

Genex Pharmaceutical, Inc.
Form 10QSB
September 12, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2006

OR

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

For the transition period from _____ to _____

Commission file Number **333-102118**

GENEX PHARMACEUTICAL, INC.

(Name of Small Business Issuer in Its Charter)

Delaware

(State or other Jurisdiction of Incorporation)

98-0383571

(I.R.S. Employer Identification No.)

**1801 Guangyin Building, Youyibeilu,
Hexi District, Tianjin City, China**

(Address of Principal Executive Offices)

300074

(Zip Code)

86 22 23370440

(Issuer's Telephone Number, Including Area Code)

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

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Company was required to file such reports), and (2) has been subject to such filing requirements for past 90 days.

Yes No

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Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Securities Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer
The registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE COMPANY

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date. As of September 8, 2006, there were 17,845,732 shares outstanding.

Transitional Small Business Disclosure Format (check one): Yes No

GENEX PHARMACEUTICAL, INC.
FORM 10-QSB
INDEX

		Page
PART I - FINANCIAL INFORMATION		
Item 1.	Financial Statements	1
Item 2.	Management's Discussion and Analysis or Plan of Operation	19
Item 3.	Controls and Procedures	25
PART II - OTHER INFORMATION		
Item 1.	Legal proceedings	27
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	27
Item 3.	Defaults upon senior securities	27
Item 4.	Submission of matters to a vote of security holders	27
Item 5.	Other information	27
Item 6.	Exhibits and Reports on Form 8-K	28
SIGNATURES		28

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

GENEX PHARMACEUTICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEET AS OF JUNE 30, 2006

AND DECEMBER 31, 2005

(Amounts expressed in US dollars, except number of shares)

(Unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 138,939	\$ 296,194
Accounts receivable, net of allowance of \$70,164 and \$47,459 as of June 30, 2006 and December 31, 2005, respectively	540,569	569,500
Other receivable	510,321	251,916
Inventories	448,282	455,050
Due from shareholder	-	931
Due from related parties	3,217,618	2,671,196
Total current assets	4,855,729	4,244,787
Property, plant and equipment, net	151,925	176,723
Total assets	\$ 5,007,654	\$ 4,421,510
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 2,854	\$ 1,691
Accrued payroll and welfare expenses	175,697	172,264
Accrued operating expenses	326,967	357,310
Income tax payable	483,009	333,295
Advances from customers	339,206	203,685
Total current liabilities	1,327,733	1,068,245
Deferred subsidy income	43,774	37,174
Total liabilities	1,371,507	1,105,419

Commitments And Contingencies (Note 13)

Shareholders' Equity

Preferred stock; \$0.0001 par value; 5,000,000 shares authorized; no shares issued and outstanding			
Common stock; \$0.0001 par value; 30,000,000 shares authorized, 17,845,732 shares issued and outstanding	1,785		1,785
Additional paid-in capital	1,146,945		1,146,945
Statutory reserve	356,235		313,389
Accumulative other comprehensive income	112,511		78,101
Retained earnings	2,018,671		1,775,871
	3,636,147		3,316,091
Total liabilities and stockholders' equity	\$	5,007,654	\$ 4,421,510

See notes to condensed unaudited consolidated financial statements.

GENEX PHARMACEUTICAL, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2006 AND 2005

(Amounts expressed in US dollars, except number of shares)

(Unaudited)

	For the three months periods ended June 30,		For the six months periods ended June 30,	
	2006	2005	2006	2005
Sales	\$ 536,457	\$ 520,977	\$ 1,138,834	\$ 948,934
Cost of goods sold	(56,640)	(49,166)	(109,321)	(99,757)
Gross profit	479,817	471,811	1,029,513	849,177
Operating expenses				
Selling expenses	(198,683)	(114,344)	(323,691)	(224,189)
General and administrative expenses	(165,724)	(123,743)	(336,561)	(266,087)
Income from operations	115,410	233,724	369,261	358,901
Other income				
Interest income, net	41,902	15,022	78,136	29,580
Other income	-	-	-	3,745
Total other income	41,902	15,022	78,136	33,325
Income before income tax	157,312	248,746	447,397	392,226
Income tax	(154,823)	-	(161,750)	-
Net income	\$ 2,489	\$ 248,746	\$ 285,647	\$ 392,226
Weighted average shares outstanding - basic and diluted	17,845,732	17,845,732	17,845,732	17,845,732
Basic and diluted net income per share	\$ 0.00	\$ 0.01	\$ 0.02	\$ 0.02

See notes to condensed unaudited consolidated financial statements.

GENEX PHARMACEUTICAL, INC. AND SUBSIDIARY
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW
 FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2006 AND 2005

(Amounts expressed in US dollars)

(Unaudited)

	June 30,		June 30,
	2006		2005
Cash flow from operating activities			
Net income	\$ 285,647	\$	392,226
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation expense	28,219		40,725
Allowance for doubtful debts	22,166		-
Changes in operating assets and liabilities:			
Increase in accounts and other receivable	(243,019)		(254,059)
Decrease in amount due from shareholder	935		-
Decrease (increase) in inventories	10,966		(7,551)
(Decrease) increase in accounts payable and accrued liabilities	(28,350)		33,647
Increase in income tax payable	145,971		-
Increase in advances from customers	133,043		268,293
Increase in amounts due to related parties	-		8,673
Net cash provided by operating activities	355,578		481,954
Cash flows from investing activities			
Acquisition of property, plant and equipment	(1,886)		-
Cash flows from financing activities			
Due from related parties	(519,567)		(649,828)
Proceeds from subsidy received	6,226		-
Net cash used in financing activities	(513,341)		(649,828)
Effect of exchange rate changes on cash	2,394		-
Net decrease in cash and cash equivalents	(157,255)		(167,874)
Cash and cash equivalents, at beginning of period	296,194		325,995
Cash and cash equivalents, at end of period	\$ 138,939	\$	158,121

See notes to condensed unaudited consolidated financial statements.

GENEX PHARMACEUTICAL, INC. AND SUBSIDIARY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SIX MONTH PERIODS ENDED JUNE 30, 2006 AND 2005

(UNAUDITED)

1. a)

DESCRIPTION OF BUSINESS AND BUSINESS COMBINATION

Tianjin Zhongjin Biology Development Co., Ltd. (TZBD) was founded in the People's Republic of China (PRC or China) on February 10, 2003. TZBD is located in the Tianjin Economic and Technological Development Zone in the People's Republic of China. The business license of TZBD was issued by Tianjin Industrial and Commercial Administration on February 10, 2004. The operating period of the business license is from February 10, 2003 to February 9, 2053. TZBD is primarily engaged in production and sales of Reconstituted Bone Xenograft (RBX) in the PRC. All of the customers are hospitals in the PRC. Marketing is either through distributors or through TZBD's sales offices in various cities in China.

On June 17, 2004, TZBD consummated a share purchase agreement (Share Purchase Agreement) with KS E-Media Holdings, Inc. (KSE), a Delaware corporation, under which TZBD shareholders sold 100% undivided interest in TZBD to KSE, in exchange for 3,658,375 shares of KSE. As a part of the agreement, KSE cancelled 2,212,500 shares of its issued and outstanding stock owned by its former president. Within ten (10) days from the Closing Date, KSE effectuated a four-for-one forward split of the KS E-Media Common Shares by way of stock dividend. On June 17, 2004, KSE was renamed Genex Pharmaceutical, Inc.

KSE was incorporated in the State of Delaware on February 28, 2002. KSE was a start-up stage Internet based fulfilment company based in Vancouver, BC, Canada. Through June 17, 2004, KSE was considered a development stage company as defined by Statement of Financial Accounting Standard (SFAS) No. 7, Accounting and Reporting by Development Stage Enterprises . KSE filed a SB-2 Registration Statement with the United States Securities and Exchange Commission (SEC) on December 23, 2002 that was declared effective May 7, 2003.

As a condition to the Share Purchase Agreement, KSE sold its business operations, as they existed immediately before the closing of the Share Purchase Agreement, to Mr. Mayur Pandya, the then president and CEO of KSE, for a consideration of 2,212,500 shares of KSE's common stock being returned to the Company by Mr. Mayur Pandya. Consequently, KSE became a non-operating shell.

According to the terms of the share exchange agreement, control of the combined companies (the Company) passed to the former shareholders of TZBD. Pursuant to the SEC's accounting interpretation and guidance, the merger or acquisition of a private operating company into a non-operating public shell corporation with nominal net assets is considered a capital transaction in substance rather than a business combination. Accordingly, for accounting purposes, the acquisition of TZBD by KSE was treated as a reverse acquisition while the cost of the acquisition was measured based on the value of KSE's net tangible assets and no goodwill or other intangible was recorded. No pro forma financial statements are being presented as the legal acquirer had no significant assets or operations prior to the acquisition.

1. b)

OWNERSHIP OF A PRC SUBSIDIARY

According to the prevailing relevant PRC laws and regulations, a foreign ownership in TZBD is prohibited unless government approvals from the Tianjin offices of the State Administration of Foreign Exchange, the Ministry of Commerce, and the State Administration for Industry and Commerce are obtained. Genex has entered into agreements with the original stockholders of TZBD in respect of the transfer of legal title of the equity interest in TZBD to Genex. However, Genex has not submitted an application for the change of the equity interest of TZBD since the agreements were entered.

Management believes that there should be no legal barriers for the Company to obtain the legal ownership of TZBD. However, in the event that the Company fails to obtain necessary approvals from those offices, there is the risk that the Company may not have equity interest of TZBD and may not enjoy the rights and benefits of being the legal owner of TZBD including repatriation of capital, distribution of profits, etc.

Nevertheless, on May 19, 2006, the Company entered into a trusteeship agreement with Mr. Fuzhi Song and Mr. Deshun Song (the Consigners), the legal shareholders of TZBD. The trusteeship agreement took effect from June 17, 2004 and stipulates that the Consigners are holding all the equity shares in TZBD in trust for the Company and that the Company shall have the exclusive power and authority to exercise any and all shareholder rights with respect to all the equity shares in TZBD as if the Company was the legal, registered owner of such shares in TZBD.

On the same date, the Company entered into a contract for management service with TZBD. The contract for management service took effect from June 17, 2004 and stipulates that the Company shall provide management, administrative and related services to TZBD, and in return, TZBD shall pay to the Company a base annual fee of RMB1,000 and a floating fee equal to TZBD's gross revenues less its gross expenses for each payment period.

1. c)

CHANGE IN REGISTRATION LOCATION

The Company changed its registration location from Tianjin Economic and Technological Development District to Tianjin Xiqing Economic Development District. The change in registration took place on March 5, 2004.

2.

BASIS OF PRESENTATION

The accompanying consolidated financial statements at June 30, 2006 and for the six months ended June 30, 2006 and 2005, includes the financial statements of the Company and its subsidiary. All significant inter-company accounts and transactions have been eliminated in consolidation.

3.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand and time deposits with banks and liquid investments with an original maturity of three months or less.

Inventories

Inventories are valued at the lower of cost (determined on a weighted average basis) or market. Management compares the cost of inventories with the market value and an allowance is made to write down the inventories to the market value, if market is lower than cost.

Accounts receivable and allowance for doubtful accounts

The Company uses the allowance method to account for uncollectible accounts receivable. The Company periodically adjusts the allowance for doubtful accounts based on management's continuing review of accounts receivable. This analysis by management is based on the composition of accounts receivable, analysis of historical bad debts, customer concentrations, customer credit worthiness, an analysis of current economic and business trends as well as changes in customer payment patterns. The Company has no specific terms of the sales. The Company records a full allowance for accounts receivable that have been determined legally to be uncollectible. For accounts receivable that have been outstanding for over 180 days, the Company determines an appropriate allowance based on individual circumstances.

As of June 30, 2006 and December 31, 2005, the general allowance for doubtful and long overdue accounts amounted to \$70,164 and \$47,459, respectively.

Advances from customers

The customers advance payments to the Company for purchases. The advances are interest free and unsecured. The advances from customers amounted to \$339,206 as of June 30, 2006.

Property, plant and equipment

Property, plant and equipment are stated at cost. Expenditures for maintenance and repairs are charged to earnings as incurred; additions, renewals and betterments are capitalized. When property, plant and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method for substantially all assets with estimated lives ranging from 3 to 7 years.

Impairment of long-lived assets

The Company periodically evaluates the carrying value of long-lived assets to be held and used in accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations for a Disposal of a*

Segment of a Business . SFAS No. 144 requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal. Based on its review, the Company believes that, as of June 30, 2006, there were no significant impairments of its long-lived assets.

Comprehensive income

SFAS No. 130, Reporting Comprehensive Income, requires disclosure of all components of comprehensive income and loss on an annual and interim basis. Comprehensive income and loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The Company had other comprehensive income of \$112,511 and \$78,101 as of June 30, 2006 and December 31, 2005, respectively. The other comprehensive income arose from the changes in foreign currency exchange rates. Consequently for the six months ended June 30, 2006 and the year ended December 31, 2005, the comprehensive income was \$398,159 and \$703,115, respectively.

Revenue recognition

The Company's revenue recognition policies are in compliance with Staff Accounting Bulletin (SAB) 104. Generally, revenue is recognized when all of four criteria are met: (i) There is persuasive evidence that an arrangement exists; (ii) Delivery has occurred or services have been rendered; (iii) The seller's price to the buyer is fixed or determinable; And (iv) collectibility is reasonably assured.

(a)

Sale of products to Hospitals

The Company's major customers consist of hospitals. Revenue from the sale of products to hospitals is recognized when the products have been delivered to the hospitals and products have been applied by the hospitals to the patients during the course of medical treatment. As such, there is no sales return after the revenue is recognized.

(b)

Sale of products to / through medical device resellers and distributors

Other than direct sales to ultimate customers by the Company's own sales personnel, the Company also sells its products through medical device resellers and distributors. Revenue from sale of products through medical resellers is recognized when the products have been delivered to medical service resellers and distributors and confirmation has been received from the resellers or distributors of their acceptance of the goods. The Company has entered into master agency agreements with the resellers and distributors which fixed the sales prices.

The products delivered to and accepted by customers, resellers or distributors are not returnable or exchangeable.

Sales are presented net of value added tax (VAT). No return allowance is made as product returns are insignificant based on historical experience.

Advertising costs

The Company expenses the costs of advertising as incurred or, as appropriate, the first time the advertising takes place. Advertising costs for the six months ended June 30, 2006 amounted to \$77,868 and were insignificant for the six months ended June 30, 2005.

Research and Development Costs

Research and development costs are expensed to operations as incurred.

Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes . SFAS No. 109 requires an asset and liability approach for financial accounting and reporting for income taxes and allows recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain.

Stock based compensation

The Company has adopted Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation , which defines a fair-value-based method of accounting for stock based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Stock compensation for stock granted to non-employees has been determined in accordance with SFAS No.123 and the Emerging Issues Task Force consensus in Issue No. 96-18, Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services (EITF 96-18), as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

The Company continues to follow Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , in accounting for stock options issued to employees (see Note 11) and non-employee directors, and pro forma disclosures of the effect on net income (loss) and net income (loss) per share as if the Company had accounted for such stock options under the fair value method prescribed by SFAS No. 123. The Company did not grant any stock options to its officers and management during the six months ended June 30, 2006 and 2005.

Earnings per share

Net income per share is calculated in accordance with the Statement of Financial Accounting Standards No. 128 (SFAS No. 128), Earnings per share . SFAS No. 128 superseded Accounting Principles Board Opinion No.15 (APB 15). Net income per share for all periods presented has been restated to reflect the adoption of SFAS No. 128. Basic net income per share is based upon the weighted average number of common shares outstanding. Diluted net income per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

Statutory reserves

In accordance with the PRC Companies Law, the Company's PRC subsidiary is required to appropriate a percentage of its profit after taxation, as determined in accordance with PRC accounting standards and regulations, to the statutory reserves before any dividend distribution. The statutory reserves are comprised of a statutory surplus reserve and a statutory common welfare fund. Subject to certain restrictions set out in the PRC Companies Law, the statutory surplus reserve may be distributed to stockholders in the form of share bonus and/or cash dividends. The statutory common welfare fund is non-distributable and is restricted for the capital expenditure for the collective benefits of all the staff of the Company's employees. During the six months ended June 30, 2006 and 2005, no dividend had been declared by TZBD.

Foreign currency translation

The Company maintains its books and accounting records in Chinese Renminbi (RMB), the PRC's currency and the Company's functional currency. The unit of Renminbi is in Yuan. Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain statements, however, require entities to report specific changes in assets and liabilities, such as gain or loss on foreign currency translation, as a separate component of the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income. Cumulative translation adjustment amount and translation adjustment gain as of June 30, 2006 amounted to \$112,511.

On July 21, 2005, the PRC government reformed the exchange rate system into a managed floating exchange rate system based on market supply and demand with reference to a basket of currencies. In addition, the exchange rate of RMB to US\$ was adjusted to RMB8.11: US\$1.00 as of July 21, 2005. The People's Bank of China announces the closing price of a foreign currency such as US\$ traded against RMB in the inter-bank foreign exchange market after the closing of the market on each working day, which will become the unified exchange rate for the trading against RMB on the following working day. The daily trading price of US\$ against RMB in the inter-bank foreign exchange market is allowed to float within a band of $\pm 0.3\%$ around the unified exchange rate published by the People's Bank of China. This quotation of exchange rates does not imply free convertibility of RMB to other foreign currencies. All foreign exchange transactions continue to take place either through the Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the Bank of China or other institutions required submitting a payment application form together with invoices, shipping documents and signed contracts.

TZBD's assets and liabilities at June 30, 2006 and its statement of operation for the six months then ended were translated at the rates of RMB7.9956:US\$1.00 and RMB8.0303:US\$1.00, respectively, whereas its assets and liabilities as of June 30, 2005 and its statement of operation for the six months then ended were translated at the single rate of RMB8.27:US\$1.00. No representation is made that RMB amounts have been, or would be, converted into US\$ at these rates.

Fair values of financial instruments

The Company values its financial instruments as required by SFAS No. 107, Disclosures about Fair Value of Financial Instruments . The Company's financial instruments primarily consist of cash and cash equivalents, accounts receivable, other receivables, prepayments, accounts payable and accruals, short-term loans and amount due to and due from related parties. The carrying values of financial instruments approximate the fair values because of their short-term maturities.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported

amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the amount of revenues and expenses during the reporting periods. Management makes these estimates using the best information available at the time the estimates are made. However, actual results could differ materially from those results.

Statement of Cash Flows

In accordance with Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows*, cash flows from the Company's operations is calculated based upon the local currencies. As a result, amounts related to assets and liabilities reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

Segment Reporting

Statement of Financial Accounting Standards No. 131 (*SFAS 131*), *Disclosure About Segments of an Enterprise and Related Information* requires use of the management approach model for segment reporting. The management approach model is based on the way a company's management organizes segments within the company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure, or any other manner in which management disaggregates a company. *SFAS 131* has no effect on the Company's consolidated financial statements as the Company consists of one reportable business segment. All revenue is from customers in China. All of the Company's assets are located in China.

Recent accounting pronouncements

In November 2004, the FASB issued *SFAS No. 151, Inventory Costs - An Amendment of Accounting Research Bulletin No. 43, Chapter 4* (*SFAS 151*). *SFAS 151* clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead as an inventory cost. The new statement also requires that allocation of fixed production overhead costs to conversion costs should be based on normal capacity of the production facilities. The provisions in *SFAS 151* must be applied prospectively and become effective for us beginning January 1, 2006. We do not expect the adoption of this statement to have a material impact on our Consolidated Financial Statements.

In December 2004, the FASB issued *SFAS No. 152 - Accounting for Real Estate Time-Sharing Transactions - an amendment of FASB Statements No. 66 and 67* (*SFAS 152*). This statement amends *FASB Statement No. 66 - Accounting for Sales of Real Estate* to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in *AICPA Statement of Position 04-2 - Accounting for Real Estate Time-Sharing Transactions* (*SOP 04-2*). *SFAS 152* also amends *FASB Statement No. 67 - Accounting for Costs and Initial Rental operations of Real Estate Projects* to state that the guidance for incidental operations and costs incurred to sell real estate projects does not apply to real estate time-sharing transactions, with the accounting for those operations and costs being subject to the guidance in *SOP 04-2*. The provisions of *SFAS 152* are effective in fiscal years beginning after June 15, 2005. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ending December 31, 2006. The Company is currently evaluating the impact of *SFAS 152* on its consolidated financial statements.

In December 2004, the FASB issued *SFAS No. 123 (Revised 2004), Share-Based Payment* (*SFAS 123R*). This statement requires financial statement recognition of compensation cost related to share-based payment transactions.

Share-based payment transactions within the scope of SFAS 123R include stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee share purchase plans. The provisions of SFAS 123R are effective for the first fiscal year beginning after June 15, 2005. However, in April 2005, the SEC deferred the effective date of SFAS 123R for SEC registrants to the first interim period beginning after June 15, 2005. Accordingly, we expect to implement the revised standard in the first quarter of 2006. We do not expect the adoption of this statement to have a material impact on our Consolidated Financial Statements.

In December 2004, the FASB issued SFAS No. 153 Exchanges of Nonmonetary Assets, an amendment of Accounting Principles Board Opinion No. 29 (SFAS 153). This statement amends Accounting Principles Board Opinion (APB) No. 29, Accounting for Nonmonetary Transactions to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that have no commercial substance. Under SFAS 153, if a nonmonetary exchange of similar productive assets meets a commercial-substance criterion and fair value is determinable, the transaction must be accounted for at fair value resulting in recognition of any gain or loss. SFAS 153 was effective for nonmonetary transactions in fiscal periods beginning after June 15, 2005. The adoption of SFAS 153 did not have any impact on our Consolidated Financial Statements.

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, an Interpretation of FASB Statement No. 143 (FIN 47). Under FIN 47, we are required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Any uncertainty about the amount and/or timing of future settlement should be factored into the measurement of the liability when sufficient information exists. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value. The provisions of FIN 47 were required to be applied no later than the end of fiscal years ending after December 15, 2005. As such, we adopted FIN 47 in the fourth quarter of 2005. The adoption of FIN 47 did not have a material impact on our Consolidated Financial Statements.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS 154). This statement changes the requirements for the accounting for and reporting of a change in accounting principle and applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. APB No. 20 required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This statement requires retrospective application to prior period financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The provisions of SFAS 154 are effective for fiscal years beginning after December 15, 2005. As such we are required to adopt SFAS 154 by January 1, 2006. We do not expect the adoption of this statement to have a material impact on our Consolidated Financial Statements.

In 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*. This Statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in indicated situations; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits an entity to choose relevant subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments. This Statement amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. It also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company has not yet determined the impact of the adoption of SFAS No. 155 on its financial statements, if any.

4.

INVENTORIES

	June 30, 2006
Raw materials and packing materials	\$ 17,670
Work-in-progress	257,477
Finished goods	173,135
	\$ 448,282

5.

DUE FROM / (TO) RELATED PARTIES

Name	Relationship with the Company	Nature	Interest rate	Amount
Tianjin Zhongjin Pharmaceutical Co., Ltd.	Former shareholder of the Tianjin Zhongjin Biology Development Co., Ltd.	Advances to suppliers ⁽¹⁾	6% p.a.	\$ -
		Short-term interest-bearing loan ⁽²⁾	6% p.a.	1,263,557
		Other prepayment	Nil	12,920
		Accrued loan interest	Nil	78,184
Tianjin Golden World Group Co., Ltd.	Common shareholders	Short-term interest-bearing loan ⁽²⁾	6% p.a.	606,584
		Accrued loan interest	Nil	42,782
Tianjin Zhongwei Pharmaceutical Co., Ltd.	Common shareholders	Short-term interest-bearing loan ⁽²⁾	6% p.a.	454,875
		Accrued loan interest	Nil	32,458
	Common shareholders		6% p.a.	545,300

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Tianjin Nanfang Medicine Co., Ltd.		Short-term interest-bearing loan ⁽²⁾		
		Accrued loan interest	Nil	14,589
Tianjin Jinshi Pharmaceutical Co Ltd	Common shareholders	Short-term interest-bearing loan ⁽²⁾	6% p.a.	175,096
		Accrued rental expenses ⁽³⁾	Nil	(13,957)
		Accrued loan interest	Nil	5,230
Total				\$ 3,217,618

(1)

Purchase deposits or advances to suppliers were paid to its related companies as the Company engages its related companies to source raw materials at cheaper prices.

(2)

During the six months ended June 30, 2006, the Company advanced some of its idle cash to the above related companies to earn interest.

(3)

Accrued rental expenses were paid and payable to the related company for factory premise.

There was no collateral for all the balances with the related companies. Accordingly, the Company considers that these amounts should not be reflected as a reduction of equity.

The Company advanced cash to parties related through common shareholders during the six months ended June 30, 2006. Out of a total of \$3,217,618, \$172,206 is interest-free, unsecured and due on repayment on December 31, 2006. The remaining \$3,045,412 bears an interest rate at 6% per annum and is also unsecured. Total interest income on the loans for the six months ended June 30, 2006 amounted to \$78,310.

The Company recorded rental expenses payable to related parties, related through common shareholders, amounting to \$13,957 for the six months ended June 30, 2006.

6.

PROPERTY AND EQUIPMENT

	June 30, 2006
Machinery and equipment	\$ 301,733
Computer equipment	18,511
	320,244
Less: Accumulated depreciation	(168,319)
	\$ 151,925

Depreciation expense was \$28,341 and \$40,725 for the six months ended June 30, 2006 and 2005, respectively.

7.

DEFERRED SUBSIDY INCOME

The amounts represent subsidies for hi-tech projects granted by the PRC government.

This subsidy was approved to be granted and was paid to the Company for financing the Company's research and development activities which meet the Good Manufacturing Practices Standard (GMP Standard) in 2005. According

to the regulation for granting this government subsidy, this fund may be treated as capital contributed by the company appointed by the PRC government (contributing company) or loan from such company which the Company will need to repay. However, no agreement has yet been reached with the contributing company regarding the final treatment of this subsidy. Therefore, the amount is included under non-current liabilities. Since the final treatment of this fund may not be confirmed in 2006, the Company deferred its recognition as other income only when the Company met the criteria set out in the Technology Subsidy Scheme including the formal certification and endorsement by the Bureau.

8.

TAX PENALTY

The Company's subsidiary, Tianjin Zhongjin Biology Development Co., Ltd. (TZBD), being registered in the PRC is subject to PRC's Enterprise Income Tax. Pursuant to the PRC Income Tax Laws, Enterprise Income Taxes is generally imposed at a statutory rate of 33%, which comprises 30% national income tax and 3% local income tax and tax returns should be filed on a quarterly basis. However, for its first two years of operation from June 2003 to May 2005, TZBD was granted a tax holiday and exempted from PRC's Enterprise Income Tax. While TZBD has been negotiating with the relevant PRC tax authority for an extension of the tax holiday, TZBD has not filed any tax return. As a result, the tax authority has imposed a penalty of \$35,009 based on the estimated income of TZBD for its fourth quarter in fiscal year 2005. See also Note 13b.

9.

INCOME TAXES

The components of income (loss) before taxes are as follows: