | December 31, 2009<br>(Unaudited) | June 30, 2009 |
|-------------------------------------|----------------------------------|---------------|
| Buildings and building improvements | \$ 12,838,821                    | \$ 12,798,375 |
| Manufacturing equipment             | 2,771,754                        | 2,715,223     |
| Office equipment and furniture      | 221,165                          | 219,979       |
| Vehicles                            | 478,044                          | 477,396       |
| Total                               | 16,309,784                       | 16,210,973    |
| Less: accumulated depreciation      | (2,648,191)                      | (2,253,576)   |
| Total                               | \$ 13,661,593                    | \$ 13,957,397 |

For the three months ended December 31, 2009 and 2008, depreciation expense amounted to approximately \$195,000 and \$143,000, respectively. For the six months ended December 31, 2009 and 2008, depreciation expense amounted to approximately \$391,000 and \$290,000, respectively.

## Note 6 - Intangible assets

Intangible assets consisted of the following:

|  | December 31, 2009<br>(Unaudited) | June 30, 2009 |
|--|----------------------------------|---------------|
| Land use rights  | \$ 29,232,319                    | \$ 11,245,938 |
| Patents  | 4,941,768                        | 4,937,050     |
| Customer lists and customer relationships                | 1,124,654                        | 1,123,580     |
| Trade secrets, formulas and manufacture process know-how | 1,026,480                        | 1,025,500     |
| Licenses   | 23,389                           | 23,368        |
| Total  | 35,348,610                       | 18,355,436    |
| Less: accumulated amortization                           | (2,105,148)                      | (1,314,255)   |
| Total  | \$ 33,243,462                    | \$ 17,041,181 |

Amortization expense for the three months ended December 31, 2009, and 2008 amounted to approximately \$401,000, and \$74,000, respectively. Total amortization expense for the six months ended December 31, 2009 and 2008 amounted to approximately \$803,000 and \$147,000, respectively.

## Note 7 - Debt

## Short term bank loan

Short term bank loan represents an amount due to a bank that is due within one year. This loan can be renewed with the bank upon maturity. The Company's short term bank loan consisted of the following:

|   | December 31,<br>2009<br>(Unaudited) | June 30,<br>2009 |
|---|-------------------------------------|------------------|
| Loan from Communication Bank; due December 2009; interest rate of 6.37% per annum; monthly interest payment; guaranteed by related party, Jiangbo Chinese-Western Pharmacy. | \$ -                                | \$ 2,197,500     |
| Total   | \$ -                                | \$ 2,197,500     |

Interest expense related to the short term bank loan amounted to approximately \$37,000 and \$0 for three months ended December 31, 2009 and 2008, respectively. Interest expense amounted to approximately \$73,000 and \$59,000 for the six months ended December 31, 2009 and 2008, respectively.

#### Notes Payable

Notes payable represents amounts due to a bank which are secured and typically renewed. All notes payable are secured by the Company's restricted cash. The Company's notes payables consist of the following:

|   | December 31,<br>2009<br>(Unaudited) | June 30, 2009 |
|---|-------------------------------------|---------------|
| Commercial Bank, various amounts, non-interest bearing, due from January 2010 to June 2010; 100% of restricted cash deposited | \$ 14,545,305                       | \$ 7,325,000  |
| Total   | \$ 14,545,305                       | \$ 7,325,000  |

#### Note 8 - Related party transactions

##### Other receivable - related parties

The Company leases two of its buildings to Jiangbo Chinese-Western Pharmacy, a company owned by the Company's Chief Executive Officer and other majority shareholders. For the three months ended December 31, 2009 and 2008, the Company recorded other income of approximately \$81,000 and \$93,000 from leasing the two buildings to this related party. For the six months ended December 31, 2009 and 2008, the Company recorded other income of approximately \$161,000 and \$237,000 from leasing the two buildings to this related party. As of December 31, 2009 and June 30, 2009, amount due from this related party was approximately \$161,000 and \$0, respectively.

##### Other payables - related parties

Other payables-related parties primarily consist of accrued salary payable to the Company's officers and directors, and advances from the Company's Chief Executive Officer. These advances are short-term in nature and bear no interest. The amounts are expected to be repaid in the form of cash.

Other payables - related parties consisted of the following:

|  | December 31,<br>2009<br>(Unaudited) | June 30,<br>2009 |
|--|-------------------------------------|------------------|
| Payable to Cao Wubo, Chief Executive Officer and Chairman of the Board | \$ 252,581                          | \$ 184,435       |
| Payable to Haibo Xu, Chief Operating Officer and Director              | 33,688                              | 33,688           |



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|   |            |            |
|---|------------|------------|
| Payable to Elsa Sung, Chief Financial Officer | 23,920     | 18,333     |
| Payable to John Wang, Director                | 12,500     | 2,500      |
| Total other payable - related parties         | \$ 332,689 | \$ 238,956 |

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## Note 9 – Concentration of major customers, suppliers, and products

For the three months ended December 31, 2009 and 2008, three products accounted for 88% and 92%, respectively, of the Company's total sales. For the six months ended December 31, 2009 and 2008, three products accounted for 87% and 95%, respectively, of the Company's total sales.

For the three months ended December 31, 2009 and 2008, five suppliers accounted for approximately 66% and 69%, respectively, of the Company's purchases. For the six months ended December 31, 2009 and 2008, five suppliers accounted for approximately 67% and 70%, respectively, of the Company's purchases. These five suppliers represented 73% and 82% of the Company's total accounts payable as of December 31, 2009 and June 30, 2009, respectively.

## Note 10 - Taxes payable

The Company is subject to the United States federal income tax at a tax rate of 34%. No provision for U.S. income taxes has been made as the Company had no U.S. taxable income during the six months ended December 31, 2009 and 2008.

The Company's wholly owned subsidiaries Karmoya International Ltd. ("Karmoya") and Union Well International Ltd. ("Union Well") were incorporated in the British Virgin Island ("BVI") and the Cayman Islands, respectively. Under the current laws of the BVI and Cayman Islands, the two entities are not subject to income taxes.

On March 16, 2007, the National People's Congress of China passed the new Enterprise Income Tax Law ("EIT Law"), and on November 28, 2007, the State Council of China passed the Implementing Rules for the EIT Law ("Implementing Rules") which became effective on January 1, 2008. The EIT Law and Implementing Rules impose a unified EIT rate of 25.0% on all domestic-invested enterprises and FIEs, unless they qualify under certain limited exceptions. Therefore, nearly all FIEs are subject to the new tax rate alongside other domestic businesses rather than benefiting from the EIT Law and its associated preferential tax treatments, beginning January 1, 2008.

In addition to the changes to the current tax structure, under the EIT Law, an enterprise established outside of China with "de facto management bodies" within China is considered a resident enterprise and will normally be subject to an EIT of 25.0% on its global income. The Implementing Rules define the term "de facto management bodies" as "an establishment that exercises, in substance, overall management and control over the production, business, personnel, accounting, etc., of a Chinese enterprise." If the PRC tax authorities subsequently determine that the Company should be classified as a resident enterprise, then the organization's global income will be subject to PRC income tax of 25.0%. Laiyang Jiangbo and GJBT were subject to 25% income tax rate since January 1, 2008.

The table below summarizes the differences between the U.S. statutory federal rate and the Company's effective tax rate for the six months ended December 31, 2009 and 2008:

|  | 2009<br>(Unaudited) | 2008<br>(Unaudited) |
|--|---------------------|---------------------|
| U.S. Statutory rates                     | 34.0%               | 34.0%               |
| Foreign income not recognized in the U.S | (34.0)%             | (34.0)%             |
| China income taxes                       | 25.0%               | 25.0%               |
| China income tax exemptions              | -                   | -                   |
| Other items(a)                           | 14.7%               | 11.6%               |
| Total provision for income taxes         | 39.7%               | 36.6%               |



(a) The 14.7% and 11.6% represent the expenses incurred by the Company that are not deductible for PRC income tax purpose for the six months ended December 31, 2009 and 2008, respectively.

#### Taxes payable

|                   | December 31,<br>2009<br>(Unaudited) | June 30,<br>2009     |
|-------------------|-------------------------------------|----------------------|
| Value added taxes | \$ 777,654                          | \$ 4,090,492         |
| Income taxes      | 2,527,828                           | 6,689,199            |
| Other taxes       | 303,183                             | 468,535              |
| <b>Total</b>      | <b>\$ 3,608,665</b>                 | <b>\$ 11,248,226</b> |

#### Note 11 - Convertible Debt

##### November 2007 Convertible Debentures

On November 7, 2007, the Company entered into a Securities Purchase Agreement (the “November 2007 Purchase Agreement”) with Pope Investments, LLC (“Pope”) (the “November 2007 Investor”). Pursuant to the November 2007 Purchase Agreement, the Company issued and sold to the November 2007 Investor, \$5,000,000 principal amount of 6% convertible subordinated debentures due November 30, 2010 (the “November 2007 Debenture”) and a three-year warrant to purchase 250,000 shares of the Company’s common stock, par value \$0.001 per share, exercisable at \$12.80 per share, subject to adjustment as provided therein. The November 2007 Debenture bears interest at the rate of 6% per annum and the initial conversion price of the debentures is \$10 per share. In connection with the offering, the Company placed in escrow 500,000 shares of its common stock. As of December 31, 2009, the 500,000 shares are still in escrow. In connection with the May 2008 financing, the November 2007 Debenture conversion price was subsequently adjusted to \$8 per share (Post 40-to-1 reverse split).

The Company evaluated the FASB’s accounting standard regarding convertible debentures and concluded that the convertible debenture has a beneficial conversion feature. The Company estimated the intrinsic value of the beneficial conversion feature of the November 2007 Debenture at \$2,904,093. The fair value of the warrants was estimated at \$2,095,907. The two amounts are recorded together as debt discount and amortized using the effective interest method over the three-year term of debentures.

The fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.5%), (2) expected warrant life of 3 years, (3) expected volatility of 197%, and (4) zero expected dividends. The total estimated fair value of the warrants granted and beneficial conversion feature of the November 2007 Debenture should not exceed the \$5,000,000 November 2007 Debenture, and the calculated warrant value was used to determine the allocation between the fair value of the beneficial conversion feature of the November 2007 Debenture and the fair value of the warrants.

In connection with the private placement, the Company paid the placement agents a fee of \$250,000 and incurred other expenses of \$104,408, which were capitalized as deferred debt issuance costs and are being amortized to interest expense over the life of the debentures. For the three months ended December 31, 2009 and 2008, amortization of financing costs related to the November 2007 Purchase Agreement was \$48,541 and \$29,534, respectively. For the six months ended December 31, 2009 and 2008, amortization of debt issuance costs related to the November 2007 Purchase Agreement was \$78,075 and \$59,086, respectively. The amortization of debt issuance costs has been included in interest expense. The remaining balance of unamortized debt issuance costs of the November 2007

Purchase Agreement at December 31, 2009 and June 30, 2009 was \$81,080 and \$159,155. The amortization of debt discounts was \$1,040,593 and \$178,337, respectively, for the three months ended December 31, 2009 and 2008. The amortization of debt discounts was \$1,394,422 and \$319,917, respectively, for the six months ended December 31, 2009 and 2008, respectively. The amortization of debt discount has been included in interest expense on the accompanying consolidated statements of income. The balance of the debt discount was \$2,242,655 and \$3,637,077 at December 31, 2009 and June 30, 2009, respectively.

The November 2007 Debenture bears interest at the rate of 6% per annum, payable in semi-annual installments on May 31 and November 30 of each year, with the first interest payment due on May 31, 2008. The initial conversion price (“November 2007 Conversion Price”) of the November 2007 Debentures is \$10 per share. If the Company issues common stock at a price that is less than the effective November 2007 Conversion Price, or common stock equivalents with an exercise or conversion price less than the then effective November 2007 Conversion Price, the November 2007 Conversion Price of the November 2007 Debenture and the exercise price of the warrants will be reduced to such price. The November 2007 Debenture may not be prepaid without the prior written consent of the Holder, as defined. In connection with the Offering, the Company placed in escrow 500,000 shares of common stock issued by the Company in the name of the escrow agent. In the event the Company’s consolidated Net Income Per Share (as defined in the November 2007 Purchase Agreement), for the year ended June 30, 2008, is less than \$1.52, the escrow agent shall deliver the 500,000 shares to the November 2007 Investor. The Company determined that its fiscal 2008 Net Income Per Share met the required amount and no shares were delivered to the November 2007 Investor. As of December 31, 2009, the 500,000 shares are still in escrow.

Pursuant to the November 2007 Purchase Agreement, the Company entered into a Registration Rights Agreement. In accordance with the Registration Rights Agreement, the Company must file on each Filing Date (as defined in the Registration Rights Agreement) a registration statement to register the portion of the Registerable Securities (as defined therein) as permitted by the Securities and Exchange Commission’s guidance. The initial registration statement must be filed within 90 days of the closing date and declared effective within 180 days following such closing date. Any subsequent registration statements that are required to be filed on the earliest practical date on which the Company is permitted by the Securities and Exchange Commission’s guidance to file such additional registration statements, these statements must be effective 90 days following the date on which it is required to be filed. In the event that the registration statement is not timely filed or declared effective, the Company will be required to pay liquidated damages. Such liquidated damages shall be, at the investor’s option, either \$1,643.83 or 164 shares of common stock per day that the registration statement is not timely filed or declared effective as required pursuant to the Registration Rights Agreement, subject to an amount of liquidated damages not exceeding either \$600,000, and 60,000 shares of common stock, or a combination thereof based upon 12% liquidated damages in the aggregate. The accounting standards require potential registration payment arrangements be treated as a contingency rather than at fair value. The November 2007 Investor has subsequently agreed to allow the Company to file the November 2007 registration statement in conjunction with the Company’s financing in May 2008 and, as such, no liquidated damages were incurred for the year ended June 30, 2008.

During the six months ended December 31, 2009, the Company issued 125,000 shares of its common stock upon conversion of \$1,000,000 November 2007 convertible debt. As of December 31, 2009, a total of \$1,000,000 November 2007 convertible debt has been converted into common shares.

#### May 2008 Convertible Debentures

On May 30, 2008, the Company entered into a Securities Purchase Agreement (the “May 2008 Securities Purchase Agreement”) with certain investors (the “May 2008 Investors”), pursuant to which, on May 30, 2008, the Company sold to the May 2008 Investors 6% convertible debentures (the “May 2008 Notes”) and warrants to purchase 1,875,000 shares of the Company’s common stock (“May 2008 Warrants”), for an aggregate amount of \$30,000,000 (the “May 2008 Purchase Price”), in transactions exempt from registration under the Securities Act (the “May 2008 Financing”). Pursuant to the terms of the May 2008 Securities Purchase Agreement, the Company will use the net proceeds from the financing for working capital purposes. Also pursuant to the terms of the May 2008 Securities Purchase Agreement, the Company must, among other things, increase the number of its authorized shares of common stock to 22,500,000 by August 31, 2008, and is prohibited from issuing any “Future Priced Securities” as such term is described by NASD IM-4350-1 for one year following the closing of the May 2008 Financing. The Company has satisfied the increase in the number of its authorized shares of common stock in August 2008 (post 40-to-1 reverse split).



The May 2008 Notes are due May 30, 2011, and are convertible into shares of the Company's common stock at a conversion price equal to \$8 per share, subject to adjustment pursuant to customary anti-dilution provisions and automatic downward adjustments in the event of certain sales or issuances by the Company of common stock at a price per share less than \$8. Interest on the outstanding principal balance of the May 2008 Notes is payable at a rate of 6% per annum, in semi-annual installments payable on November 30 and May 30 of each year, with the first interest payment due on November 30, 2008. At any time after the issuance of the May 2008 Note, any May 2008 Investor may convert its May 2008 Note, in whole or in part, into shares of the Company's common stock, provided that such May 2008 Investor shall not effect any conversion if immediately after such conversion, such May 2008 Investor and its affiliates would, in the aggregate, beneficially own more than 9.99% of the Company's outstanding common stock. The May 2008 Notes are convertible at the option of the Company if the following four conditions are met: (i) effectiveness of a registration statement with respect to the shares of the Company's common stock underlying the May 2008 Notes and the Warrants; (ii) the Volume Weighted Average Price ("VWAP" of the common stock has been equal to or greater than 250% of the conversion price, as adjusted, for 20 consecutive trading days on its principal trading market; (iii) the average dollar trading volume of the common stock exceeds \$500,000 on its principal trading market for the same 20 days; and (iv) the Company achieves 2008 Guaranteed EBT (as hereinafter defined) and 2009 Guaranteed EBT (as hereinafter defined). A holder of a May 2008 Note may require the Company to redeem all or a portion of such May 2008 Note for cash at a redemption price as set forth in the May 2008 Notes, in the event of a change in control of the Company, an event of default or if any governmental agency in the PRC challenges or takes action that would adversely affect the transactions contemplated by the Securities Purchase Agreement. The May 2008 Warrants are exercisable for a five-year period beginning on May 30, 2008, at an initial exercise price of \$10 per share.

The Company estimated the intrinsic value of the beneficial conversion feature of the May 2008 Note at \$19,111,323. The fair value of the warrants was estimated at \$10,888,677. The two amounts are recorded together as debt discount and amortized using the effective interest method over the three-year term of the debentures.

The fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.2%), (2) expected warrant life of 5 years, (3) expected volatility of 95%, and (4) zero expected dividends. The total estimated fair value of the warrants granted and beneficial conversion feature of the May 2008 Note should not exceed the \$30,000,000 debenture, and the calculated warrant value was used to determine the allocation between the fair value of the beneficial conversion feature of the May 2008 debenture and the fair value of the warrants.

In connection with the private placement, the Company paid the placement agents a fee of \$1,500,000 and incurred other expenses of \$186,500, which were capitalized as deferred debt issuance costs and are being amortized to interest expense over the life of the debenture. During the three months ended December 31, 2009 and 2008, amortization of debt issuance costs related to the May 2008 Purchase Agreement was \$236,426 and \$140,541, respectively. During the six months ended December 31, 2009 and 2008, amortization of debt issuance costs related to the May 2008 Purchase Agreement was \$384,177 and \$281,083, respectively. The remaining balance of unamortized debt issuance costs of the May 2008 Purchase Agreement at December 31, 2009 and June 30, 2009 was \$682,835 and \$1,077,513, respectively. The amortization of debt discounts was \$4,426,373 and \$805,347 for the three months ended December 31, 2009 and 2008 and was \$6,153,413 and \$1,326,318 for the six months ended December 31, 2009 and 2008 respectively, which has been included in interest expense on the accompanying consolidated statements of income. The balance of the unamortized debt discount was \$18,702,600 and \$24,856,012 at December 31, 2009 and June 30, 2009, respectively.

In connection with the May 2008 Financing, the Company entered into a holdback escrow agreement (the "Holdback Escrow Agreement") dated May 30, 2008, with the May 2008 Investors and Loeb & Loeb LLP, as Escrow Agent, pursuant to which \$4,000,000 of the May 2008 Purchase Price was deposited into an escrow account with the Escrow Agent at the closing of the Financing. Pursuant to the terms of the Holdback Escrow Agreement, (i) \$2,000,000 of the



escrowed funds will be released to the Company upon the Company's satisfaction no later than 120 days following the closing of the Financing of an obligation that the board of directors be comprised of at least five members (at least two of whom are to be fluent English speakers who possess necessary experience to serve as a director of a public company), a majority of whom will be independent directors acceptable to Pope Investments LLC ("Pope") and (ii) \$2,000,000 of the escrowed funds will be released to the Company upon the Company's satisfaction no later than six months following the closing of the Financing of an obligation to hire a qualified full-time chief financial officer (as defined in the May 2008 Securities Purchase Agreement). In the event that either or both of these obligations are not so satisfied, the applicable portion of the escrowed funds will be released pro rata to the Investors. The Company has satisfied both requirement and the holdback money was released to the Company in July 2008.

In connection with the May 2008 Financing, Mr. Cao, the Company's Chief Executive Officer and Chairman of the Board, placed 3,750,000 shares of common stock of the Company owned by him into an escrow account pursuant to a make good escrow agreement, dated May 30, 2008 (the "Make Good Escrow Agreement"). In the event that either (i) the Company's adjusted 2008 earnings before taxes is less than \$26,700,000 ("2008 Guaranteed EBT") or (ii) the Company's 2008 adjusted fully diluted earnings before taxes per share is less than \$1.60 ("2008 Guaranteed Diluted EBT"), 1,500,000 of such shares (the "2008 Make Good Shares") are to be released pro rata to the May 2008 Investors. In the event that either (i) the Company's adjusted 2009 earnings before taxes is less than \$38,400,000 ("2009 Guaranteed EBT") or (ii) the Company's adjusted fully diluted earnings before taxes per share is less than \$2.32 (or \$2.24 if the 500,000 shares of common stock held in escrow in connection with the November 2007 private placement have been released from escrow) ("2009 Guaranteed Diluted EBT"), 2,250,000 of such shares (the "2009 Make Good Shares") are to be released pro rata to the May 2008 Investors. Should the Company successfully satisfy these respective financial milestones, the 2008 Make Good Shares and 2009 Make Good Shares will be returned to Mr. Cao. In addition, Mr. Cao is required to deliver shares of common stock owned by him to the Investors on a pro rata basis equal to the number of shares (the "Settlement Shares") required to satisfy all costs and expenses associated with the settlement of all legal and other matters pertaining to the Company prior to or in connection with the completion of the Company's October 2007 share exchange in accordance with formulas set forth in the May 2008 Securities Purchase Agreement (post 40-to-1 reverse split). The Company has determined that both thresholds for the years ended June 30, 2009 and June 30, 2008 have been met. The make good shares have yet to be returned to Mr. Cao.

The security purchase agreement set forth permitted indebtedness which the Company's lease obligations and purchase money indebtedness is limited up to \$1,500,000 per year in connection with new acquisition of capital assets and lease obligations. Permitted investment set forth with the security purchase agreement limits capital expenditure of the Company not to exceed \$5,000,000 in any rolling 12 months.

Pursuant to a Registration Rights Agreement, the Company agreed to file a registration statement covering the resale of the shares of common stock underlying the May 2008 Notes and Warrants, (i) the 2008 Make Good Shares, (ii) the 2009 Make Good Shares, and (iii) the Settlement Shares. The Company must file an initial registration statement covering the shares of common stock underlying the Notes and Warrants no later than 45 days from the closing of the Financing and to have such registration statement declared effective no later than 180 days from the closing of the Financing. If the Company does not timely file such registration statement or cause it to be declared effective by the required dates, then the Company will be required to pay liquidated damages to the Investors equal to 1.0% of the aggregate May 2008 Purchase Price paid by such Investors for each month that the Company does not file the registration statement or cause it to be declared effective. Notwithstanding the foregoing, in no event shall liquidated damages exceed 10% of the aggregate amount of the May 2008 Purchase Price. The Company satisfied its obligations under the Registration Rights Agreement by filing the required registration statement and causing it to be declared effective within the time periods set forth in the Registration Rights Agreement.

During the six months ended December 31, 2009, the Company issued 525,000 shares of its common stock upon conversion of \$4,200,000 convertible debt. As of December 31, 2009, a total of \$4,360,000 May 2008 convertible debt has been converted into common shares.

The above two convertible debenture liabilities are as follows:

|  | December 31,<br>2009<br>(Unaudited) | June 30, 2009 |
|--|-------------------------------------|---------------|
| November 2007 convertible debenture note payable                               | \$ 4,000,000                        | \$ 5,000,000  |
| May 2008 convertible debenture note payable                                    | 25,640,000                          | 29,840,000    |
| Total convertible debenture note payable                                       | 29,640,000                          | 34,840,000    |
| Less: Unamortized discount on November 2007 convertible debenture note payable | (2,242,655)                         | (3,637,077)   |

|   |              |              |
|---|--------------|--------------|
| Less: Unamortized discount on May 2008 convertible debenture note payable | (18,702,600) | (24,856,012) |
| Convertible debentures, net   | \$ 8,694,745 | \$ 6,346,911 |

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## Interest

As a result of the delay in its ability to transfer cash out of PRC (partially due to the stricter foreign exchange restrictions and regulations imposed in the PRC starting in December 2008), the Company became delinquent on the payment of interests under the November 2007 Debentures and May 2008 Notes in December 2009. Accrual interest as of December 31, 2009 amounted to \$1,207,387, which are included in other payables on the accompanying consolidated balance sheets. The Company has entered to a waiver agreement relating to the delinquent interest payment. See Note 19 – Subsequent event for more details.

## Note 12 - Shareholders' equity

### Common Stock

In July 2009, the Company issued 1,009 shares of common stock to a Company's current director as part of his compensation for services. The Company valued these shares at the fair market value on the date of grant of \$9.91 per share, or \$10,000 in total, based on the trading price of common stock. For the six months ended December 31, 2009, the Company recorded stock based compensation expense of \$10,000 accordingly.

In August 2009, the Company issued 82,500 shares to Pope as interest payment for the interest due on May 30, 2009 on the November 2007 Debentures and the May 2008 Notes. The Company valued these shares at the fair market value on the date of grant of \$11.81 per share based on the trading price of common stock, or \$974,325 in total, of which \$660,000 was recorded as interest expense at June 30, 2009 and \$314,325 was recorded as additional interest expense in the six months ended December 31, 2009.

As a result of the delay in its ability to transfer cash out of the PRC (partially due to the stricter foreign exchange restrictions and regulations imposed in the PRC starting in December 2008), the Company became delinquent on the payment of interests under the November 2007 Debentures and May 2008 Notes in June 2008. On August 10, 2009, the Company and Pope entered into a Letter Agreement (the "Letter Agreement"), whereby Pope agreed (i) to waive certain provisions set forth in the November 2007 Purchase Agreement, by and between the Company and Pope with respect to the November 2007 Debentures of the Company issued to Pope, and (ii) to waive certain provisions set forth in the May 2008 Securities Purchase Agreement, by and between the Company and the investors who are parties thereto (collectively, the "Investors") with respect to the May 2008 Notes issued to the Investors. Pope is the holder of \$5,000,000 principal amount of the November 2007 Debentures and the holder of \$17,000,000 aggregate principal amount of the May 2008 Notes (collectively, the "Pope Notes"). Pursuant to the Letter Agreement, Pope (i) agreed to waive until August 17, 2009 the Events of Default (as defined in the November 2007 Debentures and May 2008 Notes) that have occurred as a result of the Company's failure to timely make interest payments on the November 2007 Debentures and May 2008 Notes that were due and payable on May 30, 2009, and agreed not to provide written notice to the Company with respect to the occurrence of either of such Events of Default provided that the Company has made such interest payment to the holders of the November 2007 Debentures and the holders of the May 2008 Notes on or prior to August 17, 2009, (ii) agreed that in lieu of payment of the \$660,000 in cash interest with respect to the Pope Notes that was due and payable to Pope on May 30, 2009, that the Company shall issue to Pope on or prior to August 17, 2009, 82,500 shares (the "Shares") of its Common Stock (such payment shall be referred to herein as the "Special Interest Payment"), and (iii) waived each and every applicable provision of the 2007 Purchase Agreement, the 2008 Securities Purchase Agreement (including, without limitation Section 4.17 (Right of First Refusal) and 4.21(c) (Additional Negative Covenants of the Company)), the November 2007 Debentures and the May 2008 Notes, each to the extent necessary in order to permit the Company to make the Special Interest Payment. As of December 31, 2009, the Company fully satisfied its interest payment obligations related to the Letter Agreement.

In September 2009, the Company issued 62,500 shares of its common stock in connection with the conversion of \$500,000 of convertible debt. In connection with the conversion, the Company recorded \$402,112 of interest expense

to fully amortize the unamortized discount and deferred financing costs related to the converted dentures. In connection with the conversion, the Company issued 938 shares of its common stock for the final interest payment. The Company valued the 938 shares at the fair market value on the date of issuance of \$11 per share and recorded \$10,300 interest expense in total.

In October 2009, the Company issued 462,500 shares of its common stock in connection with the conversion of \$3,700,000 of convertible debt. In connection with the conversion, the Company recorded \$3,032,668 of interest expense to fully amortize the unamortized discount and deferred financing costs related to the converted dentures.

In November 2009, the Company issued 62,500 shares of its common stock in connection with the conversion of \$500,000 of convertible debt. In connection with the conversion, the Company recorded \$326,425 of interest expense to fully amortize the unamortized discount and deferred financing costs related to the converted dentures.

In December 2009, the Company issued 62,500 shares of its common stock in connection with the conversion of \$500,000 of convertible debt. In connection with the conversion, the Company recorded \$309,373 of interest expense to fully amortize the unamortized discount and deferred financing costs related to the converted dentures.

#### Registered capital contribution receivable

At inception, Karmoya issued 1,000 shares of common stock to its founder. The shares were valued at par value. On September 20, 2007, the Company issued 9,000 shares of common stock to nine individuals at par value. The balance of \$10,000 is shown in capital contribution receivable on the accompanying consolidated financial statements. As part of its agreements with shareholders, the Company was to receive the entire \$10,000 in October 2007. As of December 31, 2009, the Company has not received the \$10,000.

Union Well was established on May 9, 2007, with a registered capital of \$1,000. In connection with Karmoya's acquisition of Union Well, the registered capital of \$1,000 is reflected as capital contribution receivable on the accompanying consolidated financial statements. The \$1,000 was due in October 2007, however, as of December 31, 2009, the Company has not received the \$1,000.

#### Note 13 - Warrants

In connection with the \$5,000,000 November 2007 Convertible Debenture, 6% convertible subordinated debentures note, the Company issued a three-year warrant to purchase 250,000 shares of common stock, at an exercise price of \$12.80 per share. The calculated fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.5%), (2) expected warrant life of 3 years, (3) expected volatility of 197%, and (4) zero expected dividends. In connection with the May 2008 financing, the exercise price of outstanding warrants issued in November 2007 was reduced to \$8 per share and the total number of warrants to purchase common stock was increased to 400,000.

In connection with the \$30,000,000 May 2008 Convertible Debenture, 6% convertible subordinated debentures note, the Company issued a five-year warrant to purchase 1,875,000 shares of common stock, at an exercise price of \$10 per share. The calculated fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.5%), (2) expected warrant life of 5 years, (3) expected volatility of 95%, and (4) zero expected dividends.

On February 15, 2009, the Company granted 40,000 stock warrants to a consultant at an exercise price of \$6.00 per share exercisable for a period of three years. The warrants fully vest on July 15, 2009. The fair value of this warrant grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: (1) risk-free interest rate at the date of grant (1.83%), (2) expected warrant life of three years, (3) expected volatility of 106%, and (4) zero expected dividends. In connection with these warrants, the Company recorded stock-based compensation expense of \$126,616 for the six months ended December 31, 2009.

A summary of the warrants as of December 31, 2009, and changes during the period are presented below:

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|   | Number of warrants |
|---|--------------------|
| Outstanding as of June 30, 2008                 | 2,349,085          |
| Granted   | 40,000             |
| Forfeited                                       | (74,085)           |
| Exercised                                       | -                  |
| Outstanding as of June 30, 2009                 | 2,315,000          |
| Granted   | -                  |
| Forfeited                                       | -                  |
| Exercised                                       | -                  |
| Outstanding as of December 31, 2009 (unaudited) | 2,315,000          |

The following is a summary of the status of warrants outstanding at December 31, 2009:

| Outstanding Warrants |           |  | Exercisable Warrants   |           |  |
|----------------------|-----------|--|------------------------|-----------|--|
| Exercise Price       | Number    | Average Remaining Contractual Life (Years) | Average Exercise Price | Number    | Average Remaining Contractual Life (Years) |
| \$ 6.00              | 40,000    | 2.13                                       | \$ 6.00                | 40,000    | 2.13                                       |
| \$ 8.00              | 400,000   | 0.83                                       | \$ 8.00                | 400,000   | 0.83                                       |
| \$ 10.00             | 1,875,000 | 3.42                                       | \$ 10.00               | 1,875,000 | 3.42                                       |
| Total                | 2,315,000 |  |                        | 2,315,000 |  |

The Company has 2,315,000 warrants outstanding and exercisable at an average exercise price of \$9.58 per share as of December 31, 2009.

#### Note 14 - Stock options

On July 1, 2007, 133,400 options were granted and the fair value of these options was estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

|                 | Expected Life | Expected Volatility | Dividend Yield | Risk Free Interest Rate | Grant Date Average Fair Value |
|-----------------|---------------|---------------------|----------------|-------------------------|-------------------------------|
| Former officers | 3.50 years    | 195%                | 0%             | 4.50%                   | \$ 5.20                       |

On June 10, 2008, 7,500 options were granted and the fair value of these options was estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

|                 | Expected Life | Expected Volatility | Dividend Yield | Risk Free Interest Rate | Grant Date Average Fair Value |
|-----------------|---------------|---------------------|----------------|-------------------------|-------------------------------|
| Current officer | 5 years       | 95%                 | 0%             | 2.51%                   | \$ 8.00                       |

As of December 31, 2009, of the 7,500 options held by the Company's executives, directors, and employees, are fully vested.



The following is a summary of the option activity:

|   | Number of options |
|---|-------------------|
| Outstanding as of June 30, 2008                 | 140,900           |
| Granted   | -                 |
| Forfeited                                       | -                 |
| Exercised                                       | -                 |
| Outstanding as of June 30, 2009                 | 140,900           |
| Granted   | -                 |
| Forfeited                                       | -                 |
| Exercised                                       | -                 |
| Outstanding as of December 31, 2009 (unaudited) | 140,900           |

Following is a summary of the status of options outstanding at December 31, 2009:

| Outstanding options    |         |  | Exercisable options    |         |  |
|------------------------|---------|--|------------------------|---------|--|
| Average Exercise Price | Number  | Average Remaining Contractual Life (years) | Average Exercise Price | Number  | Average Remaining Contractual Life (years) |
| \$ 4.20                | 133,400 | 0.75                                       | \$ 4.20                | 133,400 | 0.75                                       |
| \$ 12.00               | 2,000   | 3.20                                       | \$ 12.00               | 2,000   | 3.20                                       |
| \$ 16.00               | 1,750   | 3.20                                       | \$ 16.00               | 1,750   | 3.20                                       |
| \$ 20.00               | 1,875   | 3.20                                       | \$ 20.00               | 1,875   | 3.20                                       |
| \$ 24.00               | 1,875   | 3.20                                       | \$ 24.00               | 1,875   | 3.20                                       |
| \$ 4.93                | 140,900 |  | \$ 4.93                | 140,900 |  |

For the six months ended December 31, 2009 and 2008, the company recorded stock-based compensation expense of \$8,848 and \$8,861 related to those options. At December 31, 2009 and June 30, 2009, there was \$0 and \$8,488 total unrecognized compensation expense related to non vested share-based compensation arrangements for these options.

#### Note 15 - Employee pension

The employee pension in the Company generally includes two parts: the first part to be paid by the Company is 30.6% of \$128 for each qualified employee each month. The other part, paid by the employees, is 11% of \$128 each month. For the three months ended December 31, 2009 and 2008, the Company made pension contributions in the amount of \$16,908 and \$10,613, respectively. For the six months ended December 31, 2009 and 2008, the Company made pension contributions in the amount of \$30,272 and \$20,274, respectively.

#### Note 16 - Statutory reserves

The Company is required to make appropriations to reserve funds, comprising the statutory surplus reserve 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 ("PRC GAAP"). Appropriations to the statutory surplus reserve is required to be at least 10% of the after tax net income determined in accordance with PRC GAAP until the reserve is equal to 50% of the entities' registered capital. Appropriations to the discretionary surplus reserve are made at the discretion of the Board of Directors.



The statutory surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

The discretionary surplus fund may be used to acquire fixed assets or to increase the working capital to expend on production and operation of the business. The Company's Board of Directors decided not to make an appropriation to this reserve for 2008.

Pursuant to the Company's articles of incorporation, the Company is required to appropriate 10% of the net profit as statutory surplus reserve up to 50% of the Company's registered capital. During the year ended June 30, 2008, the Company's statutory surplus reserve reached 50% of its registered capital.

#### Note 17 - Accumulated other comprehensive income

The components of accumulated other comprehensive income is as follows:

|  |              |
|--|--------------|
| Balance, June 30, 2008                   | \$ 7,700,905 |
| Foreign currency translation gain        | 336,927      |
| Unrealized loss on marketable securities | (1,514,230)  |
| Balance, June 30, 2009                   | \$ 6,523,602 |
| Foreign currency translation gain        | 196,884      |
| Unrealized gain on marketable securities | 56,371       |
| Balance, December 31, 2009 (unaudited)   | \$ 6,776,857 |

#### Note 18 - Commitments and Contingencies

##### Operations based in PRC

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition, and results of operations may be influenced by the political, economic, and legal environments in the PRC, and by the general state of the PRC's economy.

The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, the political, economic, and legal environments, and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among others.

##### R&D Agreement

In September 2007, the Company entered into a three year Cooperative Research and Development Agreement ("CRADA") with a provincial university. Under the CRADA, the university is responsible for designing, researching and developing designated pharmaceutical projects for the Company. Additionally, the university will also provide technical services and trainings to the Company. As part of the CRADA, the Company will pay approximately \$3.5 million (RMB 24,000,000) plus out-of-pocket expenses to the university annually and provide internship opportunities for students of the university. The Company will have the primary ownership of the designated research and development project results.

In November 2007, the Company entered into a five year CRADA with a research institute. Under this CRADA, the institute is responsible for designing, researching and developing designated pharmaceutical projects for the Company. Additionally, the university will also provide technical services and trainings to the Company. As part of the CRADA, the Company will pay approximately \$880,000 (RMB 6,000,000) to the institute annually. The Company will have the primary ownership of the designated research and development project results.

For the three months ended December 31, 2009 and 2008, approximately \$1,100,000 and \$1,098,000, respectively was incurred as research and development expense. For the six months ended December 31, 2009 and 2008, approximately \$ 2,200,000 and \$2,196,000, respectively was incurred as research and development expense. As of December 31, 2009, the Company's future estimated payments to those two CRADAs amounted to approximately \$7.8 million.

#### Legal proceedings

The Company is involved in various legal matters arising in the ordinary course of business. The following summarizes the Company's pending and settled legal proceedings as of December 31, 2009:

CRG Partners, Inc. and Capital Research Group, Inc. and Genesis Technology Group, Inc., n/k/a Genesis Pharmaceuticals Enterprises, Inc. (Arbitration) - Case No. 32 145 Y 00976 07, American Arbitration Association, Southeast Case Management Center

On December 4, 2007, CRG Partners, Inc. ("CRGP"), a former consultant of the Company, filed a demand for arbitration against the Company alleging breach of contract and seeking damages of approximately \$10 million as compensation for consulting services rendered to the Company. The amount of damages sought by the claimant was equal to the dollar value of 29,978,900 shares of the Company's common stock (Pre 40-to-1 reverse split) in November 2007, in which the claimant alleged were due and owing to CRGP. On December 5, 2007, the Company gave notice of termination of the relationship with CRG under the consulting agreement. CRGP subsequently filed an amendment to the demand for arbitration to include Capital Research Group, Inc. ("CRG") as an added claimant and increased the damage amount sought under this matter to approximately \$13.8 million. The Company subsequently filed counter claims in reference to the aforementioned allegations of breach of contract.

In February 2009, the Company was notified by the arbitration panel of American Arbitration Association (the "Panel") that the Panel awarded CRG and CRGP jointly, a net total of \$980,070 (the "Award") to be paid by the Company on or before February 27, 2009. Once the Award is satisfied, CRG and CRGP would have no further claims against the Company's common stock or other property that were the subject of the arbitration. The amount has been charged to operations for year ended June 30, 2009, and is included in liabilities assumed from during the reorganization as of June 30, 2009.

On March 6, 2009, CRG Partners, Inc. ("CRGP") and Capital Research Group, Inc. ("CRG"), former consultants of the Company, filed a motion to confirm the arbitration award conferred by a panel of arbitrators of the American Arbitration Association on February 2, 2009. On July 15, 2009, the Circuit Court of the 11th Judicial Circuit in and for Miami-Dade County confirmed the arbitration award and entered judgment against Genesis Technology Group, Inc. At December 31, 2009, the award has been fully settled and paid.

#### Note 19- Subsequent event

In January 2010, the Company issued 311,250 shares of its common stock in connection with the conversion of \$2,490,000 of May 2008 Convertible Debentures. In connection with the conversions, the Company issued 577 shares of its common stock for the final interest payment.

On February 15, 2010, the Company and Pope Investments LLC ("Pope") entered into a Letter Agreement (the "Letter Agreement"), whereby Pope agreed (i) to waive until February 25, 2009 certain provisions set forth in the November 2007 Purchase Agreement, by and between the Company and Pope with respect to the November 2007 Debentures of the Company issued to Pope, and (ii) to waive until February 25, 2009 certain provisions set forth in the May 2008 Securities Purchase Agreement, by and between the Company and the investors who are parties thereto (collectively, the "Investors") with respect to the May 2008 Notes issued to the Investors. Pope agreed not to provide written notice to

the Company provided that the Company has made the November 2009 interest payments to the holders of the 2007 Notes and the holders of the 2008 Notes on or prior to February 25, 2010. If the interest payments are not made by February 25, 2010, all rights and remedies of Pope defined in the 2007 and 2008 Securities Purchase Agreements shall remain in full force and effect as if this waiver had not been granted. The Company also agreed that in the event that its common stock has not been listed on the Nasdaq Stock Market on or prior to April 15, 2010, that the Company shall pay to the holders of the 2007 Notes and the 2008 Notes an amount equal to the difference between the interest on such Notes previously paid for the period from June 1, 2009 to November 30, 2009. At November 30, 2009, Pope is the holder of \$4,500,000 principal amount of the November 2007 Debentures and the holder of \$17,000,000 aggregate principal amount of the May 2008 Notes (collectively, the "Pope Notes").

The Company has performed an evaluation of subsequent events through February 19, 2010, the date these consolidated financial statements were issued.

## CAUTIONARY NOTICE REGARDING FORWARD-LOOKING INFORMATION

All statements contained in this Quarterly Report on Form 10-Q ("Form 10-Q") for Jiangbo Pharmaceuticals, Inc., other than statements of historical facts, that address future activities, events or developments are forward-looking statements, including, but not limited to, statements containing the words "believe," "anticipate," "expect," and words of similar import. These statements are based on certain assumptions and analyses made by us in light of our experience and our assessment of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate under the circumstances. However, whether actual results will conform to the expectations and predictions of management is subject to a number of risks and uncertainties that may cause actual results to differ materially.

Such risks include, among others, the following: international, national and local general economic and market conditions; our ability to sustain, manage or forecast our growth; raw material costs and availability; new product development and introduction; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; the loss of significant customers or suppliers; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; the ability to protect technology; and other factors referenced in this and previous filings.

Consequently, all of the forward-looking statements made in this Form 10-Q are qualified by these cautionary statements and there can be no assurance that the actual results anticipated by management will be realized or, even if substantially realized, that they will have the expected consequences to or effects on our business operations. As used in this Form 10-Q, unless the context requires otherwise, "we," "us," "Jiangbo" or the "Company" means Jiangbo Pharmaceuticals, Inc. and its subsidiaries.

### Item 2. Management's Discussion and Analysis or Plan of Operation

The following discussion and analysis of the results of operations and financial condition of Jiangbo Pharmaceuticals, Inc. for the six months and three months ended December 31, 2009 and 2008 should be read in conjunction with Jiangbo's financial statements and the notes to those financial statements that are included elsewhere in this Quarterly Report on Form 10-Q. Our discussion includes forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions. Actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth under the Risk Factors, and Cautionary Notice Regarding Forward-Looking Statements in this Form 10-Q. We use words such as "anticipate," "estimate," "plan," "project," "continuing," "ongoing," "expect," "believe," "intend," "may," "will," "should," "could," and similar expressions to identify forward-looking statements.

### OVERVIEW

We were incorporated on August 15, 2001, in the State of Florida under the name Genesis Technology Group, Inc. On October 12, 2001, we consummated a merger with NewAgeCities.com, an Idaho public corporation formed in 1969. We were the surviving entity after the merger. On October 12, 2007, the Company's corporate name was changed to Genesis Pharmaceuticals Enterprises, Inc.

Pursuant to a Certificate of Amendment to our Amended and Restated Articles of Incorporation filed with the State of Florida which took effect as of April 16, 2009, our name was changed from "Genesis Pharmaceuticals Enterprises, Inc." to "Jiangbo Pharmaceuticals, Inc." (the "Corporate Name Change"). The Corporate Name Change was approved and authorized by our Board of Directors as well as our holders of a majority of the outstanding shares of voting stock by written consent.

As a result of the Corporate Name Change, our stock symbol changed to "JGBO" with the opening of trading on May 12, 2009, on the OTCBB.



On October 1, 2007, we completed a share exchange transaction by and among us, Karmoya International Ltd. (“Karmoya”), a British Virgin Islands company, and Karmoya’s shareholders. As a result of the share exchange transaction, Karmoya, a company which was established as a “special purpose vehicle” for the foreign capital raising activities of its Chinese subsidiaries, became our wholly-owned subsidiary and our new operating business. Karmoya was incorporated under the laws of the British Virgin Islands on July 17, 2007, and owns 100% of the capital stock of Union Well International Limited (“Union Well”), a Cayman Islands company. Karmoya conducts its business operations through Union Well’s wholly-owned subsidiary, Genesis Jiangbo (Laiyang) Biotech Technology Co., Ltd. (“GJBT”). GJBT was incorporated under the laws of the People’s Republic of China (“PRC”) on September 16, 2007, and registered as a wholly foreign owned enterprise (“WFOE”) on September 19, 2007. GJBT has entered into consulting service agreements and equity-related agreements with Laiyang Jiangbo Pharmaceutical Co., Ltd. (“Laiyang Jiangbo”), a PRC limited liability company incorporated on August 18, 2003.

## RESULTS OF OPERATIONS

Comparison of six months and three months ended December 31, 2009 and 2008

The following table sets forth the results of our operations for the periods indicated as a percentage of total net sales (\$ in thousands):

|   | Three Months Ended<br>December 31, |                 |           |                 | Six Months Ended<br>December 31, |                 |           |                 |
|---|------------------------------------|-----------------|-----------|-----------------|----------------------------------|-----------------|-----------|-----------------|
|   | 2009                               | % of<br>Revenue | 2008      | % of<br>Revenue | 2009                             | % of<br>Revenue | 2008      | % of<br>Revenue |
| SALES   | \$ 18,180                          | 100.00%         | \$ 32,945 | 100.00%         | \$ 42,564                        | 100.00%         | \$ 60,265 | 99.60%          |
| SALES- RELATED<br>PARTY                               | -                                  | -%              | -         | -%              | -                                | -%              | 244       | 0.4%            |
| COST OF SALES   | 4,667                              | 25.67%          | 7,138     | 21.67%          | 10,927                           | 25.67%          | 12,851    | 21.24%          |
| COST OF SALES-<br>RELATED PARTIES                     | -                                  | -%              | -         | -%              | -                                | -%              | 54        | 0.09%           |
| GROSS PROFIT  | 13,513                             | 74.33%          | 25,807    | 78.33%          | 31,637                           | 74.33%          | 47,604    | 78.67%          |
| SELLING,<br>GENERAL AND<br>ADMINISTRATIVE<br>EXPENSES | 5,259                              | 28.93%          | 13,282    | 40.32%          | 9,601                            | 22.56%          | 26,634    | 44.02%          |
| RESEARCH AND<br>DEVELOPMENT                           | 1,106                              | 6.08%           | 1,099     | 3.34%           | 2,206                            | 5.18%           | 2,196     | 3.63%           |
| INCOME FROM<br>OPERATIONS                             | 7,147                              | 39.31%          | 11,426    | 34.68%          | 19,830                           | 46.59%          | 18,773    | 31.03%          |
| OTHER (INCOME)<br>EXPENSES, NET                       | (151)                              | (0.83)%         | 3,206     | 9.73%           | 7,272                            | 17.08%          | 5,450     | 9.01%           |

|  |       |         |       |         |        |        |         |         |
|--|-------|---------|-------|---------|--------|--------|---------|---------|
| INCOME BEFORE<br>PROVISION FOR<br>INCOME TAXES | 7,298 | 40.14%  | 8,220 | 24.95%  | 12,558 | 29.50% | 13,323  | 22.02%  |
| PROVISION FOR<br>INCOME TAXES                  | 1,970 | 10.84%  | 2,820 | 8.56%   | 5,078  | 11.93% | 4,790   | 7.92%   |
| NET INCOME                                     | 5,328 | 29.31%  | 5,399 | 16.39%  | 7,480  | 17.57% | 8,533   | 14.10%  |
| OTHER<br>COMPREHENSIVE<br>INCOME (LOSS)        | 78    | (0.43)% | (136) | (0.41)% | 253    | 0.33%  | (1,368) | (2.26)% |
| COMPREHENSIVE<br>INCOME                        | 5,406 | 29.74%  | 5,263 | 15.98%  | 7,733  | 18.17% | 7,165   | 11.84%  |

REVENUES. Revenues by product categories were as follows (\$ in thousands):

| Product                          | Six Months Ended<br>December 31, |                  | Increase/<br>(Decrease) | Increase/<br>(Decrease) |
|----------------------------------|----------------------------------|------------------|-------------------------|-------------------------|
|                                  | 2009                             | 2008             |                         |                         |
| Western pharmaceutical medicines | \$ 27,743                        | \$ 41,781        | \$ (14,038)             | (33.60)%                |
| Chinese traditional medicines    | 14,821                           | 18,728           | (3,907)                 | (20.86)%                |
| <b>TOTAL</b>                     | <b>\$ 42,564</b>                 | <b>\$ 60,509</b> | <b>\$ (17,945)</b>      | <b>(29.66)%</b>         |

| Product                          | Three Months Ended<br>December 31, |                  | Increase/<br>(Decrease) | Increase/<br>(Decrease) |
|----------------------------------|------------------------------------|------------------|-------------------------|-------------------------|
|                                  | 2009                               | 2008             |                         |                         |
| Western pharmaceutical medicines | \$ 12,928                          | \$ 21,565        | \$ (8,637)              | (40.05)%                |
| Chinese traditional medicines    | 5,252                              | 11,380           | (6,128)                 | (53.85)%                |
| <b>TOTAL</b>                     | <b>\$ 18,180</b>                   | <b>\$ 32,945</b> | <b>\$ (14,765)</b>      | <b>(44.82)%</b>         |

REVENUE . During the sixmonths ended December 31, 2009, we had revenues of \$42.6 million as compared to revenues of \$60.5 million for the six months ended December 31, 2008, a decrease of \$17.9 million or approximately 29.7%. For the three months ended December 31, 2009, we had revenues of \$18.2 million as compared to revenues of \$32.9 million for the three months ended December 31, 2008, a decrease of \$14.8 million or 44.8%. The overall decrease in total revenue in the second quarter and first six months of fiscal year 2010 was primarily attributable to the decrease of the per unit sales price by an average of 26% for Clarithromycin Sustained-released tablets, Itopride Hydrochloride granules and Baobaole chewable tables and the sales volume of our products as compared to the periods ended December 31, 2008. In January 2009, we restructured our distribution and sales system to sell our products primarily through 28 large independent regional distributors and lowered the per unit prices of the three major products to the distributors; at the same time, we significantly reduced the commission paid to our sales representatives on those products by 80% to 83%. The decrease in sales volume was primarily attributable to a loss of production time due to the Good Manufacture Practice ( "GMP") re-certification procedure and the increased market competition as a result of the newly announced National Basic Medical Insurance in China. The GMP re-certification procedure generally is performed by the Chinese SFDA every five years and it required the production needs to be stopped for the production lines under inspection. The re-certification procedure lasted for approximately six weeks at our main facility in the second quarter of fiscal year 2010. The Company subsequently passed the GMP re-certification and successfully renewed its GMP certificate in December 2009. Our major products are also facing increasing market competition from similar products included in the National Basic Medical Insurance. As our main facility has returned to its normal operation and we have reinforced our sales effort since; we expect our revenue to improve for the remainder of the year.

COST OF SALES by product categories were as follows (\$ in thousands):

| Product                          | Six Months Ended<br>December 31, |                  | Increase/<br>(Decrease) | Increase/<br>(Decrease) |
|----------------------------------|----------------------------------|------------------|-------------------------|-------------------------|
|                                  | 2009                             | 2008             |                         |                         |
| Western pharmaceutical medicines | \$ 7,278                         | \$ 9,490         | \$ (2,212)              | (23.31)%                |
| Chinese traditional medicines    | 3,649                            | 3,416            | 233                     | 6.82%                   |
| <b>TOTAL</b>                     | <b>\$ 10,927</b>                 | <b>\$ 12,906</b> | <b>\$ (1,979)</b>       | <b>(15.33)%</b>         |

| Product                          | Three Months Ended<br>December 31, |                 | Increase/<br>(Decrease) | Increase/<br>(Decrease) |
|----------------------------------|------------------------------------|-----------------|-------------------------|-------------------------|
|                                  | 2009                               | 2008            |                         |                         |
| Western pharmaceutical medicines | \$ 3,109                           | \$ 4,951        | \$ (1,842)              | (37.20)%                |
| Chinese traditional medicines    | 1,558                              | 2,187           | (629)                   | (28.76)%                |
| <b>TOTAL</b>                     | <b>\$ 4,667</b>                    | <b>\$ 7,138</b> | <b>\$ (2,471)</b>       | <b>(34.62)%</b>         |

Cost of sales for the six months ended December 31, 2009 decreased \$2.0 million or 15.3%, from \$ 12.9 million for the six months ended December 31, 2008 to \$10.9 million for the six months ended December 31, 2009. For the three months ended December 31, 2009, cost of sales decreased \$2.5 million or 34.6%, from \$7.1 million for the three months ended December 31, 2008 to \$4.7 million for the three months ended December 31, 2009. The decrease in cost of sales and cost of sales - related parties was primarily due to decrease in our product quantities sold. The overall cost of sales as a percentage of net revenue for the six months ended December 31, 2009, was approximately 25.7% as compared to 21.3% for the six months ended December 31, 2008 and 25.7% as compared to 21.7% for the three months ended December 31, 2009 as compared to the three months ended December 31, 2008. The increase was primarily attributable to the decrease in the per unit price mentioned above.

GROSS PROFIT by product categories as a percentage of sales were as follows:

| Product                          | Six Months Ended<br>December 31, |        | Increase/<br>(Decrease) |
|----------------------------------|----------------------------------|--------|-------------------------|
|                                  | 2009                             | 2008   |                         |
| Western pharmaceutical medicines | 73.77%                           | 77.29% | (3.52)%                 |
| Chinese traditional medicines    | 75.38%                           | 81.76% | (6.38)%                 |

  

| Product                          | Three Months Ended<br>December 31, |        | Increase/<br>(Decrease) |
|----------------------------------|------------------------------------|--------|-------------------------|
|                                  | 2009                               | 2008   |                         |
| Western pharmaceutical medicines | 75.95%                             | 77.04% | (1.09)%                 |
| Chinese traditional medicines    | 70.33%                             | 80.78% | (10.45)%                |

Gross profit was \$31.6 million for the six months ended December 31, 2009, as compared to \$47.6 million for the six months ended December 31, 2008, and \$13.5 million for the three months ended December 31, 2009, as compared to \$25.8 million for the three months ended December 31, 2008, representing gross margins of approximately 74.3% and 78.7% for the six months ended December 31, 2009 and 2008, and 74.3% and 78.3% for the three months ended December 31, 2009 and 2008, respectively. The decrease in the gross profit for the period ended December 31, 2009 was primarily due to the lower unit price charged as a result of the sales network restructure mentioned above, including a reduction in the selling prices.

#### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses totaled \$9.6 million for the six months ended December 31, 2009, as compared to \$26.6 million for the six months ended December 31, 2008, a decrease of \$17.0 million or approximately 63%. Selling, general and administrative expenses totaled \$5.3 million for the three months ended December 31, 2009, as compared to \$ 13.3 million for the three months ended December 31, 2008, a decrease of \$8.0 million or approximately 57.9% as summarized below (\$ in thousands):

|   | Three Months Ended |                   | Six Months Ended  |                   |
|---|--------------------|-------------------|-------------------|-------------------|
|   | December 31, 2009  | December 31, 2008 | December 31, 2009 | December 31, 2008 |
| Advertisement, marketing and promotion            | \$ 2,203           | \$ 2,606          | \$ 3,269          | \$ 5,835          |
| Travel and entertainment - sales related          | 140                | 671               | 267               | 1,313             |
| Salaries, wages, commissions and related benefits | 1,488              | 9,198             | 3,471             | 17,837            |
| Travel and entertainment - non sales related      | 24                 | 48                | 107               | 130               |
| Depreciation and amortization                     | 472                | 151               | 945               | 302               |
| Shipping and handling                             | 113                | 130               | 264               | 252               |
| Other   | 819                | 478               | 1,278             | 965               |
| Total   | \$ 5,259           | \$ 13,282         | \$ 9,601          | \$ 26,634         |

The changes in these expenses during the second quarter and first six months of fiscal year 2010, as compared to the corresponding period in 2009 included the following:

- A decrease of \$0.4 million or approximately 15.5% in advertising, marketing and promotion spending for the second quarter of fiscal 2010 and a decrease of \$2.6 million or 44.0% for the first six months of fiscal 2010 as compared to the corresponding period in fiscal 2009. The decrease in advertising, marketing and promotion spending was primarily due to less marketing and promotion spending and better managed advertising and promotional costs in fiscal year 2010.
- Travel and entertainment - sales related expenses decreased by \$0.5 million or 79.1% for the second quarter of fiscal 2010 as compared to the corresponding period in fiscal 2009 and decreased by \$1.0 million or 79.7% for the first six months of fiscal 2010 as compared to the corresponding period in fiscal 2009. As a result of the distribution system restructuring, we rely more on the distributors to work with us to promote our products and the traveling and entertainment activities incurred by our sales representatives decreased accordingly.
- Salaries, wages, commissions and related benefits decreased by \$7.7 million or 83.8% during the second quarter of fiscal 2010 and decreased by \$14.4 million or 80.5% during the first six months of fiscal 2010 as compared to the corresponding period of fiscal 2009. The decrease in the period ended December 31, 2009 was primarily due to the significant decrease in commissions paid to our sales representatives. In connection with the sales restructuring in January 2009, we significantly reduced the commission paid to our sales representatives on the top three selling products by 80% to 83%.
- Travel and entertainment - non sales related expenses decreased slightly for the second quarter of fiscal 2010 and the first six months of fiscal 2010 as compared to prior year corresponding period was primarily due to better expense spending controls in fiscal 2009.
- Depreciation and amortization increased by \$0.3 million or 212.6% during the second quarter of fiscal 2010 and increased by \$0.6 million or 212.9% during the first six months of fiscal 2010 as compared to the corresponding period of fiscal 2009, primarily due to intangible assets acquired through Hongrui acquisition in February 2009 which started being amortized since then.
- For the six months ended December 31, 2009 and 2008 and for the three months ended December 2009 and 2008, shipping and handling expenses remained materially consistent.
- Other selling, general and administrative expenses, which include professional fees, utilities, office supplies and expenses increased by \$0.3 million or 71.3% for the second quarter of fiscal 2010 and increased by \$ 0.3 million or 32.4% for the first six months of fiscal 2010 as compared to the corresponding period in fiscal 2009 primarily due to

increased bad debt expenses.

**RESEARCH AND DEVELOPMENT COSTS.** Research and development costs, which consist of fees paid to third parties for research and development related activities conducted for the Company and cost of materials used and salaries paid for the development of the Company's products, totaled \$ 2.2 million for the six months ended December 31, 2009, materially consistent with the six months ended December 31, 2008. Research and development costs totaled \$1.1 million for the three months ended December 31, 2009, materially consistent with the three months ended December 31, 2008. Research and development expenses mainly related two R&D cooperative agreements which obligated us to make monthly payments to the designated university/institute research and development projects, plus expenses incurred.

**OTHER (INCOME) EXPENSES.** Our other expenses consisted of financial expenses, change in fair value of derivative liabilities and other non-operating expenses (income). We had other expenses of \$7.3 million for the six months ended December 31, 2009 as compared to other expenses \$5.4 million for the six months ended December 31, 2008, an increase of \$1.8 million or approximately 33.4%. For the three months ended December 31, 2009, we had other income of \$0.2 million as compared to \$3.2 million of other expense for the three months ended December 31, 2008, a decrease of \$3.4 million in expense or 106%. The increase in other expense for the six months ended December 31, 2009 was primarily due to the increase in the debt discount amortization expense and financing cost amortization related to our financing in November 2007 and May 2008 of \$6.0 million, and offset by the gain in change of fair value of derivative liabilities of \$1.9 million, decrease in realized and unrealized loss on trading marketable securities of \$1.0 million and decrease in loss from discontinued operations of \$1.5 million. The decrease in other expense for the three months ended December 31, 2009 was attributed by the gain in change of fair value of derivative liabilities of \$6.7 million and decrease of loss from discontinued operations of \$1.5 million and offset by increase in debt discount amortization expense and financing cost amortization related to our financing in November 2007 and May 2008 of \$4.6 million.

**NET INCOME.** Our net income for the six months ended December 31, 2009 was \$7.5 million as compared to \$8.5 million for the six months ended December 31, 2008, an increase of \$1.0 million or 11.8%. The net income for the three months ended December 31, 2009 was \$5.3 million as compared to \$5.4 million for the three months ended December 31, 2008, a decrease of \$0.1 million or 1.9%. For the six months ended December 31, 2009, although we had a \$1.1 million or 5.7 % increase in our income from operations, the amount was offset by the significant increase of \$1.8 million in other expenses. For the three months ended December 31, 2009, the decrease in net income was attributed to the decrease in the income from operations and partially offset by the significant decrease in other expense.

#### LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities for the six months ended December 31, 2009 was \$3.2 million as compared to net cash provided by operating activities of \$26.4 million for the six months ended December 31, 2008. The decrease in cash provided by operating activities included the following: 1) decrease in income from continuing operations of \$2.5 million 2) decrease in add-back of realized and unrealized loss on marketable securities of \$1.2million and change in fair value of derivative liabilities of \$1.9 million 3) decrease in change in advance to suppliers and other assets of \$1.8 million 4) decrease in change in accounts payable of \$3.8 million 5) decrease in change in other payable of \$1.6 million and 6) decrease in change in taxes payable of \$21.5 million and partially offset by 1) increase in add back of amortization of debt discount of \$5.9 million 2) increase in add back of other non-cash settlement of \$1.1 million 3) increase in change in other receivable of \$2.3 million.

Net cash used by investing activities for the six months ended December 31, 2009 was \$16.5 million was mainly attributable to purchase of land use right for future factory expansion of \$17 million.



Net cash used in financing activities was \$2.2 million for the six months ended December 31, 2009 was primarily attributable to change in restricted cash of \$7.2 million, payments for bank loans of \$2.2 million, and principal payments on notes payable of \$7.3 million and offset by proceeds from notes payable of \$14.5 million. Net cash provided by financing activities was \$1.4 million for the six months ended December 31, 2008 and was primarily attributable to decrease in restricted cash of \$1.3 million, proceeds from bank loans of \$2.2 million and increase in payments on notes payable of \$0.7 million, partially offset by the principal payments on short term bank loans of \$2.8 million.

We reported a net decrease in cash for the six months ended December 31, 2009 of \$15.4 million as compared to a net increase in cash of \$28.2 million for the six months ended December 31, 2008.

We have historically financed our operations and capital expenditures principally through private placements of debt and equity offerings, bank loans, and cash provided by operations. At December 31, 2009, the majority of our liquid assets were held in RMB denominations deposited in banks within the PRC. The PRC has strict rules for converting RMB to other currencies and for movement of funds from the PRC to other countries. Consequently, in the future, we may face difficulties in moving funds deposited within the PRC to fund working capital requirements in the U.S. The Company's management is currently evaluating the situation. Our working capital position remained materially consistent from the prior year end at \$99.8 million at December 31, 2009 and June 30, 2009.

We anticipate that our working capital requirements may increase as a result of our anticipated business expansion plan, potential increases in the price of our raw materials, competition and our relationship with suppliers or customers. We believe that our existing cash, cash equivalents and cash flows from operations will be sufficient to meet our present anticipated future cash needs for at least the next 12 months. We may, however, require additional cash resources due to foreign currency exchange restrictions imposed by the PRC government, changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue.

#### Contractual Obligations and Off-Balance Sheet Arrangements

##### Contractual Obligations

We have certain fixed contractual obligations and commitments that include future estimated payments. Changes in our business needs, cancellation provisions, changing interest rates, and other factors may result in actual payments differing from the estimates. We cannot provide certainty regarding the timing and amount of payments.

##### Off-balance Sheet Arrangements

We have not entered into any other financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholder's equity or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

##### Risk Factors

**Interest Rates.** Our exposure to market risk for changes in interest rates primarily relates to our short-term investments and short-term obligations; thus, fluctuations in interest rates would not have a material impact on the fair value of these securities. At December 31, 2009, we had approximately \$103.5 million in cash and cash equivalent and restricted cash. A hypothetical 2% increase or decrease in interest rates would not have a material impact on our earnings or loss, or the fair market value or cash flows of these instruments.

**Foreign Exchange Rates.** All of our sales are denominated in the Chinese Renminbi ("RMB"). As a result, changes in the relative values of U.S. Dollars and RMB affect our reported levels of revenues and profitability as the results are translated into U.S. Dollars for financial reporting purposes. In particular, fluctuations in currency exchange rates could have a significant impact on our financial stability due to a mismatch among various foreign currency-denominated sales and costs. Fluctuations in exchange rates between the U.S. Dollar and RMB affect our gross and net profit margins and could result in foreign exchange and operating losses.

Our exposure to foreign exchange risk primarily relates to currency gains or losses resulting from timing differences between signing of sales contracts and settling of these contracts. Furthermore, we translate monetary assets and liabilities denominated in other currencies into RMB, the functional currency of our operating business. Our results of operations and cash flows are translated at average exchange rates during the period, and assets and liabilities are translated at the unified exchange rate as quoted by the People's Bank of China at the end of the period. Translation adjustments resulting from this process are included in accumulated other comprehensive income in our statements of shareholders' equity. We recorded net foreign currency gains (loss) of approximately \$197,000 and \$579,000 for the six months ended December 31, 2009 and 2008, respectively. We have not used any forward contracts, currency options or borrowings to hedge our exposure to foreign currency exchange risk. We cannot predict the impact of future exchange rate fluctuations on our results of operations and may incur net foreign currency losses in the future. As our sales denominated in foreign currencies, such as RMB and Euros, continue to grow, we will consider using arrangements to hedge our exposure to foreign currency exchange risk.

Our financial statements are expressed in U.S. dollars but the functional currency of our operating subsidiary is the RMB. The value of your investment in our stock will be affected by the foreign exchange rates between the U.S. dollar and the RMB. To the extent we hold assets denominated in U.S. dollars, any appreciation of the RMB against the U.S. dollar could result in a change to our statements of operations and a reduction in the value of our U.S. dollar denominated assets. On the other hand, a decline in the value of RMB against the U.S. dollar could reduce the U.S. dollar equivalent amounts of our financial results, the value of your investment in our company and the dividends we may pay in the future, if any, all of which may have a material adverse effect on the price of our stock.

**Credit Risk.** We have not experienced significant credit risk, as most of our customers are long-term customers with excellent payment records. We review our accounts receivable on a regular basis to determine if the allowance for doubtful accounts is adequate at each quarter-end. We typically extend 30 to 90 day trade credit to our largest customers and we have not seen any of our major customers' accounts receivable go uncollected beyond the extended period of time or experienced any material write-off of accounts receivable in the past.

**Inflation Risk.** In recent years, China has not experienced significant inflation, and thus inflation has not had a material impact on our results of operations. According to the National Bureau of Statistics of China (NBS) ([www.stats.gov.cn](http://www.stats.gov.cn)), the change in Consumer Price Index (CPI) in China was 1.5%, 4.7% and 5.9% in 2006, 2007 and 2008, respectively. Inflationary factors, such as increases in the cost of our products and overhead costs, could impair our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of sales revenue if the selling prices of our products do not increase with these increased costs.

#### Related Party Transactions

##### Other receivable - related parties

The Company leases two of its buildings to Jiangbo Chinese-Western Pharmacy, a company owned by the Company's Chief Executive Officer and other majority shareholders. For the three months ended December 31, 2009 and 2008, the Company recorded other income of approximately \$81,000 and \$93,000 from leasing the two buildings to this related party. For the six months ended December 31, 2009 and 2008, the Company recorded other income of approximately \$161,000 and \$237,000 from leasing the two buildings to this related party. As of December 31, 2009 and June 30, 2009, amount due from this related party was approximately \$161,000 and \$0, respectively.

##### Other payable - related parties

Other payable-related parties primarily consist of accrued salary payable to the Company's officers and directors, and advances from the Company's Chief Executive Officer. These advances are short-term in nature and bear no interest. The amounts are expected to be repaid in the form of cash.

Other payable - related parties consisted of the following:

|  | December 31,<br>2009<br>(Unaudited) | June 30,<br>2009 |
|--|-------------------------------------|------------------|
| Payable to Cao Wubo, Chief Executive Officer and Chairman of the Board | \$ 252,581                          | \$ 184,435       |
| Payable to Haibo Xu, Chief Operating Officer and Director              | 33,688                              | 33,688           |

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|   |            |            |
|---|------------|------------|
| Payable to Elsa Sung, Chief Financial Officer | 23,920     | 18,333     |
| Payable to John Wang, Director                | 12,500     | 2,500      |
| Total other payable - related parties         | \$ 332,689 | \$ 238,956 |

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## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We believe that the application of the following accounting policies, which are important to our financial position and results of operations, require significant judgments and estimates on the part of management. Our critical accounting policies and estimates present an analysis of the uncertainties involved in applying a principle, while the accounting policies note to the financial statements (Note 2) describe the method used to apply the accounting principle.

### Recent Accounting Pronouncements

In April 2009, the FASB issued an accounting standard for accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. It amends and clarifies a previously issued accounting standard in regards to the initial recognition and measurement, subsequent measurement and accounting, and disclosures of assets and liabilities arising from contingencies in a business combination. The accounting standard applies to all assets acquired and liabilities assumed in a business combination that arise from contingencies. The accounting standard will be effective for the first annual reporting period beginning on or after December 15, 2008. The accounting standard will apply prospectively to business combinations for which the acquisition date is after fiscal years beginning on or after December 15, 2008. The adoption of the accounting standard will not have a material impact on the Company's results of operations or financial condition.

In April 2009, the FASB issued an accounting standard to make the other-than-temporary impairments guidance more operational and to improve the presentation of other-than-temporary impairments in the financial statements. This standard will replace the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired debt security until recovery with a requirement that management assert it does not have the intent to sell the security, and it is more likely than not it will not have to sell the security before recovery of its cost basis. This standard provides increased disclosure about the credit and noncredit components of impaired debt securities that are not expected to be sold and also requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. Although this standard does not result in a change in the carrying amount of debt securities, it does require that the portion of an other-than-temporary impairment not related to a credit loss for a held-to-maturity security be recognized in a new category of other comprehensive income and be amortized over the remaining life of the debt security as an increase in the carrying value of the security. This standard became effective for interim and annual periods ending after June 15, 2009. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued an accounting standard that requires disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this accounting standard, fair values for these assets and liabilities were only disclosed annually. This standard applies to all financial instruments within its scope and requires all entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. This standard does not require disclosures for earlier periods presented for comparative purposes at initial adoption, but in periods after the initial adoption, this standard requires comparative disclosures only for periods ending after initial adoption. The adoption of this standard did not have a material impact on the disclosures related to its consolidated financial statements.

In May 2009, the FASB an accounting standard which provides guidance to 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. The standard also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. The standard is effective for interim and annual periods ending after June 15, 2009, and accordingly, the Company adopted this Standard during the second quarter of 2009. The standard requires that public entities evaluate subsequent events through the date that the financial

statements are issued.

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In June 2009, the FASB issued an accounting standard amending the accounting and disclosure requirements for transfers of financial assets. This accounting standard requires greater transparency and additional disclosures for transfers of financial assets and the entity's continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, it eliminates the concept of a qualifying special-purpose entity ("QSPE"). This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2009. The Company believes the adoption of this ASU will not have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB also issued an accounting standard amending the accounting and disclosure requirements for the consolidation of variable interest entities ("VIEs"). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this accounting standard. Further, this accounting standard requires a company to perform a qualitative analysis when determining whether or not it must consolidate a VIE. It also requires a company to continuously reassess whether it must consolidate a VIE. Additionally, it requires enhanced disclosures about a company's involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the company's financial statements. Finally, a company will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2009. The Company has not completed their assessment of the impact that this pronouncement will have on the Company's financial condition, results of operations or cash flows.

In June 2009, the FASB issued an accounting standard which establishes the FASB Accounting Standards Codification™ (the "Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. The Codification is effective for interim and annual periods ending after September 15, 2009, and as of the effective date, all existing accounting standard documents will be superseded. Pursuant to the provisions of the Codification, the Company updated references to GAAP in the Company's consolidated financial statements. The Codification did not change GAAP and therefore did not impact the Company's consolidated financial statements other than the change in references.

In August 2009, the FASB issued an Accounting Standards Update ("ASU") regarding measuring liabilities at fair value. This ASU provides additional guidance clarifying the measurement of liabilities at fair value in circumstances in which a quoted price in an active market for the identical liability is not available; under those circumstances, a reporting entity is required to measure fair value using one or more of valuation techniques, as defined. This ASU is effective for the first reporting period, including interim periods, beginning after the issuance of this ASU. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued an ASU regarding accounting for own-share lending arrangements in contemplation of convertible debt issuance or other financing. This ASU requires that at the date of issuance of the shares in a share-lending arrangement entered into in contemplation of a convertible debt offering or other financing, the shares issued shall be measured at fair value and be recognized as an issuance cost, with an offset to additional paid-in capital. Further, loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the basic and diluted earnings-per-share calculation. This ASU is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The Company is currently evaluating the impact of this ASU on its consolidated financial statements.





In December 2009, FASB issued ASU No. 2009-16, Accounting for Transfers of Financial Assets. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140. The amendments in this Accounting Standards Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In December, 2009, FASB issued ASU No. 2009-17, Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Accounting Standards Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-01- Accounting for Distributions to Shareholders with Components of Stock and Cash. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification. The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51.” If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of

Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarify existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.

Item 4T: Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. We maintain "disclosure controls and procedures" as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. In designing and evaluating our disclosure controls and procedures, our management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were not effective, for the following two reasons:

1. Accounting and Finance Personnel Weaknesses - US GAAP expertise - The current staff in the accounting department do not have extensive experience with U.S. GAAP, and needs substantial training so as to meet the higher demands of being a publicly-traded company in the U.S. The accounting skills and understanding necessary to fulfill the requirements of U.S. GAAP-based reporting, including the skills of subsidiary financial statement consolidation, were inadequate and the personnel were inadequately supervised. The lack of sufficient and adequately trained accounting and finance personnel resulted in an ineffective segregation of duties relative to key financial reporting functions.

2. Lack of internal audit function— The Company lacks qualified resources to perform the internal audit functions properly, which resulted in the inability to prevent and detect control lapses and errors in the accounting of certain key areas such as revenue recognition, inter-company transactions, cash receipt and cash disbursement authorizations, inventory safeguard and proper accumulation for cost of products, in accordance with the appropriate costing method used by the Company. In addition, the scope and effectiveness of the internal audit function are yet to be developed.

In order to correct the foregoing deficiencies, we have taken the following remediation actions:

1. We have started training our internal accounting staff on U.S. GAAP and financial reporting requirements. Additionally, we are also taking steps to hire additional accounting personnel to ensure we have adequate resources to meet the requirements of segregation of duties.
2. We plan on involving both internal accounting and operations personnel and outside consultants with U.S. GAAP technical accounting expertise, as needed, early in the evaluation of a complex, non-routine transaction to obtain additional guidance as to the application of generally accepted accounting principles to such a proposed transaction. During the six months ended December 31, 2009, we have continued working with our outside internal control consultants; a reputable independent accounting firm has been engaged as internal control consultants to provide advice and assistance on improving our internal controls. The internal control consultants have begun working with our internal audit department to implement new policies and procedures within the financial reporting process with adequate review and approval procedures.



3. We have continued to evaluate the internal audit function in relation to the Company's financial resources and requirements. During the six months ended December 31, 2009, our staff from the internal audit department has started working with our internal control consultants and our accounting staff to evaluate the Company's current internal control over financial reporting process. To the extent possible, we will provide necessary trainings to our internal audit staff and implement procedures to assure that the initiation of transactions, the custody of assets and the recording of transactions will be performed by separate individuals.

We believe that the foregoing steps will remediate the significant deficiencies identified above, and we will continue to monitor the effectiveness of these steps and make any changes that our management deems appropriate to insure that the foregoing do not become material weaknesses. We plan to fully implement the above remediation plan by June 30, 2010.

A material weakness (within the meaning of PCAOB Auditing Standard No. 5) is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

Our management is not aware of any material weaknesses in our internal control over financial reporting, and nothing has come to the attention of management that causes them to believe that any material inaccuracies or errors exist in our financial statements as of December 31, 2009. The reportable conditions and other areas of our internal control over financial reporting identified by us as needing improvement have not resulted in a material restatement of our financial statements, nor are we aware of any instance where such reportable conditions or other identified areas of weakness have resulted in a material misstatement or omission in any report we have filed with or submitted to the Commission.

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.

(b) Changes in internal controls over financial reporting. During the three months covered by this quarterly report, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control systems are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Such limitations include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures, such as simple errors or mistakes or intentional circumvention of the established process.

## PART II

### Item 1. Legal Proceedings

The Company is involved in various legal matters arising in the ordinary course of business. The following summarizes the Company's pending and settled legal proceedings as of December 31, 2009:

CRG Partners, Inc. and Capital Research Group, Inc. and Genesis Technology Group, Inc., n/k/a Genesis Pharmaceuticals Enterprises, Inc. (Arbitration) - Case No. 32 145 Y 00976 07, American Arbitration Association, Southeast Case Management Center

On December 4, 2007, CRG Partners, Inc. (“CRGP”), a former consultant of the Company, filed a demand for arbitration against the Company alleging breach of contract and seeking damages of approximately \$10 million as compensation for consulting services rendered to the Company. The amount of damages sought by the claimant was equal to the dollar value of 29,978,900 shares of the Company’s common stock (Pre 40-to-1 reverse split) in November 2007, in which the claimant alleged were due and owing to CRGP. On December 5, 2007, the Company gave notice of termination of the relationship with CRG under the consulting agreement. CRGP subsequently filed an amendment to the demand for arbitration to include Capital Research Group, Inc. (“CRG”) as an added claimant and increased the damage amount sought under this matter to approximately \$13.8 million. The Company subsequently filed counter claims in reference to the aforementioned allegations of breach of contract.

In February 2009, the Company was notified by the arbitration panel of American Arbitration Association (the “Panel”) that the Panel awarded CRG and CRGP jointly, a net total of \$980,070 (the “Award”) to be paid by the Company on or before February 27, 2009. Once the Award is satisfied, CRG and CRGP would have no further claims against the Company’s common stock or other property that were the subject of the arbitration. The amount has been charged to operations for year ended June 30, 2009, and is included in liabilities assumed from during the reorganization as of June 30, 2009.

On March 6, 2009, CRG Partners, Inc. (“CRGP”) and Capital Research Group, Inc. (“CRG”), former consultants of the Company, filed a motion to confirm the arbitration award conferred by a panel of arbitrators of the American Arbitration Association on February 2, 2009. On July 15, 2009, the Circuit Court of the 11th Judicial Circuit in and for Miami-Dade County confirmed the arbitration award and entered judgment against Genesis Technology Group, Inc. At December 31, 2009, the award has been fully settled and paid.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In October 2009, the Company issued 462,500 shares of its common stock to certain holders of its 2008 Notes in connection with the conversion of \$3,700,000 aggregate principal amount of such Notes pursuant to the terms thereof by such holders. Each of the recipient of those shares was an accredited investor, and each of the issuances of these shares was exempt from registration under the Securities Act in reliance on an exemption provided by Section 4(2) of that Act.

In November 2009, the Company issued 62,500 shares of its common stock to certain holder of its 2007 Notes in connection with the conversion of \$500,000 aggregate principal amount of such Notes pursuant to the terms thereof by such holders. The recipient of those shares was an accredited investor, and each of the issuances of these shares was exempt from registration under the Securities Act in reliance on an exemption provided by Section 4(2) of that Act.

In December 2009, the Company issued 62,500 shares of its common stock to certain holders of its 2007 Notes in connection with the conversion of \$500,000 aggregate principal amount of such Notes pursuant to the terms thereof by such holders. The recipient of those shares was an accredited investor, and each of the issuances of these shares was exempt from registration under the Securities Act in reliance on an exemption provided by Section 4(2) of that Act.

In November 2009, the Company issued 62,500 shares of its common stock in connection with the conversion of \$500,000 of convertible debt. The recipient of those shares was an accredited investor, and each of the issuances of these shares was exempt from registration under the Securities Act in reliance on an exemption provided by Section 4(2) of that Act.



In December 2009, the Company issued 62,500 shares of its common stock in connection with the conversion of \$500,000 of convertible debt. The recipient of those shares was an accredited investor, and each of the issuances of these shares was exempt from registration under the Securities Act in reliance on an exemption provided by Section 4(2) of that Act.

Item 3. Defaults Upon Senior Securities

None.

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Item 4. Submissions of Matters to a Vote of Security Holders

None.

Item 5. Other Information.

As a result of the delay in its ability to transfer cash out of PRC (partially due to the stricter foreign exchange restrictions and regulations imposed in the PRC starting in December 2008), the Company became delinquent on the payment of interests under the November 2007 Debentures and May 2008 Notes in December 2009.

On February 15, 2010, the Company and Pope Investments LLC (“Pope”) entered into a Letter Agreement (the “Letter Agreement”), whereby Pope agreed (i) to waive certain provisions set forth in the Securities Purchase Agreement, by and between the Company and Pope Asset Management LLC, dated as of November 6, 2007 (the “2007 Securities Purchase Agreement”) with respect to the 6% Convertible Subordinated Debenture of the Company dated November 6, 2007 issued to Pope (the “2007 Notes”), and (ii) to waive certain provisions set forth in the Securities Purchase Agreement, by and between the Company and the investors who are parties thereto (collectively, the “Investors”), dated as of May 30, 2008 (the “2008 Securities Purchase Agreement”) with respect to the 6% Convertible Notes May 30, 2008, issued to the Investors (collectively, the “2008 Notes”). Pope is the holder of \$4,000,000 principal amount of the 2007 Notes and the holder of \$15,000,000 aggregate principal amount of 2008 Notes.

Pursuant to the Letter Agreement, Pope (i) agreed to waive until February 25, 2010 the Events of Default (as defined in the 2007 Notes and 2008 Notes) that have occurred as a result of the Company’s failure to timely make interest payments on the 2007 Notes and 2008 Notes that were due and payable on November 30, 2009, and agreed not to provide written notice to the Company with respect to the occurrence of either of such Events of Default provided that the Company has made such interest payment to the holders of the 2007 Notes and the holders of the 2008 Notes on or prior to February 25, 2010. If the interest payments are not made by February 25, 2010, all rights and remedies of the holders of the 2007 Notes and the holders of the 2008 Notes, as set forth in the 2007 Securities Purchase Agreement, the 2008 Securities Purchase Agreements, the 2007 Notes and the 2008 Notes, respectively, shall remain in full force and effect as if the Letter Agreement had not been executed.

Notwithstanding the foregoing, the Company also agreed that in the event that its common stock has not been listed on The Nasdaq Stock Market on or prior to April 15, 2010, that the Company shall pay to the holders of the 2007 Notes and the 2008 Notes an amount equal to the difference between the interest on such Notes previously paid for the period from June 1, 2009 to November 30, 2009 (the "Interest Period") and the default rate of interest that would have been payable with respect to such Notes for the Interest Period.

The Company became delinquent on the payment of interests under the 2007 Notes and 2008 Notes due to delays in its ability to transfer cash out of the People’s Republic of China.

A copy of the Letter Agreement is filed herewith as Exhibit 10.1 and to this Quarterly Report on Form 10-Q and is incorporated herein by reference.

Item 6. Exhibits

| No.  | Description  |
|------|--|
| 10.1 | Letter Agreement Between the Company and Pope Investments LLC dated February 15, 2010. |
| 31.1 | Rule 13a-14(a)/ 15d-14(a) Certification of Chief Executive Officer                     |

31.2 Rule 13a-14(a)/ 15d-14(a) Certification of Chief Financial Officer

32.1 Section 1350 Certification of Chief Executive Officer and Chief Financial Officer

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

JIANGBO PHARMACEUTICALS, INC.

Date: February 19, 2010

By: /s/ Cao Wubo  
Cao Wubo  
Chief Executive Officer and President