

China Botanic Pharmaceutical  
Form 10-K  
January 30, 2012

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

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

For the fiscal year ended October 31, 2011

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

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

**Commission File Number: 001-34808**

**CHINA BOTANIC PHARMACEUTICAL INC.**

*(Exact name of registrant as specified in its charter)*

Nevada 88-1273503  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

**Level 11, Changjiang International Building**

**No. 28, Changjiang Road**

**Nangang District, Harbin**

**Heilongjiang Province, China 150090**

*(Address of principal executive offices)*

**86-451-5762-0378**

*(Registrant's Telephone Number, Including Area Code)*

**Securities registered under Section 12(b) of the Act:**

| Title of each class             | Name of each exchange on which registered |
|---------------------------------|---|
| Common Stock, \$0.001 par value | NYSE Amex LLC                             |

**Securities registered under Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes  No

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

Edgar Filing: China Botanic Pharmaceutical - Form 10-K

company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of April 29, 2011, the last business day of the registrant’s most recently completed second fiscal quarter, was approximately \$23,177,849 based upon the closing price of \$1.43 as quoted on the NYSE AMEX. Shares of common stock held by each executive officer and director and by each person who is known to own 10% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates of the Company. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of December 31, 2011, there were 37,239,536 shares of the registrant’s \$0.001 par value common stock issued and outstanding.

No documents are incorporated into the text by reference.

**TABLE OF CONTENTS**

**PART I**

|                                    |    |
|------------------------------------|----|
| Item 1. Business                   | 1  |
| Item 1A. Risk Factors              | 19 |
| Item 1B. Unresolved Staff Comments | 33 |
| Item 2. Properties                 | 33 |
| Item 3. Legal Proceedings          | 34 |
| Item 4. [Removed and Reserved.]    | 34 |

**PART II**

|   |    |
|---|----|
| Item 5. Market for the Registrant’s Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities | 35 |
| Item 6. Selected Financial Data   | 36 |
| Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations                           | 36 |
| Item 7A. Quantitative and Qualitative Disclosures About Market Risk   | 47 |
| Item 8. Financial Statements and Supplementary Data   | 47 |
| Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure                            | 47 |
| Item 9A. Controls and Procedures  | 48 |
| Item 9B. Other Information  | 49 |

**PART III**

|   |    |
|---|----|
| Item 10. Directors, Executive Officers and Corporate Governance   | 50 |
| Item 11. Executive Compensation   | 56 |
| Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 61 |
| Item 13. Certain Relationships and Related Transactions, and Director Independence                      | 63 |
| Item 14. Principal Accountant Fees and Services   | 63 |

**PART IV**

|   |    |
|---|----|
| Item 15. Exhibits and Financial Statement Schedules | 64 |
|---|----|

## FORWARD LOOKING STATEMENTS

In this Annual Report on Form 10-K, references to “dollars” and “\$” are to United States dollars and, unless the context otherwise requires, references to “we,” “us” and “our” refer to China Botanic Pharmaceutical Inc. Inc. and its consolidated subsidiaries.

This Annual Report contains certain forward-looking statements. When used in this Annual Report, statements which are not historical in nature, including the words “anticipate,” “estimate,” “should,” “expect,” “believe,” “intend” “may,” “project” or “continue,” and similar expressions are intended to identify forward-looking statements. They also include statements containing anticipated business developments, a projection of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

The forward-looking statements in this Annual Report are based upon management’s beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to them. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. These forward-looking statements are based on our current plans and expectations and are subject to a number of uncertainties and risks that could significantly affect current plans and expectations and our future financial condition and results.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this filing might not occur. We qualify any and all of our forward-looking statements entirely by these cautionary factors. As a consequence, current plans, anticipated actions and future financial conditions and results may differ from those expressed in any forward-looking statements made by or on our behalf. You are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented herein.

## **PART I**

### **Item 1. *Business.***

#### **Overview**

We are a high-tech enterprise engaged in the research, development, manufacture, and distribution of botanical products, bio-pharmaceutical products, and traditional Chinese medicines, or TCM, in the People's Republic of China ("PRC" or "China"). We have three "Good Manufacturing Practice" or GMP certified production facilities - Ah City Natural and Biopharmaceutical plant, Dongfanghong pharmaceutical plant and Qingyang natural extraction plant -capable of producing 18 dosage forms and over 200 different products. Our products include but are not limited to (i) botanical anti-depression and nerve-regulation products, (ii) biopharmaceutical products, and (iii) botanical antibiotic and traditional over-the-counter ("OTC") Chinese medicines. Botanical anti-depression and nerve-regulation products account for approximately 70% of our revenues and we intend to strengthen our development in this area. We have entered into sales agency agreements with our sales agents through them our products are sold to over 3,000 distributors and over 70 sales centers across 24 provinces in China.

#### **Corporate History and Structure**

We were incorporated in the State of Nevada on August 18, 1988, originally under the corporate name of Solutions, Incorporated. We were inactive until August 16, 1996, when we changed our corporate name to Suarro Communications, Inc, and engaged in the business of providing internet based business services. In 2006 we discontinued our business operation at the time and became a non-operating public company.

On August 28, 2006, we entered into a Share Exchange Agreement (the "Exchange Agreement") with Harbin Renhuang Pharmaceutical Company Limited or Renhuang BVI, a company incorporated in the British Virgin Islands. Pursuant to the Exchange Agreement we acquired all of the outstanding capital stock of Renhuang BVI, and indirect ownership of Renhuang BVI's wholly owned subsidiary, Harbin Renhuang Pharmaceutical Co. Ltd or CBP China, which operates a pharmaceutical development, manufacturing and distribution business through various research and manufacturing facilities in the PRC.

Since our inception, we have had the following name changes:

|             |                         |
|-------------|-------------------------|
| August 1988 | Solutions, Incorporated |
|-------------|-------------------------|

Edgar Filing: China Botanic Pharmaceutical - Form 10-K

|               |                                      |
|---------------|--------------------------------------|
| August 1996   | Suarro<br>Communications, Inc.       |
| June 1997     | Comtech Consolidation<br>Group, Inc. |
| February 1999 | E-Net Corporation                    |
| May 1999      | E-Net Financial<br>Corporation       |
| January 2000  | E-Net.Com Corporation                |
| February 2000 | E-Net Financial.Com<br>Corporation   |
| January 2002  | Anza Capital, Inc<br>("Anza")        |
| July 2006     | Renhuang<br>Pharmaceuticals, Inc     |
| November 2010 | China Botanic<br>Pharmaceutical Inc. |

Substantially all of our assets and operations are located in the PRC. The following diagram illustrates our corporate structure as of October 31, 2011

China Botanic Pharmaceutical Inc. and its subsidiaries will be referred collectively as “We”, “us” or “the Company” hereinafter.

### **Recent Developments**

*Siberian Ginseng Polysaccharide Extract Powder.* On December 13, 2011, The Company issued a press release to announce that the company has successfully developed a new Siberian Ginseng Polysaccharide Extract Powder and was awarded the Scientific and Technological Achievements Appraisal Certificate by the Science and Technology Bureau of Heilongjiang Province. The Siberian Ginseng (Acanthopanax) Polysaccharide Extract Powder is an all-natural substance extracted from the stem of Siberian Ginseng utilizing proprietary extraction technology developed by the China Botanic research team. The Company's Extract Powder technology was developed using its patented process of separating and extracting effective parts of the Siberian Ginseng (China Patent Number: ZL200710301682X), which was granted by the State Intellectual Property Office of the People's Republic of China in December 2010. According to pharmacological research, Siberian Ginseng Extract Powder contains strong immunogenic and antitumor properties with minimal side effects. The Company's management estimates a significant market potential for Extract Powder based products, such as Siberian Ginseng Polysaccharide Extract Powder tablets and capsules. The Company plans to gradually launch its Extract Powder products in the market in 2012.

In the fourth quarter of 2011, we entered into purchase agreements with unrelated third parties to acquire the following five patents:

- Patent of Ingredients and Preparation for Parkinson Drug
- Patent of Ingredients and Preparation for XiangDouSu
- Patent of Mudouye Extract
- Patent of Hongdoushan Extract
- Patent of Ingredients and Preparation for Jizhi Pills



*Patent for “Extraction of effective ingredients of Siberian Ginseng and its preparation and application” (China Patent Number: ZL200710301682X).* In December of 2010, the Company was granted a patent by State Intellectual Property Office of PRC. The extraction method has helped the Company successfully segregate effective ingredients from Siberian Ginseng, which include three main active elements, including, Syringin, Total Glucosides and Total Flavonoids. In particular, Syringin has significant effect in the treatment of depression and nerve regulation. This patent will be a catalyst to drive the development of the Company’s innovative Acanthopanax series, such as Lyophilized Syringin Powder and Total Glucosides Total Flavonoids Soft Capsule. The patent covers a wide variety of possible Siberian Ginseng extraction methods and applications, creating a high barrier to entry for competitors seeking to develop similar Siberian Ginseng products. The patent will also provide market exclusivity for a period of 20 years.

*Ah City Phase Two project.* We have finished the architectural design of Ah City Phase Two project and are in the process of obtaining approval from relevant government authorities. We expect to finish all the procedures by April, 2012 and will start the construction once we receive approval documents. As of October 31, 2011, we have incurred a total of \$1,937,103 of construction-in-progress. The Ah City Phase Two project is expected to be completed in the year of 2013.

## Our Products

Our products mainly fall into the following three categories: (i) botanical anti-depression & nerve-regulation products, (ii) biopharmaceutical products, and (iii) botanical antibiotics and traditional OTC Chinese medicines. The table below is an illustration of our products and their main functions according to the Chinese Pharmacopeia:

| Product Category  | Product  | Main Functions  |
|---|--|---|
| Botanical anti-depression and nerve-regulation products | Siberian Ginseng (Acanthopanax) Series:  | Antidepressant properties: Regulation of nervous excitation and inhibition; calm and inhibit spontaneous activities; improve sleep and anticonvulsant properties  |
|   | Siberian Ginseng (Acanthopanax) Tablets  |   |
|   | Siberian Ginseng (Acanthopanax) Syrup  |   |
|   | Siberian Ginseng (Acanthopanax) Extract(100g)  |   |
|   | Siberian Ginseng (Acanthopanax) Extract(338g) [Note: The Drug Approval Number of Ginseng (Acanthopanax) Extract is under the | Improve blood properties: Improve blood flow, blood lipid profile and blood viscosity; prevent and improve cerebral thrombosis, hyperlipidemia, hypotension (low blood pressure), coronary heart disease, diabetes, leukopenia, and gonadotrophic dilation of blood vessels |

Edgar Filing: China Botanic Pharmaceutical - Form 10-K

name of Renhuang Stock\*]

*Tianma Series:*

Tianma Tablets (sugar coated, 48 tablets)

Dispel coldness; relieve pain and headache caused by blood supply shortage and blood stasis

Tianma Tablets (sugar coated, 100 tablets)

Compound Yangjiao Tablets (sugar coated, 50 tablets)

Relieve pain from migraines, vascular headaches, tension headaches and nervous headaches

Edgar Filing: China Botanic Pharmaceutical - Form 10-K

| Product Category  | Product   | Main Functions  |
|---|---|---|
|   | Compound Schizandra Tablets   | Regulation of the central nervous system. to generate body fluids and alleviate thirst, nourish the kidneys, cure insomnia and palpitations, and is also widely used as treatment for neurasthenia. |
|   | Badger Oil  | Treatment of burn and scald   |
| Biopharmaceutical products                                  | [Note: The Drug Approval Number of Badger Fat is under the name of Renhuang Stock*]                   |   |
|   | Ginseng and Venison Extract   | Nourish the blood and the kidneys, restore the body's energy and increase endurance.  |
| Botanical antibiotics and traditional OTC Chinese medicines | [Note: The Drug Approval Number of Ginseng and Venison Extract are under the name of Renhuang Stock*] |   |
|   | Banlangen Granules  | Antiviral (anti-influenza) and broad-spectrum antibiotic  |
|   | Compound Honeysuckle Granules   | Antiviral; antibacterial; and anti-inflammatory   |
|   | Shengmai Granules   | Regulate blood flow; strengthen heart beat; and improve the immune system and blood quality   |
|   | Qing Re Jie Du Oral Liquid  | Treating the flu, upper respiratory infections, and sore throats  |

The Siberian Ginseng (Acanthopanax) Extract, Badger Oil, and Ginseng and Venison Extract are registered by \*Renhuang Stock Co. (“Renhuang Stock”), a company of which Mr. Shaoming Li, our chairman, chief executive officer and president, serves as chairman and is a 50% shareholder. In 2010, we received licenses from Renhuang Stock to produce Siberian Ginseng (Acanthopanax) Extract.

The following table reflects the approximate sales, before sales rebates, of our three product categories during the fiscal years ended October 31, 2011 and 2010:

Edgar Filing: China Botanic Pharmaceutical - Form 10-K

| Product Category  | 2011                   |                    |               | 2010                   |                    |               | Change (2011 – 2010)   |                    |               |
|---|------------------------|--------------------|---------------|------------------------|--------------------|---------------|------------------------|--------------------|---------------|
|   | Quantity<br>(Pack'000) | Amount<br>(\$'000) | % of<br>Sales | Quantity<br>(Pack'000) | Amount<br>(\$'000) | % of<br>Sales | Quantity<br>(Pack'000) | Amount<br>(\$'000) | % of<br>Sales |
| Botanical anti-depression and nerve-regulation products     | 489                    | 55,789             | 70.1 %        | 529                    | 44,697             | 71.3 %        | (40)                   | 11,092             | 24.8 %        |
| Biopharmaceutical products                                  | 75                     | 10,464             | 13.1 %        | 15                     | 3,210              | 5.1 %         | 60                     | 7,254              | 226.0 %       |
| Botanical antibiotics and traditional OTC Chinese medicines | 242                    | 13,355             | 16.8 %        | 307                    | 14,794             | 23.6 %        | (65)                   | (1,439 )           | (9.7 )%       |
| Total   | 806                    | 79,608             | 100.0 %       | 851                    | 62,701             | 100.0 %       | (45)                   | 16,907             | 27.0 %        |

The following table reflects the approximate sales rebates and net sales, of our three product categories during the fiscal years ended October 31, 2011 and 2010:

| Product Category  | 2011              |                              |                          | 2010              |                              |                          | Change (2011-2010) |                       |                   |
|---|-------------------|------------------------------|--------------------------|-------------------|------------------------------|--------------------------|--------------------|-----------------------|-------------------|
|   | Sales<br>(\$'000) | Sales<br>rebates<br>(\$'000) | Net<br>sales<br>(\$'000) | Sales<br>(\$'000) | Sales<br>rebates<br>(\$'000) | Net<br>sales<br>(\$'000) | Sales<br>%         | Sales<br>rebates<br>% | Net<br>sales<br>% |
| Botanical anti-depression and nerve-regulation products     | \$55,789          | \$6,326                      | \$49,463                 | \$44,697          | \$5,459                      | \$39,238                 | 24.8 %             | 15.9 %                | 26.1 %            |
| Biopharmaceutical products                                  | 10,464            | —                            | 10,464                   | 3,210             | 1,004                        | 2,206                    | 226.0 %            | (100.0 )%             | 374.3 %           |
| Botanical antibiotics and traditional OTC Chinese medicines | 13,355            | 568                          | 12,787                   | 14,794            | 1,054                        | 13,740                   | (9.7 )%            | (46.1 )%              | (6.9 )%           |
| Total   | \$79,608          | \$6,894                      | \$72,714                 | \$62,701          | \$7,517                      | \$55,184                 | 27.0 %             | (8.3 )%               | 31.8 %            |

***Botanical anti-depression and nerve-regulation products***

Botanical anti-depression and nerve-regulation products contributed approximately \$49.46 million to our revenue in 2011 (\$39.23 million in 2010) and accounted for approximately 68.0% of total product sales after sales rebates in 2011 (71.1% in 2010).

***Siberian Ginseng (Acanthopanax):***

Acanthopanax, which is known in the United States as Siberian Ginseng, has been used for centuries in China. According to Chinese Pharmacopoeia, it has numerous medical efficacies including, improving kidney and

## Edgar Filing: China Botanic Pharmaceutical - Form 10-K

spleen function; tranquilizing the mind (anxiolytic effect), improving appetite; decreasing pain (analgesic effect); and improving sleep quality. In addition, further pharmacologic studies and clinical trials conducted over the medical efficacies of Siberian Ginseng (*Acanthopanax*) have shown additional benefits, including:

- Antidepressant

*Regulating the nervous system:* Siberian Ginseng (*Acanthopanax*) not only improves the excitation process of the central nervous system but also the inhibition process, making it more efficient. It also helps to balance the two processes to improve human intellectual and physical functions. (Source: "Chinese Medicine Information" - Microbiology Teaching and Research Section of Suzhou Medical College)

*Treating neurasthenia:* Siberian Ginseng (Acanthopanax) can significantly reduce the symptoms of neurasthenia; improves insomnia, restless sleep, heart palpitations, forgetfulness, and fatigue. (Source: “*Chinese Patent Medicine Studies, Acanthopanax Research Situation at Home and Abroad*” - Traditional Chinese Medicine Research Section of Heilongjiang Institute of Chinese Medicine)

*Treating insomnia:* Siberian Ginseng (Acanthopanax) has been proven to be effective in treating hypochondria and depression caused by insomnia and nerve dysfunction by an increasing number of scientific research departments and national institutions. There is a natural link between insomnia and depression. “Junk sleep” will lead to restlessness, low spirits and decreased work quality. Although hypochondria and depression can be attributed to external stimulus, stress and other factors, they are mainly attributed to nerve dysfunction and are classified as a psychiatric illness. (Source: “Insomnia and Depression Treatment Website” <http://www.shimianyiyu.net> )

***Treat cerebrovascular and cardiovascular disease.*** Siberian Ginseng (Acanthopanax) has positive effects on coronary heart disease, angina, high blood pressure and blood pressure regulation. (Source: “China Acanthopanax Web” <http://bjcp.xsjk.net>)

***Anti-fatigue.*** Total Glucosides of Siberian Ginseng (Acanthopanax) has powerful anti-fatigue effects that are more effective than Ginseng. (Source: “China Acanthopanax Web” <http://bjcp.xsjk.net>)

***Antioxidant.*** Siberian Ginseng (Acanthopanax) helps to delay the aging process. (Source: “China Acanthopanax Web” <http://bjcp.xsjk.net>)

***Strengthening the body:*** Total Glucosides of Siberian Ginseng (Acanthopanax) promotes fat, sugar and protein metabolism, and regeneration of hepatic (liver) cells; it improves protein and nucleic acid synthesis and strengthens physical performance. (Source: “China Acanthopanax Web” <http://bjcp.xsjk.net>)

#### *Tianma Tablets and Compound Yangjiao Tablets:*

Tianma Tablets and Compound Yangjiao Tablets are botanic drugs used to treat headaches and regulate nerves. Their known benefits and low side-effects have led to them being the top sellers among medication with similar properties in China.

#### *Compound Schisandra Tablets*

Compound Schisandra Tablets are also botanic drug which is used to regulate central nervous system, generate body fluids and alleviate thirst, nourish the kidneys, cure insomnia and palpitations, and is also widely used as treatment for neurasthenia.

***Biopharmaceutical products***

Biopharmaceutical products contributed approximately \$10.46 million to our revenue net of sales rebate in 2011 (\$3.21 million in 2010) and accounted for approximately 14.4% of total product sales net of sales rebate, in 2011 (4.0% in 2010).

### *Ginseng and Venison Extract*

Ginseng and Venison Extract comprises nutrients from ginseng and deer, and is used to nourish the blood and the kidneys, restore the body's energy and increase endurance.

### *Badger Oil*

Badger Oil expels toxin by cooling, swelling and relieving pain. For mild water and fire burns, scalds and skin pain. Promoting cells reborn and helping for improving parched, chapped and rough skin.

### ***Botanical antibiotics and traditional OTC Chinese medicine products***

Botanical antibiotics and traditional OTC Chinese medicines contributed approximately \$12.79 million to our revenue net of sales rebate in 2011 (\$13.74 million in 2010) and accounted for approximately 17.6% of total product sales net of sales rebate in 2011 (24.9% in 2010).

### **Raw materials and Suppliers**

The raw materials of Siberian Ginseng (*Acanthopanax*) based products are effective ingredients extracted from the Siberian Ginseng (*Acanthopanax*) plant. In China, about 94% of the wild Siberian Ginseng (*Acanthopanax*) resources grow in the Heilongjiang Province (Source: Heilongjiang Dongbei net). The company controlled over 75% of the wild Siberian Ginseng (*Acanthopanax*) resources production in China through exclusive purchase agreements with local governments.

On January 11, 2011, the Company through its wholly own subsidiary, CBP China, replaced and supplemented the July 8, 2010 Exclusive Purchase Agreement with Yichun Red Star Forestry Bureau of Heilongjiang Province (the "Forestry Bureau") with the Exclusive Licensing Agreement for Harbin Renhuang Pharmaceutical Co., Ltd. to Use Forest Resources under Yichun Red Star Forestry Bureau (the "Agreement") which provides us with 30 years exclusive license right to use approximately 6,667 hectares of undergrowth resources including approximately 67 hectares of Siberian Ginseng GAP cultivation base in Heilongjiang Province. We will be responsible for continued maintenance and protection of wild resources to make this area a professional Siberian Ginseng base.



In addition, through the Exclusive Purchase Agreement with Dongfanghong Forestry Bureau, we also have the exclusive rights for an indefinite term to purchase the wild Siberian Ginseng (*Acanthopanax*) grown on 6,667 hectares of land in Dongfanghong, Heilongjiang Province.

Other raw materials and packaging materials are purchased from various independent suppliers, and we do not rely on any one supplier. To ensure consistent quality, we have established long-term relationships with many of our suppliers, ensuring that we have at least ten different suppliers for each type of raw materials. We chose our suppliers based on criteria such as quality, reputation, price, delivery capacity and GMP certification. In addition, we conduct stringent inspections on each batch of raw materials supplied, and perform a periodic review of supplier qualifications.

### **Manufacturing and production facilities**

We have three production facilities: Ah City Natural and Biopharmaceutical plant, Dongfanghong pharmaceutical plant and Qingyang natural extraction plant. The facilities, with a total usable area of over 160 thousand square meters, are capable of producing more than 200 kinds of pharmaceuticals, health food, and functional food in 18 dosage forms, including tablets, capsules (hard and soft), granules, oral liquid, frozen powder injection, powder injection, liquid injection, dropping pills, and ointments. We also have  $\beta$ -lactams and plant extraction lines and automatic packaging lines.

Our production is in strict compliance with "Good Manufacturing Practice", or GMP, and Chinese standards of "Health Food Good Manufacturing Practice", and "Sterile Product Quality Control Norms". We have state of the art automated equipment, precise testing instruments, efficient air conditioning, cleaning systems and a modern logistic center for storage and distribution of products.

With the increasing demand of our products and further expansion of our business, we started Siberian Ginseng Depth Development and Industrialization Project ("Ah City Phase Two") in the beginning of 2011. We have finished the architectural design of Ah City Phase Two project and are in the process of obtaining approval documents from relevant government authorities. We expect to receive all the documents by April, 2012 and will start the construction thereafter. As of October 31, 2011, we have incurred a total of \$1,937,103 of construction-in-progress. The Ah City Phase Two project is expected to be completed in the year of 2013.

### **Quality Assurance**

We are committed to delivering high-quality pharmaceutical products, and have set in place comprehensive testing and quality control measures. We have a quality control team that carries out quality control procedures in compliance with internal policies, GMP standards and State Food and Drug Administration, or SFDA, regulations. There are quality checks at every stage of production, including testing the quality of raw materials throughout our manufacturing process, testing finished products against various criteria such as ingredient composition, weight and physical appearance, and testing sanitary conditions of the production line. We also have a pre-arranged emergency plan in the case of adverse events such as emergency plans for operational accidents and force majeure.

Our production facilities comply with pharmaceutical GMP standards. We employ automated processes and scientific parameters throughout the manufacturing process that are designed to ensure that all products meet our quality requirements. We believe that our rigorous testing and inspection procedures have been critical in ensuring that our products are quality products.

### **Marketing and Product Distribution**

We have entered into sales agency agreements with sales agents through which our products are sold to over 3,000 distributors and over 70 sales centers across 24 provinces in China. Our products are mainly sold by our distributors to pharmacies, medicine wholesale centers, hospitals and other medical agencies. No customer has contributed over 10% of our total revenue before sales rebate in fiscal year 2011 compared with one customer has contributed to 11.01% of our total revenue before sales rebate in fiscal year 2010.

Based on our product nature, distribution channel and market practices, we currently manage our sales and distribution network through four departments: