CHINA SKY ONE MEDICAL, INC.
Form 10-Q
August 09, 2010

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

FORM 10-Q

(Mark One)

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

For the six months ended: June 30, 2010

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number: 001-34080

CHINA SKY ONE MEDICAL, INC.
(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	87-0430322 (I.R.S. Employer Identification No.)
No. 2158, North Xiang An Road, Song Bei District, Harbin, People's Republic of China (Address of principal executive offices)	150028 (Zip Code)
Registrant's telephone number, including area code:	86-451-87032617 (China)

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 preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small 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 o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Yes o No x

As of July 31, 2010, the registrant had 16,790,851 shares of common stock issued and outstanding.

QUARTERLY REPORT ON FORM 10-Q

OF CHINA SKY ONE MEDICAL, INC. AND SUBSIDIARIES
FOR THE PERIOD ENDED JUNE 30, 2010

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, together with other statements and information we publicly disseminate, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and include this statement for purposes of complying with these safe harbor provisions.

Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “should”, “v “could”, “may”, “plan”, “possible”, “project” or similar expressions. You should not rely on forward-looking statements since they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control and which could materially affect actual results, performances or achievements.

Factors that may cause actual results to differ materially from current expectations include, but are not limited to the “Risk Factors” discussed in our Annual Report on Form 10-K for the year ended December 31, 2009, as amended. Accordingly, there is no assurance that our expectations will be realized. Except as otherwise required by the federal securities laws, we disclaim any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change our expectations with regard thereto, or any change in events, conditions or circumstances on which any such statement is based.

The terms “the Company,” “we,” “us” and “our” refer to China Sky One Medical, Inc., together with our consolidated subsidiaries.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Income
(Unaudited, $ in thousands except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009 (restated)	2010	2009 (restated)
Revenues	$ 40,760	$ 32,181	$ 69,663	$ 57,015
Cost of Goods Sold	11,216	7,752	18,491	13,793
Gross Profit	29,544	24,429	51,172	43,222
Operating Expenses				
Depreciation and amortization	827	449	1,668	901
Research and development	5,910	3,682	9,674	6,095
Selling	7,983	7,796	13,894	13,763
General and administrative	1,123	420	2,113	1,330
Total operating expenses	15,843	12,347	27,349	22,089
Income from Operations	13,701	12,082	23,823	21,133
Other Income (Expense)				
Interest income	30	14	59	26
Change in fair value of derivative warrant liability	2,087	(1,066)	7,013	1,173
Total other income (expense)	2,117	(1,052)	7,072	1,199
Net Income Before Provision for Income Tax	15,818	11,030	30,895	22,332
Provision for Income Taxes	3,576	2,639	6,065	4,459
Net Income	$ 12,242	$ 8,391	$ 24,830	$ 17,873
Basic Earnings Per Share	$ 0.73	$ 0.51	$ 1.48	$ 1.09
Basic Weighted Average Shares Outstanding	16,790,851	16,537,066	16,783,896	16,475,833
Diluted Earnings Per Share	$ 0.73	$ 0.51	$ 1.47	$ 1.08
Diluted Weighted Average Shares Outstanding	16,812,810	16,628,892	16,894,775	16,547,037
Other Comprehensive Income				
Foreign currency translation adjustment	$ 535	$ 6	$ 556	$ 123
Net Income	12,242	8,391	24,830	17,873
Comprehensive Income	$ 12,777	$ 8,397	$ 25,386	$ 17,996

See accompanying summary of accounting policies and notes to the condensed consolidated financial statements.

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
($ in thousands, except share data)

	June 30, 2010 (Unaudited)	December 31, 2009 (Restated)
ASSETS		
Current Assets		
Cash and cash equivalents	$ 64,656	$ 52,756
Accounts receivable, net	23,964	21,146
Inventories	5,559	2,413
Prepaid and other current assets	24	74
Total current assets	94,203	76,389
Property and equipment, net	15,451	15,491
Intangible assets, net	23,853	25,114
Construction in progress	12,986	12,932
Land use rights, net	4,559	4,586
Construction and land deposits	13,219	5,851
Total Assets	$ 164,271	$ 140,363
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	$ 7,768	$ 4,186
Taxes payable	5,734	3,873
Derivative warrant liability	3,549	11,435
Total current liabilities	17,051	19,494
Commitments and Contingencies	-	-
Stockholders' Equity		
Preferred stock ($0.001 par value, 5,000,000 shares authorized, none issued and outstanding)	-	-
Common stock ($0.001 par value, 50,000,000 shares authorized, 16,790,851 and 16,714,267 issued and outstanding, respectively)	17	17
Additional paid-in capital	38,154	37,188
Retained earnings	102,615	77,785
Accumulated other comprehensive income	6,434	5,879
Total stockholders' equity	147,220	120,869
Total Liabilities and Stockholders' Equity	$ 164,271	$ 140,363

See accompanying summary of accounting policies and notes to the condensed consolidated financial statements.

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited, $ in thousands)

	Six Months Ended June 30,	
	2010	2009 (restated)
Cash flows from operating activities		
Net Income	$ 24,830	$ 17,873
Adjustments to reconcile net cash provided by (used in) operating activities:		
Depreciation and amortization	1,919	1,168
Change in fair value of derivative warrant liability	(7,013)	(1,173)
Net change in assets and liabilities		
Accounts receivable	(2,719)	(1,184)
Inventories	(3,124)	(1,109)
Prepaid and other current assets	50	41
Accounts payable and accrued expenses	3,487	1,308
Taxes payable	1,838	898
Net cash provided by operating activities	19,268	17,822
Cash flows from investing activities		
Land deposit	(7,316)	
Purchase of fixed assets	(407)	(84)
Purchase of construction in progress	-	(9,878)
Net cash used in investing activities	(7,723)	(9,962)
Cash flows from financing activities		
Proceeds from warrants conversion	94	29
Net cash provided by financing activities	94	29
Effect of exchange rate changes on cash and cash equivalents	261	56
Net increase in cash and cash equivalents	11,900	7,945
Cash and cash equivalents at beginning of period	52,756	40,288
Cash and cash equivalents at end of period	$ 64,656	$ 48,233
Supplemental disclosure of cash flow information		
Interest paid	$ -	$ -
Taxes paid	$ 4,942	$ 3,929

See accompanying summary of accounting policies and notes to the condensed consolidated financial statements.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Description of Business

China Sky One Medical Inc. ("China Sky One" or the "Company"), a Nevada corporation, was formed on February 7, 1986, and formerly known as Comet Technologies, Inc. ("Comet"). On July 26, 2006, the Company changed the name of the reporting company from "Comet Technologies, Inc." to "China Sky One Medical, Inc."

China Sky One is a holding company whose principal operations are through its wholly-owned subsidiaries. The Company has no revenues separate from its subsidiaries, and has expenses related to its status as a public reporting company and to its ownership interest in American California Pharmaceutical Group, Inc. ("ACPG") and Harbin City Tian Di Ren Medical Co. ("TDR").

ACPG, the Company's non operating United States holding company subsidiary, was incorporated on December 16, 2003, in the State of California, under the name "QQ Group, Inc." QQ Group, Inc. changed its name to "American California Pharmaceutical Group, Inc." in anticipation of the Stock Exchange Agreement with China Sky One (then known as "Comet Technologies, Inc.") and TDR, described herein. On December 8, 2005, ACPG completed a stock exchange transaction with TDR a People's Republic of China ("China" or "PRC") based operating company and TDR's subsidiaries (the "TDR Acquisition"), each of which were fully operating companies in the PRC. Under the terms of the agreement, ACPG exchanged 100% of its issued and outstanding common stock for 100% of the capital stock of TDR and its subsidiaries, described below.

Thereafter, on May 11, 2006, ACPG entered into a Stock Exchange Agreement (the "Exchange Agreement") with the shareholders of China Sky One. The terms of the Exchange Agreement were consummated and the acquisition was completed on May 30, 2006. As a result of the transaction, the Company issued a total of 10,193,377 shares of its common voting stock to the stockholders of ACPG, in exchange for 100% of the capital stock of ACPG resulting in ACPG becoming our wholly-owned subsidiary. The transaction is treated as a reverse merger for accounting purposes.

TDR, formerly known as "Harbin City Tian Di Ren Medical Co.," was originally formed in 1994 and its principal executive office is located in Harbin City of Heilongjiang Province, in the PRC. TDR was reorganized and incorporated as a limited liability company on December 29, 2000, under the "Corporation Laws and Regulations" of the PRC. At the time of the TDR Acquisition by ACPG in December of 2005, TDR had two wholly-owned subsidiaries, Harbin First Bio-Engineering Company Limited ("First") and Kangxi Medical Care Product Factory, until July, 2006, when the two were merged, with First as the surviving subsidiary of TDR. The principal activities of TDR and First are the research, manufacture and sale of over-the-counter non-prescription health care products. TDR commenced its business in the sale of branded nutritional supplements and over-the-counter pharmaceutical products in the Heilongjiang Province. TDR has subsequently evolved into an integrated manufacturer, marketer, and distributor of external use natural Chinese medicine products sold primarily to and through independent agents and China's large pharmaceutical chains.

As of October 16, 2006, the Company organized Harbin Tian Qing Biotech Application Company as a wholly-owned PRC subsidiary of TDR ("Tian Qing"), to conduct research and development in the areas of tissue and stem cell banks. As of June 30, 2010, Tian Qing had insignificant operations.

On April 3, 2008, TDR completed an acquisition pursuant to an Equity Transfer Agreement dated February 22, 2008, between TDR and Heilongjiang Tianlong Pharmaceutical, Inc., a corporation with a multitude of medicines approved by the PRC's State Food and Drug Administration ("SFDA") and new medicine applications, organized under the laws

of the PRC ("Tianlong"), which is in the business of manufacturing external-use pharmaceuticals. Pursuant to the Equity Transfer Agreement, TDR acquired 100% of the issued and outstanding capital stock of Tianlong from Tianlong's sole stockholder, in consideration for an aggregate purchase price of approximately $8,300,000, consisting of (i) $8,000,000 in cash, and (ii) 23,850 shares of China Sky One (at $12 per share). The acquisition received regulatory approval and closed on April 3, 2008.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Description of Business (Continued)

The following table summarizes the approximate estimated fair values of the assets acquired in the Tianlong acquisition.

	($ in thousands)
Fixed assets	$ 6,315
Intangible assets – SFDA licenses for drug batch numbers	1,787
Other	170
Net assets acquired	$ 8,272

On April 18, 2008, China Sky One through its subsidiary TDR consummated a share acquisition pursuant to an Equity Transfer Agreement with the shareholders of Heilongjiang Haina Pharmaceutical Inc., a recently formed corporation organized under the laws of the PRC ("Haina") licensed as a wholesaler of TCD, bio-medicines, bio-products, medicinal devices, antibiotics and chemical medicines. Haina does not have an established sales network and was acquired for its primary asset, a Good Supply Practice (GSP) license (License No. A-HLJ03-010) issued by the Heilongjiang office of the State Food and Drug Administration ("SFDA"). The SFDA recently started issuing such licenses to resellers of medicines that maintain certain quality controls. The GSP license was issued as of December 21, 2006 and will expire on January 29, 2012 and will enable the Company to expand its sales of medicinal products without having to go through a lengthy license application process.

The following table summarizes the approximate estimated fair values of the assets acquired in the Haina acquisition.

	($ in thousands)
Cash	$ 84
Intangible assets – Goodwill	353
Net assets acquired	$ 437

Pursuant to the Equity Transfer Agreement, TDR acquired 100% of the issued and outstanding capital stock of Haina from its three stockholders in consideration for payment of 3,000,000 RMB (approximately $437,000). TDR has been overseeing the operations of Haina since January of 2008 as part of its due diligence prior to closing of this acquisition.

On June 9, 2008, TDR entered into a Merger and Acquisition Agreement (the "Acquisition Agreement") with Peng Lai Jin Chuang Company, a corporation organized under the laws of the People's Republic of China ("Peng Lai"), which was organized to develop, manufacture and distribute pharmaceutical, medicinal and diagnostic products in the PRC. Pursuant to the Acquisition Agreement, TDR acquired all of the assets of Peng Lai in consideration for an aggregate of approximately (i) U.S.$2.5 million in cash, and (ii) 381,606 shares of the Company's common stock with a fair value of approximately $4.6 million (at $12 per share). The acquisition of Peng Lai closed on September 5, 2008.

The following table summarizes the approximate estimated fair values of the assets acquired in the Peng Lai acquisition.

	($ in thousands)
Fixed assets	$ 4,177

Intangible assets - SFDA licenses for drug batch numbers		2,917
Net assets acquired	$	7,094

All of our significant operations and long lived assets are located in the PRC.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

2. Restatement

On May 11, 2010, the Company filed with the Securities and Exchange Commission ("SEC") a Current Report on Form 8-K, as amended on May 24, 2010, to report management's determination that the Company's financial statements for the year ended December 31, 2009, included in its Annual Report on Form 10-K filed with the SEC on March 16, 2010, as amended on March 17, 2010 (the "2009 Form 10-K"), should no longer be relied upon due to an error in such financial statements with respect to the accounting for the 750,000 common stock purchase warrants the Company issued in connection with its January 31, 2008 private placement (the "Warrants"). The Company received comments from the staff of the SEC, which led to the Company's conclusion that the historical financial statements for the year ended December 31, 2009 in the 2009 Form 10-K required restatement to properly record the Warrants as a derivative liability.

On June 24, 2010, the Company filed with the SEC an additional Current Report on Form 8-K to report management's determination that the Company's financial statements: (i) for the fiscal quarter ended March 31, 2009, included in its Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2010, filed with the SEC on May 17, 2010 (the "March 2010 Form 10-Q"); (ii) for the fiscal quarter ended June 30, 2009, included in its Quarterly Report on Form 10-Q filed with the SEC on August 14, 2009 (the "June 2009 Form 10-Q"); and (iii) for the fiscal quarter ended September 30, 2009, included in its Quarterly Report on Form 10-Q filed with the SEC on November 16, 2009 (the "September 2009 Form 10-Q" and, collectively with the March 2010 Form 10-Q and June 2009 Form 10-Q, the "Form 10-Qs"), should no longer be relied upon due to an error in such financial statements with respect to the accounting for the Warrants. The Company received comments from the staff of the SEC, which led to the Company's conclusion that the historical financial statements in the Form 10-Qs required restatement to properly record the Warrants as a derivative liability.

The Company has performed a complete assessment of the Warrants and has concluded that the Warrants are within the scope of Accounting Standards Codification 815-40, "Derivatives and Hedging – Contracts in Entity's Own Equity" ("ASC 815-40"), formerly Emerging Issues Task Force Issue No. 07-05, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock" ("EITF 07-05"), due to the inclusion in the Warrants of a provision requiring a weighted average adjustment to the exercise price of the Warrants in the event the Company issues common stock, or securities convertible into or exercisable for common stock, at a price per share lower than such exercise price. Accordingly, ASC 815-40, formerly EITF 07-05, which was effective as of January 1, 2009, should have been applied resulting in a reclassification of the warrants as a liability, measured at fair value, with changes in fair value recognized as part of other income or expense for each reporting period thereafter.

On July 23, 2010, the Company filed amendments to the 2009 Form 10-K and March 2010 Form 10-Q with the SEC, reflecting the restatement.

This Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010 incorporates corrections made in response to the accounting errors described above by restating the Company's financial statements presented herein for the three and six months ended June 30, 2009. The corrections to the quarterly information in this Form 10-Q had no impact on the Company's previously reported income from operations or cash flows for the periods being restated.

The following tables ($ in thousands, except per share information) show the effects of the restatement on the Company's consolidated statements of operations and comprehensive income and consolidated statements of cash flows for the three and six month period ended June 30, 2009:

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

2. Restatement (Continued)

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Income
(Unaudited, $ in thousands except per share data)

	Three Months Ended June 30, 2009		Six Months Ended June 30, 2009	
	As Previously Recorded	As Restated	As Previously Recorded	As Restated
Change in fair value of derivative warrant liability	$ -	$ (1,066)	$ -	$ 1,173
Total other income (expense)	$ 14	$ (1,052)	$ 26	$ 1,199
Net Income Before Provision for Income Tax	$ 12,096	$ 11,030	$ 21,159	$ 22,332
Net Income	$ 9,457	$ 8,391	$ 16,700	$ 17,873
Basic Earnings Per Share	$ 0.57	$ 0.51	$ 1.01	$ 1.09
Diluted Earnings Per Share	$ 0.57	$ 0.51	$ 1.01	$ 1.08
Other Comprehensive Income				
Foreign currency translation adjustment	$ 6	$ 6	$ 123	$ 123
Net Income	9,457	8,391	16,700	17,873
Comprehensive Income	$ 9,463	$ 8,397	$ 16,823	$ 17,996

The gain (loss) resulting from the change in fair value of derivative warrant liability for the three and six month period ended June 30, 2009 was incurred at the corporate level (a Nevada corporation). The Company did not recognize any income tax benefits (expense) associated with the change in fair value in the three and six months ended June 30, 2009 (see Note 14). Therefore, the restatement did not have an effect on the Company's taxable income for the three and six months ended June 30, 2009.

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited, $ in thousands)

	Six Months Ended June 30, 2009	
	As Previously Recorded	As Restated

Net Income	$	16,700	$	17,873
Change in fair value of derivative liability		-		(1,173)
Total:	$	16,700	$	16,700

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

3. Summary of Significant Accounting Policies

We have established various accounting policies that govern the application of accounting principles generally accepted in the United States of America ("U.S."), which are utilized in the preparation of our financial statements. Certain accounting policies involve significant judgments and assumptions by management that have a material impact on the carrying value of certain assets and liabilities. The judgments and assumptions used by management are based on our historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of operations.

Principles of Consolidation – The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, ACPG, TDR, First, Tian Qing, Tianlong, Haina and Peng Lai. All significant inter-company transactions and balances were eliminated.

These financial statements are stated in U.S. Dollars and have been prepared in accordance with accounting principles generally accepted in the United States of America. This basis of accounting differs from that used under applicable accounting requirements in the PRC. No material adjustment was required.

Certain items in our 2009 restated financial statements (see Note 2) have been reclassified to conform with the 2010 financial statements presentation.

Management acknowledges its responsibility for the preparation of the accompanying interim consolidated financial statements, which reflect all adjustments, consisting of normal recurring adjustments, considered necessary, in its opinion, for a fair presentation of its consolidated financial position and the results of its operations for the interim period presented. These consolidated financial statements should be read in conjunction with the summary of significant accounting policies and notes to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, as amended.

The accompanying unaudited condensed consolidated financial statements for China Sky One Medical, Inc. and Subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole.

Use of estimates – The preparation of these financial statements in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reported periods.

Significant estimates include values and assigned lives to acquired tangible and intangible assets, uncollectible accounts receivable, impairment testing of goodwill and other long-lived assets, the valuation allowance for income taxes, and the evaluation and estimate for contingencies. Actual results may differ from these estimates.

Earnings per share - Basic earnings per common share is computed by dividing net earnings applicable to common shareholders by the weighted-average number of common shares outstanding during the period. When applicable,

diluted earnings per common share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents, consisting of shares that might be issued upon exercise of common stock options and warrants.

Potential common shares issued are calculated using the treasury stock method, which recognizes the use of proceeds that could be obtained upon the exercise of options and warrants in computing diluted earnings per share. It assumes that such proceeds would be used to purchase common stock at the average market price of the common stock during the period.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

3. Summary of Significant Accounting Policies (Continued)

Cash and cash equivalents – The Company considers all highly liquid instruments purchased with a maturity period of three months or less to be cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents approximate their fair value.

A significant amount of our cash and cash equivalents are held in commercial bank checking accounts in the PRC and earn interest income (annual yield of approximately 0.36% for the year ended December 31, 2009). For all the bank accounts in the PRC and in the U.S., the Company earned interest income of approximately $59,000 and $26,000 for the six months ended June 30, 2010 and 2009, respectively.

Accounts receivable – Accounts receivable are stated at net realizable value, net of an allowance for doubtful accounts. The allowance for estimated bad debts is based upon the periodic analysis of individual customer balances including an evaluation of days of sales outstanding, payment history, recent payment trends, and perceived credit worthiness. As of June 30, 2010 and December 31, 2009, the Company's allowance for doubtful accounts was $56,000.

Inventories – Inventories include finished goods, raw materials, freight-in, packing materials, labor, and overhead costs and are valued at the lower of cost or market using the first-in, first-out method. Inventory units are valued using the weighted average method. Provisions are made for slow moving, obsolete and/or damaged inventory based upon the periodic analysis of individual inventory items including an evaluation of historical usage and/or movement, age, expiration date, and general conditions. The Company recorded no inventory reserve position as of June 30, 2010 and December 31, 2009.

Property and equipment – Property and equipment are stated at historical cost less accumulated depreciation. Depreciation on property and equipment is provided using the straight-line method over the estimated useful lives of the assets. The Company uses an estimated residual value of 5% of cost, or valuation for both financial and income tax reporting purposes. The estimated lengths of the useful lives of our property and equipment are as follows:

Building and Improvements	30 years
Land use rights	50 years
Furniture & Equipment	5 to 7 years
Transportation Equipment	5 to 15 years
Machinery and Equipment	7 to 14 years

Expenditures for renewals and betterments are capitalized while repairs and maintenance costs are charged to the consolidated statement of operations in the year in which they were incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalized as an additional cost of the asset. Upon sale or disposal of an asset, the historical cost and related accumulated depreciation or amortization of such asset is removed from their respective accounts, and any gain or loss is recorded in the consolidated statements of operations.

Property and equipment are evaluated for impairment in value whenever an event or change in circumstances indicates that the carrying values may not be recoverable. If such an event or change in circumstances occurs and potential impairment is indicated because the carrying value exceeds the estimated future undiscounted cash flows of the asset, the Company will measure the impairment loss as the amount by which the carrying value of the asset exceeds its fair value. The Company did not record any impairment charges of property and equipment in the three or six months ended June 30, 2010 and 2009.

Construction-in-progress – Properties currently under development are accounted for as construction-in-progress. Construction-in-progress includes the acquisition and land right costs, development expenditures, professional fees, and capitalized interest costs during the period of construction.

Upon completion and readiness for use of the project, the cost of construction-in-progress is transferred as part of property and equipment. In the case of construction-in-progress, management takes into consideration the estimated cost to complete the project when making the lower of cost or market calculation.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

3. Summary of Significant Accounting Policies (Continued)

Intangible assets – Intangible assets are accounted for in accordance with ASC topic 350, "Intangibles – Goodwill and Other." Intangible assets with finite useful lives are amortized while intangible assets with indefinite useful lives are not amortized. The Company reviews its long-lived assets and finite-lived intangible assets for impairment on at least an annual basis or whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of its long-lived assets, the Company evaluates the probability that future undiscounted net cash flows will be less than the carrying amount of the assets. Impairment costs, if any, are measured by comparing the carrying amount of the related assets to their fair value. The Company recognizes an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Fair value is determined by the use of undiscounted future cash flows, independent appraisals or other approximate methods. The Company did not record any impairment charges for the six months ended June 30, 2010 and 2009.

Our intangible assets consist of proprietary technologies, SFDA licenses for drug batch numbers, and goodwill. Proprietary technologies are technologies that we own. The SFDA licenses for drug batch numbers and goodwill were acquired in the business acquisitions of Tianlong, Peng Lai and Haina. We have registered "Kang Xi" as our trademark, which is used for all of the Company's Tradition Chinese Medicine ("TCM") products. The "Kang Xi" trademark was developed internally and registered by TDR before the Company became a public company. The Company's cost basis in the trademark is nominal. Therefore, the Company did not have its "Kang Xi" trademark appraised, or recorded an intangible asset for it. Additionally, none of the costs associated with the trademark have been capitalized. As of June 30, 2010, the weighted average amortization period for our intangible assets is approximately 8 years.

Derivative Instruments – The Class A Warrants ("the Warrants") issued in connection with the private placement the Company consummated on January 31, 2008 include a reset provision triggered if the Company issues common shares below the exercise price of $12.50 as defined under the Warrant Agreement. Effective January 1, 2009 the reset provision of these warrants preclude equity accounting treatment under ASC 815 (formerly EITF 07-05). Accordingly, effective January 1, 2009, the Company was required to reclassify the Warrants at their fair value to liabilities each reporting period under ASC 815-40. At June 30, 2010, the fair value of the Company's derivative warrants liability was $3,549,000. The Company used the Monte Carlo valuation model to estimate the fair value of the Warrants. Significant assumptions used at June 30, 2010 include a term of approximately 3.7 years; volatility of 73.0% and a risk free interest rate of 1.43%. Significant assumptions used at June 30, 2009 include a term of approximately 3.7 years; volatility of 66.0% and a risk free interest rate of 1.94%. Changes in fair value of these warrants are recognized in earnings each reporting period.

Foreign Currency - The Company's principal country of operations is in the PRC. The financial position and results of operations of the Company are recorded in Renminbi ("RMB") as the functional currency. The results of operations denominated in foreign currency are translated at the average rate of exchange during the reporting period. Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the market rate of exchange at that date. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of the capital contribution. All translation adjustments resulting from the translation of the financial statements into U.S. Dollars are recorded as accumulated other comprehensive income, a component of stockholders' equity.

Revenue recognition - Revenue is recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped and the customer takes ownership and assumes the risk of loss;

(3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. The Company believes that all of these criteria are satisfied upon shipment from its facilities. Historically, the Company's estimated returns, allowances and claims have been deemed immaterial. The Company's sale agreements only allow a return if the product has quality related issues. In such event, the Company accepts the return for equivalent product exchange from inventory only. The Company's revenues do not include multiple deliverable arrangements.

The Company occasionally applies to various government agencies for research grants. Revenue from such research grants is recognized when earned. In situations where the Company receives payment in advance for the performance of research and development services, such amounts are deferred and recognized as revenue as the related services are performed.

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3. Summary of Significant Accounting Policies (Continued)

Research and development - Research and development expenses include the costs associated with the Company's internal research and development as well as research and development conducted by third parties. These costs primarily consist of salaries, clinical trials, outside consultants, and materials. All research and development costs are expensed as incurred.

Third-party expenses reimbursed under non-refundable research and development contracts are recorded as a reduction to research and development expense in the consolidated statement of operations.

The Company recognizes in-process research and development in accordance with ASC topic 730, "Research and Development." Assets to be used in research and development activities, specifically, compounds that have yet to receive new drug approval and would have no alternative use, should approval not be given, are immediately charged to expense when acquired. Certain assets and other technologies acquired that has foreseeable future cash flows are capitalized as intangible assets. Such intangible assets are amortized starting from the year revenue is generated and amortized over the estimated stream of revenues derived from the product sale. Should under any circumstances these capitalized intangible assets have no future benefit; the Company will record an immediate write-off for the remaining net carrying value within the consolidated statement of operations.

The Company incurred research and development expenses of approximately $5,910,000 and $3,682,000, for the three months ended June 30, 2010 and 2009, respectively, and $9,674,000 and $6,095,00, for the six months ended June 30, 2010 and 2009, respectively.

Advertising – The Company signs contracts with agents who then place its advertising in the mediums of television, radio and internet. Advertising expense is incurred in the period the advertisements take place. Thus, costs of advertising are expensed as incurred. Advertising costs were approximately $3,710,000 and $3,438,000 for the three months ended June 30, 2010 and 2009, respectively, and $6,396,000 and $6,214,000 for the six months ended June 30, 2010 and 2009, respectively. An immaterial amount of the Company's advertisement expenses were related to advertising production costs. Advertising costs are reported as part of selling expenses in the consolidated statements of operations.

Taxation – The Company uses the asset and liability method of accounting for deferred income taxes. The Company's provision for income taxes includes income taxes currently payable and those deferred because of temporary differences between the financial statement and tax bases of assets and liabilities. The Company records liabilities for income tax contingencies based on our best estimate of the underlying exposures.

The Company periodically estimates its tax obligations using historical experience in tax jurisdictions and informed judgments. There are inherent uncertainties related to the interpretation of tax regulations in the jurisdictions in which the Company transacts business. The judgments and estimates may change based on the outcome of tax audits, as well as changes to, or further interpretations of, regulations. The Company adjusts income tax expense in the period in which these events occur.

Provision for the PRC enterprise income tax is calculated at the prevailing rate based on the estimated assessable profits less available tax relief for losses brought forward. The Company does not accrue taxes on unremitted earnings from foreign operations as it is the Company's intention to invest these earnings in the foreign operations indefinitely.

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3. Summary of Significant Accounting Policies (Continued)

Enterprise income tax

According to "Enterprise Income Tax and Certain Preferential Policies Notice" published by the Ministry of Finance and the National Tax Affairs Bureau, if the enterprise is authorized by the State Council as a special entity, the enterprise income tax rate is reduced to 15%. The following table sets forth the Company's income tax rate for TDR and its subsidiaries for the six months ended June 30, 2010 and 2009:

Income Tax Rate for Subsidiaries	As of June 30, 2010	2009
TDR	15%	15%
First	15%	15%
Tianlong	15%	15%
Haina	25%	25%
Peng Lai	2% of Revenue *	2% of Revenue *

* Reflects a 25% tax rate on 8% of Peng Lai's revenue, regardless of its taxable income. As authorized by Peng Lai Municipal Tax Bureau, Peng Lai was not required to pay tax on the remaining 92% of revenue.

Value added tax

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

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

According to "Agriculture Product Value Added Tax Rate Adjustment and Certain Items' Value Added Tax Waiver" published by the Ministry of Finance and the National Tax Affairs Bureau, the value added tax for agriculture related products is to be taxed at 13%. Furthermore, traditional Chinese medicine and medicinal plant are by definition agriculture related products.

We may from time-to-time be assessed interest or penalties by major tax jurisdictions, although such assessments historically have been minimal and immaterial to our financial results. Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense.

The Company files corporate income tax returns in the U.S. for China Sky One and ACPG. ACPG wholly owns 100% of TDR and subsidiaries in the PRC. China Sky One and ACPG are holding companies and do not generate business

revenues and management's intent is not to distribute dividend income from TDR and subsidiaries to either China Sky One or ACPG. As such, management has established a full valuation allowance for the net operating losses incurred by China Sky One and ACPG. The Company files income tax returns in the PRC for TDR and its subsidiaries.

Comprehensive income – Comprehensive income consists of net income and other gains and losses affecting stockholders' equity that, under generally accepted accounting principles are excluded from net income. For the Company, such items consist entirely of foreign currency translation gains and losses.

China Sky One Medical, Inc. and Subsidiaries
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3. Summary of Significant Accounting Policies (Continued)

Retirement benefit costs – According to the PRC regulations on pension plans, the Company contributes to a defined contribution retirement plan organized by municipal government in the province in which the Company is registered and all qualified employees as defined by statutory regulations are eligible to participate in the plan.

Contributions to the pension or retirement plan are calculated at 22% of the employees' salaries above a fixed threshold amount. The employees contribute between 2% to 8% to the pension plan, and the Company contributes the balance. The Company has no other material obligations for the payment of retirement benefits beyond the annual contributions under this plan. The Company incurred retirement benefit costs of $72,000 and $51,000 for the three months ended June 30, 2010 and 2009, respectively, and $116,000 and $90,000 for the six months ended June 30, 2010 and 2009, respectively.

Fair value of financial instruments – The carrying amounts of certain financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, and other payables approximate their fair values at June 30, 2010 and December 31, 2009 because of the relatively short-term maturity of these instruments.

Subsequent Events

The Company evaluated subsequent events through the date of filing of this Form n10-Q in accordance with the Subsequent Events Topic of the FASB Accounting Standards Codification under ASC topic 855.

Recent accounting pronouncements

The Financial Accounting Standards Board ("FASB") has codified a single source of authoritative nongovernmental U.S. GAAP, the "Accounting Standards Codification" (the "Codification" or "ASC"). While the Codification does not change U.S. GAAP, it introduces a new structure that is organized in an easily accessible, user-friendly on-line research system. The Codification supersedes all existing accounting standards documents. All other accounting literature not included in the Codification will be considered nonauthoritative. Unless needed to clarify a point to readers, we will refrain from citing specific section references when discussing application of accounting principles or addressing new or pending accounting rule changes.

In April 2010, the FASB issued Accounting Standard Update ("ASU") 2010-17, Revenue Recognition – Milestone Method, which amended guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. A vendor can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive.

The consideration earned by achieving the milestone should:

1. Be commensurate with either of the following:

   a. The vendor's performance to achieve the milestone; or
   b. The enhancement of the value of the item delivered as a result of a specific outcome resulting from the vendor's performance to achieve the milestone

2. Relate solely to past performance

3. Be reasonable relative to all deliverables and payment terms in the arrangement.

A milestone should be considered substantive in its entirety. An individual milestone may not be bifurcated. An arrangement may include more than one milestone, and each milestone should be evaluated separately to determine whether the milestone is substantive. Accordingly, an arrangement may contain both substantive and non-substantive milestones.

The amendments in this ASU are effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. The new accounting guidance did not have a material impact on our consolidated financial statements.

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3. Summary of Significant Accounting Policies (Continued)

In February 2010, the FASB issued ASU No. 2010-09, Subsequent Events (Topic 855); Amendments to Certain Recognition and Disclosure Requirements. This ASU amended the guidance on subsequent events and will no longer require that an SEC filer disclose the date through which subsequent events have been evaluated. The amendment is effective for interim and annual periods ending after June 15, 2010.

In April 2009, the FASB issued new accounting guidance regarding the accounting for assets acquired and liabilities assumed in a business combination due to contingencies. This new guidance clarifies the initial and subsequent recognition, subsequent accounting and disclosure of assets and liabilities arising from contingencies in a business combination. This new guidance requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, if the acquisition date fair value can be reasonably estimated. If the acquisition-date fair value of an asset or liability cannot be reasonably estimated, the asset or liability would be measured at the amount that would be recognized using the accounting guidance related to accounting for contingencies or the guidance for reasonably estimating losses. This new accounting guidance becomes effective for us on November 1, 2010; however, as the provision of the guidance will be applied prospectively to business combinations with an acquisition date on or after the guidance becomes effective, the impact to us cannot be determined until a transaction occurs.

4. Revenue By Product Category and Geographic Region

For the six months ended June 30, 2010 and 2009, overseas sales were approximately $3,726,000 and $4,426,000, respectively. For the three months ended June 30, 2010 and 2009, overseas sales were approximately $2,910,000 and $3,246,000, respectively.

The following table sets forth our principal product categories based on application type and the approximate amount and percentage of revenue from each of such product categories, during the six months ended June 30, 2010 and 2009:

	For the Six Months Ended June 30, ($ in thousands)				
	2010		2009		Variance
Product Category	Sales	% of Sales	Sales	% of Sales	
Patches	$ 17,927	25.7%	$ 19,059	33.5%	$ (1,132)
Ointments	19,419	27.9%	12,740	22.3%	6,679
Sprays	8,124	11.7%	7,711	13.5%	413
Diagnostic Kits	3,778	5.4%	6,789	11.9%	(3,011)
Others	20,415	29.3%	10,716	18.8%	9,699
Total	$ 69,663	100.0%	$ 57,015	100.0%	$ 12,648

Please refer to “Part I, Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” for an analysis on changes in revenue by product category.

5. Concentrations of Business and Credit Risk

Substantially all of the Company's long-lived assets and business operations are located in the PRC.

The Company maintains certain bank accounts in the PRC which are not protected by FDIC insurance or other insurance. As of June 30, 2010, the Company held approximately $1,148,000 of cash and cash equivalent account balances within the U.S. and all of the deposits were within the FDIC insurance limits. As of June 30, 2010, the Company had approximately $63,508,000 in China bank deposits, which are not insured.

A significant amount of the Company’s sales are concentrated in China. Accordingly, the Company is susceptible to fluctuations in its business caused by adverse economic conditions in China. Difficult economic conditions in other geographic areas into which the Company may expand may also adversely affect its business, operations and finances.

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5. Concentrations of Business and Credit Risk (Continued)

The Company provides credit in the normal course of business. The Company performs ongoing credit evaluations of its customers and maintains allowances for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends, and other information.

The Company does not require collateral for financial instruments subject to credit risk.

The Company is self-insured for all risks and carries no liability or property insurance coverage of any kind. The Company does not set aside any reserves for product liability risks or other potential claims. The Company's policy is to record losses associated with its lack of insurance coverage at such time as a realized loss is incurred. Historically, the Company has not had any material losses in connection with its lack of insurance coverage and was not party to any material pending legal proceedings as of June 30, 2010. Management's intention is to use the Company's working capital to fund any such losses incurred due to the Company's exposure to inadequate insurance coverage.

Payments of dividends may be subject to some restrictions due to the Company's operating subsidiaries all being located in the PRC.

Major Customers

For the six months ended June 30, 2010, no customer accounted for more than 10% of our total revenues. For the six months ended June 30, 2009, Shanxi Xintai and Harbin Shiji Baolong Medicine Company accounted for 18% and 21% respectively of total revenues. At June 30, 2010, Harbin Shiji Baolong Medicine Company accounted for approximately 10% of all accounts receivable. At June 30, 2009, Shanxi Xintai and Harbin Shiji Baolong Medicine Company accounted for 15% and 34%, respectively, of all accounts receivable. No other customers accounted for 10% or more of our total revenues or accounts receivable for the six months ended June 30, 2010 and 2009.

Major Suppliers

For the six months ended June 30, 2010, Heilongjiang Kangda Medicine Company accounted for approximately 50% of the Company's total inventory purchases. For the six months ended June 30, 2009, Heilongjiang Kangda Medicine Company accounted for approximately 41% of the Company's total inventory purchases. No other suppliers accounted for 10% or more of our total inventory purchases for the six months ended June 30, 2010 and 2009. We believe alternative local suppliers are available to meet our fulfillment needs if necessary. Therefore, we are not substantially dependent on any specific supplier.

6. Earnings Per Share

We have applied SFAS No. 128, "Earnings Per Share" in our calculation and presentation of earnings per share - "basic" and "diluted". Basic earnings per share are computed by dividing net earnings available to common shareholders (the numerator) by the weighted average number of common shares (the denominator) for the period presented. The computation of diluted earnings per share is similar to basic earnings per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

Warrants to purchase 593,800 shares of common stock and no stock options to purchase shares of common stock were outstanding and exercisable as of June 30, 2010. Warrants to purchase 750,000 shares of common stock and stock options to purchase 12,500 shares of common stock were exercisable and outstanding as of June 30, 2009. These common stock equivalents were included in the computation of diluted earnings per share because the option exercise prices were less than the average market price of our common stock during these periods.

The dilutive potential common shares on warrants and options is calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all warrants and options are used to repurchase common stock at the average market price of the common stock during the relevant period. The amount of shares remaining after the proceeds are exhausted represent s the potential dilutive effect of the securities.

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6. Earnings Per Share (Continued)

The following table sets forth the Company's computation of basic and diluted net income per share for the three months ended June 30, 2010 and 2009:

	For the three months ended June 30, ($ in thousands, except share and per share data)	
	2010	2009 (restated)
Numerator:		
Net income used in calculation of basic and diluted earnings per share	$ 12,242*	$ 8,391**
Denominator:		
Weighted-average common shares outstanding used in calculation of basic earnings per share	16,790,851	16,537,066
Effect of dilutive securities:		
Warrants and Options	21,959	91,826
Weighted-average common shares used in calculation of diluted earnings per share	16,812,810	16,628,892
Net income per share:		
Basic	$ 0.73	$ 0.51
Diluted	$ 0.73	$ 0.51

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* Includes a gain of $2,087 and $0.12 per share (basic and diluted) relating to the change in fair value of the derivative warrant liability relating to the Class A Warrants.
** Includes a loss of ($1,066) and ($0.06) per share (basic and diluted) relating to the change in fair value of the derivative warrant liability relating to the Class A Warrants.

The following table sets forth the Company's computation of basic and diluted net income per share for the six months ended June 30, 2010 and 2009:

	For the six months ended June 30, ($ in thousands, except share and per share data)	
	2010	2009 (restated)
Numerator:		
Net income used in calculation of basic and diluted earnings per share	$ 24,830*	$ 17,873**
Denominator:		

Weighted-average common shares outstanding used in calculation of basic earnings per share		16,783,896		16,475,833
Effect of dilutive securities:				
Warrants and Options		110,879		71,204
Weighted-average common shares used in calculation of diluted earnings per share		16,894,775		16,547,037
Net income per share:				
Basic	$	1.48	$	1.09
Diluted	$	1.47	$	1.08

* Includes a gain of $7,013 and $0.42 per share (basic and diluted) relating to the change in fair value of the derivative warrant liability relating to the Class A Warrants.

** Includes a gain of $1,173 and $0.07 per share (basic and diluted) relating to the change in fair value of the derivative warrant liability relating to the Class A Warrants.

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7. Equity and Share-based Compensation

Compensation cost for all stock-based compensation awards granted is based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. Under the fair value recognition provisions of SFAS No. 123R, we recognize stock-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line prorated basis over the requisite service period of the award.

In July 2006, the Company's stockholders approved the 2006 Stock Incentive Plan (the "2006 Plan"). The 2006 Plan, provides for the grant of stock options, restricted stock awards, and performance shares to qualified employees, officers, directors, consultants and other service providers. The 2006 Plan originally authorized the Company to grant options and/or rights to purchase up to an aggregate of 1,500,000 shares of common stock. As of June 30, 2010, there have been a total of 198,202 common shares granted based on the 2006 Plan to Company employees and consultants.

8. Securities Purchase Agreement and Related Transaction

On January 31, 2008 (the "Closing Date"), the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with certain accredited investors (the "Investors"), for the purchase and sale of units consisting of an aggregate of: (i) 2,500,000 shares of the Company's common stock, and (ii) Class A Warrants to purchase 750,000 additional shares of the Company's common stock exercisable at $12.50 per share, and expiring on July 31, 2011 (the "Class A Warrants"), for a purchase price of $10.00 per unit (the "Unit Purchase Price"), or gross offering proceeds of $25.0 million (the "2008 Offering"). The Company received net proceeds of approximately $23.5 million in connection with the 2008 Offering.

Pursuant to the Purchase Agreement, among other things, if, and whenever, within twelve (12) months of the Closing Date, the Company issued or sold, or was deemed to have issued or sold, any shares of common stock, or securities convertible into or exercisable for shares of common stock, or modified any of the foregoing which may be outstanding (with the exception of certain excluded securities), to any person or entity at a price per share, or conversion or exercise price per share less than the Unit Purchase Price, then the Company would have been required to issue, for each such occasion, additional shares of its common stock to the Investors in such number so that the average per share purchase price of the shares of common stock purchased by the Investors in the 2008 Offering would have automatically been reduced to such other lower price per share. This right expired on January 30, 2009.

In addition, as of the Closing Date, the Company entered into a Make Good Agreement (the "Make Good Agreement") with Liu Yan-qing, its Chairman, Chief Executive Officer and President, and a principal shareholder of the Company, (the "Principal Shareholder") and the Investors (collectively, the "Make Good Parties"), pursuant to which the Principal Shareholder deposited 3,000,000 shares of his common stock of the Company (the "Escrow Shares") into escrow, to be released to the Investors in an amount pro rata pro to their initial investments in the 2008 Offering, in the event the Company failed to attain earnings per share, as adjusted, of at least (i) $1.05 per share for the fiscal year ending December 31, 2007 (based on an aggregate of 13,907,696 shares outstanding), and/or (ii) $1.63 per share for the fiscal year ending December 31, 2008 (based on 16,907,696 shares outstanding).

The Company deemed the Escrow Shares arrangement as analogous to the issuance of a fixed number of warrants in an equity transaction. Under the Make Good Agreement these Escrow Shares would have been reallocated on a pro rata basis to the Investors only if certain earnings targets were not achieved in years 2007 and 2008. If the earnings targets were met, the Escrow Shares would automatically have been released to the Principal Shareholder. As of

January 31, 2008, the date the common shares were placed into escrow, the Company achieved the 2007 earnings target and, based upon internal forecasts, was confident the 2008 target would also be met. Based upon certain assumptions, including the low probability that the Escrow Shares would be released to the Investors and not be returned to the Principal Shareholder, the Company considered the fair value of the right held by the Investors through the Escrow Shares provision under the Make Good Agreement to be immaterial. As of December 31, 2008, the Company satisfied the earnings per common share targets for each of fiscal 2007 and 2008 as defined under the Make Good Agreement and, as such, the Escrow Shares were released to the Principal Shareholder in 2009.

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8. Securities Purchase Agreement and Related Transaction (Continued)

In connection with the 2008 Offering, the Company and the Investors entered into a Put Agreement whereby the Investors were granted the right, but not the obligation, to require the Company to repurchase certain common shares issued under the Purchase Agreement at $10.00 per share (the Unit Purchase Price). The Investors could only exercise their Put Right in the event that either:

1. the Adjusted EPS of the Company for the fiscal year ending December 31, 2007 was less than $0.80 per share, as set forth in the fiscal year 2007 audited financial statements; or

2. the Company's accounts receivable exceeded $12.0 million at December 31, 2007, as set forth in the fiscal year 2007 audited financial statements.

As of the Closing Date, based on preliminary financial results for the fiscal year ended December 31, 2007, the Company determined that the events triggering the Investors' put right did not occur and that the put right would expire unexercised on or prior to March 31, 2008 (the date the Company's Form 10-KSB was required to be filed with the SEC). Based upon these preliminary results, the Company determined that the value of the put obligation was immaterial and did not record it as a liability. Both of the targets were met upon the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2007 on March 31, 2008, and the Investors' rights under the Put Agreement were terminated unexercised.

Additional information relating to the Class A Warrants is provided in Note 9.

9. Outstanding Warrants and Options

The following table summarizes information about stock warrants outstanding and exercisable as of June 30, 2010:

	Shares Underlying Warrants	Weighted average Exercise Price Warrants	Shares underlying Options	Weighted average Exercise Price Options
Outstanding as of June 30, 2009	750,000	$ 12.50	12,500	$ 3.65
Exercised	-	2.00	(12,500)	3.65
Outstanding as of December 31, 2009	750,000	12.50	-	-
Exercised	(156,200)	12.50	-	-
Outstanding as of June 30, 2010	593,800	$ 12.50	-	$ -

As of December 31, 2009, the Class A Warrants granted in connection the Securities Purchase Agreement represented the right to purchase an aggregate of 750,000 shares of Common Stock of the Company, at an exercise price of $12.50 per share. In addition, the Class A Warrants have the following characteristics:

- The Class A Warrants became exercisable beginning on the six-month anniversary of the closing of the January 2008 Offering and will expire July 31, 2011 (subject to extension as described below).

- Commencing on the one-year anniversary of the Closing Date, in the event the Warrant Shares are not freely salable by the holders of the Class A Warrants due to the Company's failure to satisfy its registration requirements and an exemption for such sale is not otherwise available to the Warrantholders under Rule 144, the Class A Warrants will be exercisable on a cashless basis.

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9. Outstanding Warrants and Options (Continued)

- The Exercise Price and number of Warrant Shares are subject to adjustment for standard dilutive events, such as dividends or distributions on the Company's common stock paid in shares of common stock, reclassifications or reorganizations of the common stock, distributions of indebtedness or assets (other than cash) to all holders of the common stock, a merger or consolidation with another corporation in which the Company is not the survivor, or sale, transfer or other distribution of all or substantially all of the Company's assets to another corporation to prevent dilution to the holders of the Class A Warrants as a result of such event. The Exercise Price is also subject to adjustment on a weighted-average basis for issuance of common stock, or securities convertible into or exercisable for shares of common stock, at a price per share, or conversion or exercise price per share less than the Class A Warrant exercise price of $12.50 per share (a "Trigger Issuance"). In the event of a Trigger Issuance, the then-existing Exercise Price shall be reduced, as of the close of business on the effective date of the Trigger Issuance, to a price determined as follows:

$$\text{Adjusted Warrant Price} = \frac{(A \times B) + D}{A+C}$$

where

"A" equals the number of shares of the Company's common stock outstanding, including Additional Shares of Common Stock (as defined below) deemed to be issued hereunder, immediately preceding such Trigger Issuance;

"B" equals the Exercise Price in effect immediately preceding such Trigger Issuance;

"C" equals the number of Additional Shares of Common Stock issued or deemed issued hereunder as a result of the Trigger Issuance; and

"D" equals the aggregate consideration, if any, received or deemed to be received by the Company upon such Trigger Issuance;

provided, however, that in no event shall the Exercise Price after giving effect to such Trigger Issuance be greater than the Warrant Price in effect prior to such Trigger Issuance.

For purposes of hereof, "Additional Shares of Common Stock" shall mean all shares of common stock issued by the Company, or deemed to be issued in connection with a the Trigger Issuance, other than certain excluded issuances (as defined in the Class A Warrants).

In June 2008, the Emerging Issues Task Force issued EITF Consensus 07-05 ("Issue 07-05) "Determining Whether an Instrument (for Embedded Feature) is Indexed to an Entity's Own Stock". Under Issue 07-05, instruments which contain anti-dilution provisions will no longer be considered indexed to a company's own stock for purposes of determining whether it meets the first part of the scope exception in paragraph 11(a) of SFAS 133. Issue 07-05

provides new guidance for determining whether equity instruments are indexed to a company's own stock, and as a result, whether those contracts should be marked-to-market. Issue 07-05 contains 20 examples illustrating its application. In particular, Example 8 addresses an exercise price reset feature that is common in many arrangements. Example 8, concludes that because of the reset feature, the Class A Warrants will no longer be considered indexed to a company's own stock for purposes of determining whether it meets the first part of the scope exception in paragraph 11(a) of SFAS 133. The adoption of Issue 07-05 required the Company to (1) evaluate the Class A Warrants contingent exercise provisions and (2) evaluate the instrument's settlement provisions. The Company determined that the Class A Warrants are akin to Example 8 of EITF 07-05 and not Example 16 of EITF 07-05, as the anti-dilution provision is designed to protect the holder from issuances below the exercise price (rather than below market price issuances.).

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9. Outstanding Warrants and Options (Continued)

- At anytime following the date a Registration Statement covering the Warrant Shares is declared effective, we will have the ability to call the Class A Warrants at a price of $0.01 per Class A Warrant, upon thirty (30) days prior written notice to the holders of the Class A Warrants, provided (i) the closing price of the Common stock exceeded $18.75 for each of the ten (10) consecutive trading days immediately preceding the date that the call notice is given by the Company, and (ii) the Company has attained an Adjusted EPS of at least $1.75 per share for the fiscal year ending December 31, 2008, as set forth in our audited financial statements of the Company.

- If, among other things, the Company fails to cause a Registration Statement covering the Warrant Shares to be declared effective prior to the applicable dates set forth in the Registration Rights Agreement, the expiration date of the Class A Warrants shall be extended one day for each day beyond the Effectiveness Deadlines. The registration rights do not require a cash settlement and the Class A Warrants can be settled in unregistered shares. Therefore, paragraphs 14-18 of EITF 00-19 does not apply to the registration rights associated with the Class A Warrants. As a result, no liability accounting is required.

During the six months ended June 30, 2010, the Warrantholders exercised 156,200 warrants including 148,700 warrants exercised on a cashless basis for a total of 69,084 shares of the Company's common stock, and 7,500 warrants exercised for cash proceeds of $93,750.

At June 30, 2010, the Company had 593,800 Class A Warrants outstanding. The Company used the Monte Carlo valuation model to estimate the fair value of the Class A Warrants. Significant assumptions used at June 30, 2010 include a term of approximately 3.7 years; volatility of 73.0% and a risk free interest rate of 1.43%. The outstanding Class A Warrants at June 30, 2010 had a fair value of approximately $3,549,000. At June 30, 2010, the Company recorded income of $7,013,000 due to the change in fair value of the related derivative warrant liability for the six months ended June 30, 2010. At June 30, 2010, the Company recorded income of $2,087,000 due to the change in fair value of the related derivative warrant liability for the three months ended June 30, 2010.

At June 30, 2009, the Company had 750,000 Class A Warrants outstanding. The Company used the Monte Carlo valuation model to estimate the fair value of the Class A Warrants. Significant assumptions used at June 30, 2009 include a term of approximately 3.7 years; volatility of 66.0% and a risk free interest rate of 1.94%. The outstanding Class A Warrants at June 30, 2009 had a fair value of approximately $5,455,000. At June 30, 2009, the Company recorded income of $1,173,000 due to the change in fair value of the related derivative warrant liability for the six months ended June 30, 2009. At June 30, 2009, the Company recorded an expense of $1,066,000 due to the change in fair value of the related derivative warrant liability for the three months ended June 30, 2009.

10. Inventories

The Company values its inventories at the lower of cost and market method. Inventories are accounted for using the first-in, first-out method. Inventories include packing materials, raw materials, supplemental materials, work-in-process, and finished products.

As of June 30, 2010 and December 31, 2009, inventories consisted of the following:

($ in thousands)

	June 30, 2010 (Unaudited)	December 31, 2009
Raw Material	$ 1,889	$ 1,192
Work-in-Process	1,241	578
Finished Products	2,429	642
Total Inventories	$ 5,559	$ 2,413

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10. Inventories (Continued)

Historically, our inventory is at its lowest levels at the end of each calendar year and in the first fiscal quarter. We draw down our inventory levels in December of each year for two main reasons. First, our customers want to receive goods prior to the holiday season. In addition, the first calendar quarter is traditionally our slowest sales period. Since a lower volume of sales activity normally occurs during the first quarter of each calendar year, we believe it is prudent to avoid incurring unnecessary inventory carrying costs. At the appropriate time toward the end of the first calendar quarter of each fiscal year, we begin to ramp up our inventory levels to prepare for increased demand during the coming stronger selling periods. Historically, we signed agreements with suppliers that allow us to hold extra raw materials at the cost of the suppliers. As a result, we could minimize our own inventory carrying costs, and improve our cash management, by keeping the inventory at the minimum level required to support the short-term sales. However, due to price increases of raw materials, in addition to overhead costs for storing such raw materials, the Company started to increase the inventory levels at our own cost at the end of year 2009.

Management calculates its inventory turnover rate using total inventory rather than just finished goods, because its production cycle is of an extremely short duration. The inventory turnover rate is further discussed in the Liquidity section in the Management's Discussion and Analysis.

11. Property and Equipment, net

As of June 30, 2010 and December 31, 2009, Property and Equipment, net, consisted of the following:

	($ in thousands) June 30, 2010 (Unaudited)	December 31, 2009
Buildings and improvements	$ 11,142	$ 10,570
Machinery and equipment	5,757	5,868
Transportation equipment	959	955
Furniture and equipment	342	325
Total Property and Equipment	18,200	17,718
Less: Accumulated Depreciation	(2,749)	(2,227)
Property and Equipment, Net	$ 15,451	$ 15,491

For the six months ended June 30, 2010 and 2009, depreciation expense totaled $511,000 and $462,000, respectively.

Depreciation expense included within Cost of Goods Sold for the six months ended June 30, 2010 and 2009 amounted to $251,000 and $268,000, respectively.

12. Intangible Assets, net

Intangible assets consists of proprietary technologies that we purchased during our normal course of business. The SFDA licenses for drug batch numbers and goodwill were acquired in connection with our business acquisitions of Tianlong and Peng Lai in 2008.

A breakdown of our intangible assets, net, by subsidiaries as of June 30, 2010 is as follows:

	Intangible Assets as of June 30, 2010, net ($ in thousands) (Unaudited)					
Item	TDR	Haina	Tianlong	First	Peng Lai	Total
Proprietary Technologies	$ 1,205	$ -	$ 4,798	$ 11,229	$ -	$ 17,232
SFDA licenses for drug batch numbers	-	-	1,653	-	4,205	5,858
Goodwill	408	355	-	-	-	763
Total	$ 1,613	$ 355	$ 6,451	$ 11,229	$ 4,205	$ 23,853

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12. Intangible Assets, net (Continued)

A breakdown of our intangible assets, net by subsidiaries as of December 31, 2009 is as follows:

	Intangible Assets as of December 31, 2009, net ($ in thousands)					
Item	TDR	Haina	Tianlong	First	Peng Lai	Total
Proprietary Technologies	$ 1,275	$ -	$ 5,034	$ 11,854	$ -	$ 18,163
SFDA licenses for drug batch numbers	-	-	1,751	-	4,441	6,192
Goodwill	406	353	-	-	-	759
Total	$ 1,681	$ 353	$ 6,785	$ 11,854	$ 4,441	$ 25,114

Historically, we included our proprietary technologies and SFDA licenses for drug batch numbers under the category of patents. We now believe it is more accurate to categorize such intangible assets in separate categories.

As of June 30, 2010, the weighted average amortization period for our proprietary technologies and SFDA licenses for drug batch numbers is approximately 8 years.

Amortization expense of our intangible assets with finite lives for each of the six months ended June 30, 2010 and 2009 was approximately $1,362,000 and $707,000, respectively.

13. Taxes Payable

Taxes payable as of June 30, 2010 and December 31, 2009 consisted of the following:

	($ in thousands)	
	June 30, 2010 (Unaudited)	December 31, 2009
Value Added Tax, net	$ 2,000	$ 1,291
Enterprise Income Tax	3,590	2,452
City Tax	79	43
Other Taxes and additions	65	86
Total Taxes Payable	$ 5,734	$ 3,873

14. Income Taxes

Under the Provisional Regulations of PRC Concerning Income Tax on Enterprises promulgated by the PRC, income tax is payable by enterprises at a rate of 25% of their taxable income. Preferential tax treatment may, however, be granted pursuant to any law or regulations from time to time promulgated by the State Council.

According to “Enterprise Income Tax and Certain Preferential Policies Notice” published by the Ministry of Finance and the National Tax Affairs Bureau, if the enterprise is authorized by the State Council as a special entity, the enterprise income tax rate is reduced to 15%. The following table sets force the income tax rate for TDR and its

subsidiaries for the six months ended June 30, 2010 and 2009:

	As of June 30,	
Income Tax Rate	2010	2009
TDR	15%	15%
First	15%	15%
Tianlong	15%	15%
Haina	25%	25%
Peng Lai	2% of Revenue *	2% of Revenue *

* Reflects a 25% Tax rate on 8% of Peng Lai's revenue, regardless of its taxable income. As authorized by Peng Lai Municipal Tax Bureau, Peng Lai was not required to pay tax on the remaining 92% of revenue.

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14. Income Taxes (Continued)

All the favorable tax rates for TDR, First, Tianlong and Peng Lai will expire by the end of fiscal year 2010. The Company plans to seek renewal of these favorable tax rates in fiscal 2010.

The Company records a full valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event the Company were to determine that it would be able to realize our deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Pursuant to Sections 382 and 383 of the Internal Revenue Code ("IRC"), annual use of the Company's net operating losses and tax credit carryforwards may be limited because of cumulative changes in ownership of more than 50% that have occurred. Net operating loss ("NOL") carryforwards only apply to the Company's U.S. holding companies because they incurred certain general and administrative costs without generating any revenue and, therefore, suffered a loss. The Company has no current intentions to distribute dividend income from its China-based subsidiaries to the U.S. holding companies.

Therefore, the Company has established a full valuation allowance for the NOL carryforwards incurred by the U.S. holding companies. Provision for the PRC enterprise income tax is calculated at the prevailing rate based on the estimated assessable profits less available tax relief for losses brought forward. The Company does not accrue taxes on unremitted earnings from foreign operations as it is the Company's intention to invest these earnings in the foreign operations indefinitely.

As of June 30, 2010, the Company has U.S. net operating loss carryforwards of approximately $10.0 million which will begin to expire in 2029. Accordingly, as mentioned above, any deferred tax asset that would result from these carryforwards have been fully reserved as of June 30, 2010.

During the six months ended June 30, 2010 and 2009, the Company's U.S. holding companies recorded income of approximately $7,013,000 and $1,173,000 respectively related to the change in fair value of its derivative warrant liability with a full valuation allowance. Historically, the Company's U.S. holding companies have incurred ongoing operating losses, since the U.S. holding companies do not generate any revenue. As such, Management has recorded a full valuation allowance for its net operating loss carryforwards since Management's position it is more like than not that the future tax benefits associated with the U.S. holding companies operating loss carryforwards will not be realized. The net operating loss carryforwards at June 30, 2010 and 2009, for tax reporting purposes, exceed the income generated from the change in fair value of the derivative warrant liability of $7,013,000 and $1,173,000 for each of the respective periods. Accordingly, management did not record any unrecognized income tax benefits due to the change in fair value of the derivative warrant liability for each of the six months ended June 30, 2010 and 2009.

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14. Income Taxes (Continued)

The Company's effective tax rate was approximately 19.6% and 20.0% for the six month ended June 30, 2010 and 2009, respectively. A reconciliation of the statutory tax provision to the Company's tax provision for the six months ended June 30, 2010 and 2009 is as follows:

	($ in thousands) Six Months Ended June 30, 2010		
	China	U.S.	Total
Pre tax income	$ 24,726	$ 6,169	$ 30,895
Effective statutory tax rate	25%	34%	
Provision for statutory income tax	6,182	2,098	8,280
Other (Special Entity, etc.)	(117)	-	(117)
Full valuation allowance	-	(2,098)	(2,098)
Provision for income taxes	$ 6,065	$ -	$ 6,065
Effective tax rate	24.5%	-	19.6%

	($ in thousands - Restated) Six Months Ended June 30, 2009		
	China	U.S.	Total
Pre tax income	$ 21,526	$ 806	$ 22,332
Effective statutory tax rate	25%	34%	
Provision for statutory income tax	5,382	274	5,656
Other (Special Entity, etc.)	(923)	-	(923)
Full valuation allowance	-	(274)	(274)
Provision for income taxes	$ 4,459	$ -	4,459
Effective tax rate	21.0%	-	20.0%

Pre-tax income generated by business operations in China during the six months ended June 30, 2010 were primarily derived from Haina's business operations which are taxed at a rate of 25%.

15. Land Use Rights and Construction in Progress

The Company considers the fact that, in the PRC, there is no land ownership but rather land use rights and it is more appropriate to allocate land use rights under a separate category and amortize land use rights based on 50 years of the land use rights, or the term of the lease. Land use rights, net, are approximately $4,559,000 and $4,586,000 at June 30, 2010 and December 31, 2009, respectively.

During the second quarter in 2007 TDR entered into an agreement with the Development and Construction Administration Committee of Harbin Song Bei New Development district to purchase the land use rights for 50 years for the development of a new corporate headquarters. The Company spent approximately $9.9 million, $730,000, and $2.1 million in the years of 2009, 2008, and 2007 respectively for this construction in progress. The majority of the construction was completed in January 2010, and the Company moved into the new facilities in January 2010. There was no expenditure for construction in progress during the six months ended June 30, 2010. Management estimates the additional cost to complete our construction in progress in 2010 shall amount to approximately $3.0 million, which should be completed in the third quarter of 2010.

During the second quarter in 2010, TDR submitted a bid deposit of approximately $7,316,000 to Harbin High Technology Development Zone to participate in an auction for a parcel of land of approximately 85,000 square meters in the Harbin Song Bei District High Technology Zone. The auction is set to take place during the third quarter of 2010. If we win the auction, we plan to build a facility for the research and development and production of the Company's bio-engineering projects. If our bid is not accepted, the deposit will be returned to TDR.

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16. Commitments and Contingencies

The formulation, manufacturing, processing, packaging, labeling, advertising, distribution and sale of external use Chinese medicine such as those sold by the Company are subject to regulations by one or more federal agencies. The principal federal agencies include the State Food and Drug Administration of the Government of the Peoples Republic of China, the Food and Drug Administration (the "FDA"), Heilongjiang Provincial Food and Drug Administration of the People's Republic of China (PFDA), National Biology Products Inspection Institute (NBPI) and the National Food and Drug Administration (NFDA) of the People's Republic of China and, to a lesser extent, the Consumer Product Safety Commission. These activities are also regulated by various governmental agencies for the countries, states and localities in which the Company's products are sold.

Although management believes that the Company is in material compliance with the statutes, laws, rules and regulations of every jurisdiction in which it operates, no assurance can be given that the Company's compliance with the applicable statutes, laws, rules and regulations will not be challenged by governing authorities or private parties, or that such challenges will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

The Company, like any other distributor or manufacturer of products is exposed to the inherent risk of product liability claims in the events of possible injuries caused by the use of its products. The Company does not have liability insurance with respect to product liability claims; the insurance environment of China is neither sufficient nor mature. Inadequate insurance or lack of contractual indemnification from parties supplying raw materials or marketing its products, and product liabilities related to defective products could have a material adverse effect on the consolidated financial statements of the Company.

The Company is not involved in any legal matters arising in the normal course of business at June 30, 2010. While incapable of estimation, in the opinion of the management, the individual regulatory and legal matters in which the Company might be involved in the future are not expected to have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

FORWARD LOOKING STATEMENTS

The following discussion should be read in conjunction with the information contained in our consolidated financial statements and the notes thereto appearing elsewhere herein and in the risk factors and "Forward Looking Statements" summary set forth in the forepart of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, as amended, as well as the "Risk Factors" section above and are afforded the safe harbor provisions of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended. Readers should carefully review the risk factors disclosed in this Annual Report and other documents filed by us with the SEC.

DISCUSSION

General

We are engaged, through our China-based indirect subsidiaries described below, in the development, manufacture, marketing and sale of over-the-counter, branded nutritional supplements and over-the-counter plant and herb-based pharmaceutical and medicinal products. Our principal products are external use TCMs. We have evolved into an integrated manufacturer, marketer and distributor of external-use TCM products sold primarily in the PRC and through Chinese domestic pharmaceutical chains. All of our business is conducted through our wholly-owned subsidiary, ACPG which, in turn, wholly owns Harbin TDR, and TDR's subsidiaries.

We achieved continuing growth on the sale of our own product line through our sustained efforts to expand our distribution channels and promote our products. For the six months ended June 30, 2010, total revenues were $69,663,000, compared to $57,015,000 for the six months ended June 30, 2009. Net income was $24,830,000, or $1.47 per share for the six months ended June 30, 2010, compared to net income of $17,873,000, or $1.08 per share in the same period of 2009, as calculated on a diluted basis. For the three months ended June 30, 2010, total revenues were $40,760,000, compared to $32,181,000 for the three months ended June 30, 2009. Net income was $12,242,000, or $0.73 per share for the three months ended June 30, 2010, compared to net income of $8,391,000, or $0.51 per share in the same period of 2009, as calculated on a diluted basis.

This Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010 incorporates corrections made in response to the accounting errors described elsewhere in this Form 10-Q and restates our financial statements for the three and six months ended June 30, 2009 (see Note 2 to the Notes to Condensed Consolidated Financial Statements). The corrections to the quarterly information in this Form 10-Q had no impact on our previously reported income from operations or cash flows for the periods being restated.

Product Line

During the six months ended June 30, 2010, we manufactured and marketed 114 products, compared to 89 products for the six months ended June 30, 2009. Our manufacturing operations are conducted at our subsidiaries' facilities located in Heilongjiang Province and Shan Dong Province in the PRC. We sell our products under five main categories:

Product Category	2010	2009
Patches	5	5
Ointments	23	18
Sprays	16	15
	3	3

Diagnostic Kits		
Others	67	48
Total:	114	89

A description of our principle products, which generated approximately 70% of our sales revenue for the six months ended June 30, 2010 is as follows:

Patch Category:

Sumei Slim Patch

The Sumei Slim Patch is marketed and sold within and outside the PRC as a more natural treatment to lose weight. The Sumei Slim Patch uses Saponin as its major ingredient, and is effective in regulating and restraining the excessive secretion of certain hormones, while promoting others to foster weight loss as well as prevent weight gain.

Pain Relief Patch

A pain relief patch is designed to apply to the area of neck, shoulder, and waist. The patch is used for a number of ailments, including fever, headache, heart dysentery, diarrhea, and stiffness and pain caused by hypertension.

Anti-Hypertension Patch

The anti-hypertension patch is based on five thousand years of Chinese herbal vein therapy that has been adapted to a modern transdermal therapeutic system ("TTS"). The product utilizes a Body-Yong-Guan point technique, which is believed to maximize the effectiveness of the medicinal ingredients. The product is believed to stimulate blood capillaries and to be effective in improving circulation and reducing blood pressure.

QiXue Asthma Patch

QiXue asthma patch is designed for the treatment of chronic airways and lung inflammation.

Ointment Category:

Hemorrhoids Ointment

This product contains Acetate, Radix Notoginseng, and Rhizoma Coptidis. It is made in soft ointment form that is effective in sterilizing and relieving hemorrhoid symptoms, including itching, distending pain, burning, and bleeding.

Compound Camphor Cream

This product is for the treatment of various pathogens on the skin surface and subcutaneously, such as mycete, trichopytic, staphylococcal bacteria aureus, bacillus coli, and candida albicans (thrush).

Kecuo Yintong Ointment

This product is designed to regulate sebum secretion and to prevent acne outbreaks.

Spray Category:

Stomatitis Spray

This spray is used for the treatment of dental ulcers, pharyngitis, and faucitis. It is made with pure herbal medicines and, thus, has minimum side effects to human bodies.

Diagnostic Kit Category:

Cardiac Arrest Early Examination Kit

This product is used for early stage diagnosis of myocardial infarction (heart attacks).

Kidney Disease Testing Kit

The Urinate Micro Albumin Examination Testing Kit is used in connection with early stage diagnosis for primary kidney disease, hypertension and diabetes.

Other Product Category:

We include 67 of our products under the "Other" product category, because there is no individual category of applications for these products that represents a material amount of our revenues. The Other product category includes suppositories, eye drops, nasal drops, capsules, granules, injections, syrups, liniments, tablets and wash fluids.

Naftopidil Dispersible Tablet

This tablet is designed to treat benign enlargement of the prostate among males in their middle age. It is effective in its treatment because its ingredients can be easily digested and absorbed by the human body.

Naphazoline Hydrochloride Eye Drop

Naphazoline is recommended for the temporary relief of eye redness associated with minor irritations. This product can comfort the eyes by lubricating them and relieving such irritations.

Tinea Liniment

Tinea Liniment is an anti-fungal cream for the treatment of skin fungal infection and yeast infection.

Please refer to "Sales by Product Line" hereunder for additional information.

Summary of Our Research and Development Activities

Research and Development

We conduct all of our research and development ("R&D") activities either internally or through collaborative arrangements with universities and research institutions in the PRC. We have our own research, development and laboratory facilities located in the facilities of First and Tianlong.

For the six months ended June 30, 2010, total research and development expense was approximately $9,674,000. The major research and development projects that accounted for the majority of our total research and development expenses are as follows:

Major Research and Development Expenses during the Six Months Ended June 30, 2010
($ in thousands)

Projects	Expense	% of total R&D	Aggregate Expense Since Commencement of Project	Estimated Additional Cost to Complete Research
Diagnostic Kits - 10 products	$ 1,893	19.6%	$ 4,623	$ 3,900
Optimization Experiments for Five Products	1,653	17.1%	2,533	-
Endostatin	1,010	10.4%	1,449	9,000

Antrodia Cinnamomea Extract l	849	8.8%	1,236	16,000
Tumor Markers	775	8.0%	775	210
Tiopronin for Injection	644	6.7%	1,170	150
Breast Cancer Technology	497	5.1%	2,767	8,300
Clindamycin Phosphate for Injection	424	4.4%	475	1,000
Levofloxacin Hydrochloride Eye Drops	410	4.2%	450	500
Nimesulide Granules	439	4.5%	455	800
Total	$ 8,594	88.8%	$ 15,933	$ 39,860

For the six months ended June 30, 2009, total research and development expense is approximately $6,095,000. The major research and development projects that accounted for the majority of our total research and development expenses are as follows:

Major Research and Development Expenses during the Six Months Ended June 30, 2009
($ in thousands)

Projects	Expense	% of total R&D	Aggregate Expense Since Commencement of Project	Estimated Additional Cost to Complete Research
Breast Cancer Technology	$ 1,507	24.7%	$ 1,507	$ 9,300
Monoclonal Antibody	964	15.8%	3,162	2,000
Diagnostic Kits - 3 products	856	14.0%	2,172	100
Omeprazole Sodium for Injection	540	8.8%	540	1,000
Tiopronin for Injection	526	8.6%	526	800
Nimesulide Granules	512	8.4%	512	1,700
Clindamycin Phosphate for Injection	410	6.7%	410	1,800
Levofloxacin Hydrochloride Eye Drops	336	5.5%	336	1,300
Ozagrel Sodium for Injection	183	3.0%	183	1,000
Total	$ 5,834	95.5%	$ 9,348	19,000

Historically, research and development expense fluctuates during each quarter. In general, different project has different requirements and different time span associated with different costs and different payment terms. Some main factors for the R&D expense fluctuation are listed as the following:

- Each project will go through multi stages before being submitted to the SFDA.
- Different drugs require for different amount of testing samples or trials which will result in different time span for the testing and approval process.
- R&D expense is incurred at different stages of the process based on our agreement signed with the third party (qualified hospitals or professional research institutions).
- Since different drugs require different stages of process or different amount of samples to be collected, the same R&D stage for different drugs result in different time span and different expense.
- In some cases, after we submit the completed document to the SFDA, we may be required to supply additional testing or document, which will result in longer time span and increased expense.
- For the R&D projects that are conducted internally, we only record the related personnel and material costs.

Significant Accounting Estimates and Policies

The discussion and analysis of our financial condition and results of operations is based upon our financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities. On an on-going basis, we evaluate our methodologies and

assumptions used to derive these estimates. Significant estimates include the reserve allowance for doubtful accounts and inventories, our impairment test for long-lived assets and goodwill, the valuation allowance for income taxes, the remaining useful lives of our long-lived assets and our evaluation and recording contingencies. We base our estimates on historical experience and on other assumptions that we believes to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. Our significant estimates include the following:

Long-lived assets are evaluated for impairment whenever indicators of impairment exist. Accounting standards require that if an impairment indicator is present, we must assess whether the carrying amount of the asset is unrecoverable by estimating the sum of the future cash flows expected to result from the asset, undiscounted and without interest charges. If the recoverable amount is less than the carrying amount, an impairment charge must be recognized based on the fair value of the asset.

As part of the process of preparing our financial statements, we are required to estimate our income taxes. This process involves estimating our current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We have deemed our temporary tax differences related to our principal business operations in the PRC to be immaterial. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent that we establish a valuation allowance or increase this allowance in a period, we must include a tax provision or reduce our tax benefit in the statements of operations. We use our judgment to determine our provision or benefit for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We believe, based on a number of factors including the continued historical operating losses of China Sky and ACPG, that we will not realize the future benefits of a significant portion of our net deferred tax assets and we have accordingly provided a full valuation allowance against our deferred tax assets. China Sky and ACPG do not generate revenues and were established as the Holding Companies of our foreign operations. Management has no intention to remit to either China Sky or ACPG any undistributed earnings of business operations in China. However, various factors may cause those assumptions to change in the near term.

We cannot predict what future laws and regulations might be passed that could have a material effect on our results of operations. We assess the impact of significant changes in laws and regulations on a regular basis and update the assumptions and estimates used to prepare our financial statements when we deem it necessary.

We review our accounting policies on a periodic basis to ensure compliance with GAAP. Our most significant accounting policies are those related to intangible assets and research and development.

Derivative liabilities - The Class A Warrants (“the Warrants”) issued in connection with the private placement we consummated on January 31, 2008 private placement include a reset provision triggered if the Company issues common shares below the exercise price of $12.50 as defined under the Warrant Agreement. Effective January 1, 2009 the reset provision of these Warrants preclude equity accounting treatment under ASC 815 (formerly EITF 07-5). Accordingly, effective January 31, 2009, the Company is required to reclassify the Warrants at their fair value to liabilities each reporting period under ASC 815-40. At June 30, 2010, we had 593,800 Warrants outstanding. The Company used the Monte Carlo valuation model to estimate the fair value of the Warrants. Significant assumptions used at June 30, 2010 include a term of approximately 3.7 years; volatility of 73.0% and a risk free interest rate of 1.43%. At June 30, 2009, the Company had 750,000 Warrants outstanding. The Company used the Monte Carlo valuation model to estimate the fair value of the Warrants. Significant assumptions used at June 30, 2009 include a term of approximately 3.7 years; volatility of 66.0% and a risk free interest rate of 1.94%. The outstanding Warrants at June 30, 2010 and 2009 had a fair value of approximately $3,549,000 and $5,455,000, respectively. Due to the change in fair value of derivative warrant liability the Company realized income of $7,013,000 and $1,173,000 for the six months ended June 30, 2010 and 2009, respectively. Due to the change in fair value of derivative warrant liability the Company realized income of $2,087,000 and recorded an expense of $1,066,000 for the three months ended June 30, 2010 and 2009, respectively.

Intangible assets – Our intangible assets consists of proprietary technologies, SFDA licenses for drug batch numbers, and goodwill. Proprietary technologies are technologies that we own. The SFDA licenses for drug batch numbers and goodwill were acquired in the business acquisitions of Tianlong, Peng Lai and Haina. We have registered “Kang Xi” as our trademark, which is used for all of the Company’s Tradition Chinese Medicine (“TCM”) products. The “Kang Xi”

trademark was developed internally and registered by TDR before the Company became a public company. The Company's cost basis in the trademark is nominal. Therefore, the Company did not have its "Kang Xi" trademark appraised, or recorded an intangible asset for it. Additionally, none of the costs associated with the trademark have been capitalized.

Intangible assets with finite useful lives are amortized while intangible assets with indefinite useful lives are not amortized. Goodwill and intangible assets are tested periodically for impairment. Accordingly, the Company reviews its long-lived assets, including property and equipment and finite-lived intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of its long-lived assets, we evaluate the probability that future undiscounted net cash flows will be less than the carrying amount of the assets. Impairment costs, if any, are measured by comparing the carrying amount of the related assets to their fair value. The Company did not record any impairment charges related to its tangible and intangible assets held during the three and six months ended June 31, 2010 and 2009.

As of June 30, 2010, the weighted average amortization period of our intangible assets approximated 8 years.

Research and development—Research and development expenses include the costs associated with the Company's internal research and development as well as research and development conducted by third parties. These costs primarily consist of salaries, clinical trials, outside consultants, and materials. All research and development costs are expensed as incurred.

Third-party expenses reimbursed under non-refundable research and development contracts are recorded as a reduction to research and development costs in the statement of operations.

Assets to be used in research and development activities, specifically, compounds that have yet to receive new drug approval and would have no alternative use, should approval not be given, are immediately charged to expense when acquired. Certain assets and high technologies acquired that has a foreseeable future cash flows are capitalized as intangible assets. Such intangible assets are amortized starting from the year revenue is generated and amortized over its estimated life. If a capitalized intangible asset is deemed to have no future benefit, the unamortized carrying value will be expensed.

For the six months ended June 30, 2010 and 2009, we incurred $9,674,000 and $6,095,000, respectively, in research and development expenditures. For the three months ended June 30, 2010 and 2009, we incurred $5,910,000 and $3,682,000, respectively, in research and development expenditures.

Trends and Uncertainties

In 2008, general worldwide economic conditions declined due to sequential effects of the sub prime lending crisis, general credit market crisis, collateral effects on the finance and banking industries, concerns about inflation, slower economic activity, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. However, since all of our business operations, and most of our sales, are currently conducted in the PRC, we have not been greatly affected by the economic downtown. We cannot predict the timing or duration of any economic slowdown or recession or the timing or strength of a subsequent recovery, worldwide, or in the specific markets we serve. If the markets for our products significantly deteriorate due to these economic effects, our business, financial condition and results of operations may be materially and adversely affected.

We have benefited from the overall economic development in the PRC in recent years and the increase in the number of elderly people in China, which together have resulted in increased expenditures on medicine in the PRC, including TCMs. A slowdown in overall economic growth, an economic downturn or recession or other adverse economic developments in the PRC may materially reduce the demand for our products and materially and adversely affect our business.

Historically, we signed agreements with suppliers that allowed us to hold extra raw materials at the cost of the suppliers. As a result, we were able to minimize our own inventory carrying costs, and improve our cash management, by keeping the inventory at the minimum level required to support the short-term sales. However, due to our forecasts for certain cost increases of raw materials and the overhead costs for storing such raw materials in fiscal 2010, we began to increase our inventory levels toward the second half of 2009 and in 2010. We expect this practice to continue for the foreseeable future.

For the remainder of fiscal year 2010, we anticipate price increases of certain raw materials due to unforeseen natural disasters and inflation that will result in the increase of our cost of goods sold. In addition, our sales and marketing strategy to promote certain of our products which have less market competition by coordinating with reputable distributors who have extensive market channel and will launch these products at lower margins. These factors will have negative impact on our overall gross product margins as discussed below.

Results of Operations

Restatement of Financial Statements

As discussed in Note 2 to the Financial Statements, we restated our financial statements for the fiscal quarter ended June 30, 2009. On May 7, 2010, we determined that ASC 815-40, which was effective January 1, 2009, should have been applied to warrants issued in connection with our 2008 private placement, resulting in a reclassification of the warrants as a liability, measured at fair value, with changes in fair value recognized as part of other income or expense for each reporting period thereafter.

For the three months ended June 30, 2010 and 2009

Revenue, Cost of Goods Sold Gross Profit and Gross Profit Margin

The following table sets forth our revenues, cost of goods sold, gross profit and gross profit margin during the three months ended June 30, 2010 and 2009:

	For the Three Months Ended June 30, ($ in thousands)		
	2010	2009	Variance
Revenues	$ 40,760	$ 32,181	26.7%
Cost of Goods Sold	11,216	7,752	44.7%
Gross Profit	$ 29,544	$ 24,429	20.9%
Gross Profit Margin	72.5%	75.9%	(3.4)%

For the three months ended June 30, 2010, total revenues increased by approximately $8,579,000, or 26.7%, as compared to the same period of 2009. The increase is primarily due to the strong sales from products in our Ointment and Others product categories, partially offset by the decreased revenue from the sales of our Slim Patch and Diagnostic Kits (see “Sales by Product Line” below).

Cost of goods sold increased by $3,464,000, or 44.7%, compared to the same period in the prior year. The higher cost of goods sold is principally attributable to our higher sales volume. However, the ratio of cost of goods sold to revenues increased to 27.5%, compared to 24.1% in the prior year, due to unforeseen natural disasters which caused an increase in the price of raw materials we use to produce certain of our products, including Honey Suckle Flower and Notoginseng. For the remainder of fiscal year 2010, we anticipate price increases of certain raw materials due to inflation that will result in the increase of our cost of goods sold.

For the remainder of 2010, we anticipate certain price increases of raw materials and the overhead costs for storing such raw materials that will result in the increase our cost of goods sold. Our sales and marketing strategy is to promote certain of our products which have less market competition by coordinating with reputable distributors who have extensive market channels and will resell these products at lower margins. We expect these factors will continue to have a negative impact on our overall gross product margins.

Sales by Product Line

We believe that the most meaningful presentation of our products is by categories of method of delivery. The following table sets forth our principal product categories based on application type, and the approximate amount and percentage of revenue from each of such product categories, during each of the three months ended June 30, 2010 and 2009:

For the Three Months Ended June 30, ($ in thousands)							
	2010			2009			Variance
Product Category	# of Products	Sales	% of Sales	# of Products	Sales	% of Sales	
Patches	5	$ 9,709	23.8%	5	$ 9,937	30.9%	$ (228)
Ointments	23	11,614	28.5%	18	7,658	23.8%	3,956
Sprays	16	5,125	12.6%	15	4,857	15.0%	268
Diagnostic Kits	3	2,318	5.7%	3	3,688	11.5%	(1,370)

Others	67	11,994	29.4%	48	6,041	18.8%	5,953
Total	114	$ 40,760	100.0%	89	$ 32,181	100.0%	$ 8,579

We marketed 114 products during the three months ended June 30, 2010, compared with 89 products during the three months ended June 30, 2009. The Company's total revenue increased by $8,579,000, or 26.7%, as compared to the same period of 2009. The revenue increase is primarily due to the strong sales from our Ointment and Others product categories, which was partially offset by the decreased sales generated from our Patches and Diagnostic Kits. The revenue generated from the 25 new products we introduced in the second quarter of fiscal 2010 was $2,664,000, or 6.5% of our total revenue for this period.

For the three months ended June 30, 2010, revenues from Patch products decreased $228,000, or 2.3%, as compared to the same period of 2009. The decrease is primarily due to the decreased sales of our Slim Patch products, which began to decline in the fourth quarter of 2009. The revenue generated from Slim Patch was $4,766,000 and $6,915,000 for the three months ended June 30, 2010 and 2009, respectively. Slim Patch sales have historically been higher in the second and third quarter due to seasonality. The regulations and restrictions recently launched by the Chinese government prohibiting television advertisement of weight loss products in the PRC also have negative impact to the Slim Patch distribution channel. Other Patch products sold for the three months ended June 30, 2010 partially offset the loss of sales from the Slim Patch. The revenue generated from other Patch products for the three months ended June 30, 2010 and 2009 were $4,943,000 and $3,022,000, respectively.

For the three months ended June 30, 2010, revenues from Ointments increased by $3,956,000, or 51.7%, as compared to the same period of 2009. The increase is primarily due to the increased sales from our Compound Camphor Cream and Kecuo Yintong Ointment. Revenue generated from Compound Camphor Cream was $6,097,000 and $3,301,000 for the three months ended June 30, 2010 and 2009, respectively. This increase is primarily due to our continued efforts to promote and advertise this product during the second quarter of 2010. Revenue generated from our Kecuo Yintong Ointment was $528,000 and $33,000 for the three months ended June 30, 2010 and 2009, respectively. This increase is primarily due to our entry into a distribution agreement in the third quarter of 2009 for sales of this product, which lead to increased sales. The five new Ointment products we introduced in the three months ended June 30, 2010 generated $129,000 in revenues.

For the three months ended June 30, 2010, revenue generated from our Sprays increased by $268,000, or 5.5%, as compared to the same period of 2009, primarily due to the increase sales of our Stomatitis spray.

For the three months ended June 30, 2010, revenue generated from our Diagnostic Kits decreased by $1,370,000, or 37.1%, as compared to the same period of 2009. The decrease is primarily due to the limited support we have recently provided to the distributors of our Diagnostic Kits. We began addressing this issue in 2010 by training a professional team to better co-operate with our distributors. We are also creating new policies and incentives to encourage the distributors for better performance.

For the three months ended June 30, 2010, revenues from our Other products category increased by $5,953,000, or 98.5%, as compared to the same period of 2009. The revenue increase is primarily due to the sales increase in the (i) Naphazoline Hydrochloride eye drops, (ii) Napadil tablet, and (iii) Tinea liniment. Revenues generated from these three products were $4,062,000 and $1,445,000 for the three months ended June 30, 2010 and 2009, respectively. In addition, the 19 new products we introduced our Other product category in the three months ended June 30, 2010 generated $2,524,000 in revenues. Distributors and agents are also highly motivated in actively promoting such products in the market due to the significant effect and competitive pricing compared to peer products in the market. Radix Isatidis syrup and Loquat syrup in our Other products category contributed increased revenues in the aggregate of $620,000 for the three months ended June 30, 2010. We acquired these two products through the Peng Lai acquisition in October 2008. Peng Lai had nominal operation before the acquisition. The revenue generated from these two syrup products was $67,000 for the three months ended June 30, 2009.

Operating Expenses

The following table summarizes the changes in our operating expenses for the three months ended June 30, 2010 and 2009:

	For the Three Months Ended June 30, ($ in thousands)		
Operating Expenses	2010	2009	Variance
Selling expense	$ 7,983	$ 7,796	2.4%

General and administrative expense	1,123	420	167.4%
Depreciation and amortization	827	449	84.2%
Research and development	5,910	3,682	60.5%
Total operating expenses	15,843	12,347	28.3%
Total revenue	$ 40,760	$ 32,181	26.7%
% of operating expenses to revenue	38.9%	38.4%	0.5%

For the three months ended June 30, 2010, selling expense remained constant with the same period of 2009, primarily due to our transferring of certain logistic expenses to our distributors. In addition, our advertising costs remained consistent in the second quarters of 2010 and 2009.

General and administrative expense for the three months ended June 30, 2010 increased by 167% compared to the same period in the prior year, primarily due to a significant increase in our professional fees related to meeting public company requirements.

Depreciation and amortization expense amounted to $827,000 compared to $449,000 for the three months ended June 30, 2010 and 2009, respectively. This increase of $378,000 was primarily due to the amortization expense of our proprietary technologies - Antroquinonol and Small RNAs Technology, that we acquired during the fourth quarter of 2009. These two proprietary technologies were acquired for approximately $10,969,000 and are being amortized over an estimated useful life of 10 years.

For the three months ended June 30, 2010, research and development expense increased by approximately $2,228,000, or 60.5%, as compared to the same period of 2009. For the three months ended June 30, 2010, total research and development expense was approximately $5,910,000. The major research and development projects that accounted for the majority of our total research and development expense are as follows:

Major Research and Development Expense during the Three Months Ended June 30, 2010
($ in thousands)

Projects		Expense	% of total R&D
Diagnostic Kits - 10 products	$	1,405	23.8%
Endostatin		1,010	17.1%
Antrodia Cinnamomea Extract l		849	14.4%
Tumor Markers		775	13.1%
Tiopronin for Injection		644	10.9%
Optimization Experiments for Five Products		1,031	17.4%
Total	$	5,714	96.7%

For the three months ended June 30, 2009, total research and development expense is approximately $3,682,000. The major research and development projects that accounted for the majority of our total research and development expense is listed are as follows:

Major Research and Development Expense during the Three Months Ended June 30, 2009
($ in thousands)

Projects		Expense	% of total R&D
Diagnostic Kits - 3 products	$	856	23.3%
Breast Cancer Technology		1,507	40.9%
Clindamycin Phosphate for Injection		410	11.1%
Levofloxacin Hydrochloride Eye Drops		336	9.1%
Nimesulide Granules		512	13.9%
Total	$	3,621	98.3%

Other Income (Expense) (restated)

For the three months ended June 30, 2010, we recorded an unrealized gain of $2,087,000 due to the change in fair value of our derivative warrant liability resulting from the decrease in fair value of the warrants issued in our January

2008 private placement (as described in Note 8 to the Notes to the financial statements appearing elsewhere in this report). For the three months ended June 30, 2009 (restated), we recorded an unrealized loss of $1,066,000 due to the change in fair value of our derivative warrant liability resulting from the increase in fair value of the warrants issued in our January 2008 private placement (as described in Note 8 to the Notes to the financial statements appearing elsewhere in this report).

For the six months ended June 30, 2010 and 2009

Revenue, Cost of Goods Sold Gross Profit and Gross Profit Margin

The following table sets forth our revenues, cost of goods sold, gross profit and gross profit margin during the six months ended June 30, 2010 and 2009:

	For the Six Months Ended June 30, ($ in thousands)		
	2010	2009	Variance
Revenues	$ 69,663	$ 57,015	22.2%
Cost of Goods Sold	18,491	13,793	34.1%
Gross Profit	$ 51,172	$ 43,222	18.4%
Gross Profit Margin	73.5%	75.8%	(2.3)%

For the six months ended June 30, 2010, total revenues increased by approximately $12,648,000, or 22.2%, as compared to the same period of 2009. The revenue increase is primarily due to the strong sales from Ointment and Others product categories. The positive variance is partially offset by the decreased revenue from the sales of our Slim Patch and Diagnostic Kits (see “Sales by Product Line” below).

Cost of Goods Sold increased by $4,698,000, or 34.1%, compared to the same period in the prior year. The higher cost of goods sold is principally attributable to our higher sales volume. However, the ratio of cost of goods sold to revenues increased to 26.5%, compared to 24.2% in the prior year, due to unforeseen natural disasters which caused an increase in the price of raw materials we use to produce certain of our products, including Honey Suckle Flower and Notoginseng. For the remainder of fiscal year 2010, we anticipate price increases of certain raw materials due to inflation that will result in the increase of our cost of goods sold.

For the remainder of 2010, we anticipate certain price increases of raw materials and the overhead costs for storing such raw materials that will result in the increase our cost of goods sold. Our sales and marketing strategy is to promote certain of our products which have less market competition by coordinating with reputable distributors who have extensive market channels and will resell these products at lower margins. We expect these factors will continue to have a negative impact on our overall gross product margins.

Sales by Product Line

We believe that the most meaningful presentation of our products is by categories of method of delivery. The following table sets forth our principal product categories based on application type, and the approximate amount and percentage of revenue from each of such product categories, during each of the six months ended June 30, 2010 and 2009:

For the Six Months Ended June 30, ($ in thousands)							
	# of Products	2010		# of Products	2009		Variance
Product Category		Sales	% of Sales		Sales	% of Sales	
Patches	5	$ 17,927	25.7%	5	$ 19,059	33.5%	$ (1,132)
Ointments	23	19,419	27.9%	18	12,740	22.3%	6,679
Sprays	16	8,124	11.7%	15	7,711	13.5%	413
Diagnostic Kits	3	3,778	5.4%	3	6,789	11.9%	(3,011)
Others	67	20,415	29.3%	48	10,716	18.8%	9,699

Total	114	$ 69,663	100.0%	89	$ 57,015	100.0%	$ 12,648

We marketed 114 products during the six months ended June 30, 2010, compared with 89 products during the six months ended June 30, 2009. The Company's total revenue increased by $12,648,000, or 22.2%, as compared to the same period of 2009. The increase is primarily due to the strong sales from our Ointment and Others product categories, which was partially offset by the decreased sales generated from our Patches and Diagnostic Kits. The revenue generated from the 25 new products we introduced during the first half of fiscal 2010 was $2,664,000, or 3.8% of our total revenue for this period.

For the six months ended June 30, 2010, revenues from Patch products decreased $1,132,000, or 5.9%, as compared to the same period of 2009. The decrease was due to the decreased sales of our Slim Patch products, which began to decline in the fourth quarter of 2009. The revenue generated from Slim Patch was $6,349,000 and $11,544,000 for the six months ended June 30, 2010 and 2009, respectively. Slim Patch sales have historically been higher in the second and third quarter due to its seasonality. The regulations and restrictions recently launched by the Chinese government prohibiting television advertisement of weight loss products in the PRC also have negative impact to the Slim Patch distribution channel. Other Patch products sold for the six months ended June 30, 2010 partially offset the loss of sales from the Slim Patch. The revenue generated from other patch products for the six months ended June 30, 2010 and 2009 were $11,578,000 and $7,515,000, respectively.

For the six months ended June 30, 2010, revenues from Ointments increased by $6,679,000, or 52.4%, as compared to the same period of 2009. The increase was primarily due to the increased sales from our Compound Camphor Cream and Kecuo Yintong Ointment. Revenue generated from Compound Camphor Cream was $9,139,000 and $4,720,000 for the six months ended June 30, 2010 and 2009, respectively. This increase is primarily due to our continued efforts to promote and advertise this product during the second quarter of 2010. Revenue generated from our Kecuo Yintong Ointment was $1,708,000 and $78,000 for the six months ended June 30, 2010 and 2009, respectively. This increase was primarily due to our entry into a distribution agreement in the third quarter of 2009 for sales of this product.

For the six months ended June 30, 2010, revenue generated from our Diagnostic Kits decreased by $3,011,000, or 44.4%, as compared to the same period of 2009. The decrease is primarily due to the limited support we have provided to distributors of our Diagnostic Kits. We began addressing this issue in 2010 by training a professional team to better co-operate with our distributors. We are also creating new policies and incentives to encourage the distributors for better performance.

For the six months ended June 30, 2010, revenue generated from our Sprays increased by $413,000, or 5.4%, as compared to the same period of 2009, primarily due to the increase sales from our Stomatitis spray.

For the six months ended June 30, 2010, revenues from our Other products category increased by $9,699,000, or 90.5%, as compared to the same period of 2009. The revenue increase is primarily due to the sales increase in the (i) Naphazoline Hydrochloride eye drops, (ii) Napadil tablet, and (iii) Tinea liniment. Revenues generated from these three products were $7,530,000 and $2,536,000 for the six months ended June 30, 2010 and 2009, respectively. Distributors and agents are also highly motivated in actively promoting such products in the market due to the significant effect and competitive pricing comparing to peer products in the market. Radix Isatidis syrup and Loquat syrup in our Other products category contributed increased revenues of an aggregate of $1,438,000 for the six months ended June 30, 2010. We acquired these two products through the Peng Lai acquisition in October 2008. Peng Lai had nominal operation before the acquisition. The revenue generated from these two syrup products was $150,000 for the six months ended June 30, 2009.

Operating Expenses

The following table summarizes the changes in our operating expenses for the six months ended June 30, 2010 and 2009:

	For the Six Months Ended June 30, ($ in thousands)		
Operating Expenses	2010	2009	Variance
Selling expense	$ 13,894	$ 13,763	1.0%
General and administrative expense	2,113	1,330	58.9%

Depreciation and amortization	1,668	901	85.1%
Research and development	9,674	6,095	58.7%
Total operating expenses	27,349	22,089	23.8%
Total revenue	$ 69,663	$ 57,015	22.2%
% of operating expenses to revenue	39.3%	38.7%	0.6%

For the six months ended June 30, 2010, selling expense remained constant with the same period of 2009, primarily due to our transferring of certain logistic expenses to our distributors. In addition, our advertising costs remained consistent in the first halves of 2010 and 2009.

General and administrative expense for the six months ended June 30, 2010 increased by 58.9% compared to the same period in the prior year, primarily due to a significant increase in our professional fees related to meeting public company requirements.

Depreciation and amortization expense amounted to $1,668,000 compared to $901,000 for the six months ended June 30, 2010 and 2009, respectively. This increase of $767,000 is primarily due to the amortization expense of our proprietary technologies - Antroquinonol and Small RNAs Technology, that we acquired during the fourth quarter of 2009. These two proprietary technologies were acquired for approximately $10,969,000 and are being amortized over an estimated useful life of 10 years.

For the six months ended June 30, 2010, research and development expense increased by approximately $3,579,000, or 58.7%, as compared to the same period of 2009. For the six months ended June 30, 2010, total research and development expense was approximately $9,674,000. The major research and development projects that accounted for the majority of our total research and development expense are as follows:

Major Research and Development Expenses during the Six Months Ended June 30, 2010
($ in thousands)

Projects	Expense	% of total R&D	Aggregate Expense Since Commencement of Project	Estimated Additional Cost to Complete Research
Diagnostic Kits - 10 products	$ 1,893	19.6%	$ 4,623	$ 3,900
Optimization Experiments for Five Products	1,653	17.1%	2,533	-
Endostatin	1,010	10.4%	1,449	9,000
Antrodia Cinnamomea Extract l	849	8.8%	1,236	16,000
Tumor Markers	775	8.0%	775	210
Tiopronin for Injection	644	6.7%	1,170	150
Breast Cancer Technology	497	5.1%	2,767	8,300
Clindamycin Phosphate for Injection	424	4.4%	475	1,000
Levofloxacin Hydrochloride Eye Drops	410	4.2%	450	500
Nimesulide Granules	439	4.5%	455	