

RENHUANG PHARMACEUTICALS INC  
Form 10-Q  
September 17, 2010

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

Form 10-Q

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

For the quarterly period ended July 31, 2010

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

RENHUANG PHARMACEUTICALS, INC.  
(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

84-1273503  
(I.R.S. Employer  
Identification No.)

The 11th Floor, Changjiang International Building, No. 28, Changjiang Road, Nangang District, Harbin, Heilongjiang  
Province, P.R. China 150090  
(Address of principal executive offices)

86-451-8260-2162  
(Registrant's Telephone Number, Including Area Code)

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of September 2, 2010, there were 37,239,536 shares of the registrant's \$0.001 par value common stock issued and outstanding.

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In this Quarterly Report on Form 10-Q, references to “dollars” and “\$” are to United States dollars and, unless the context otherwise requires, references to “we,” “us” and “our” refer to Renhuang Pharmaceuticals, Inc. and its consolidated subsidiaries.

This Quarterly Report contains certain forward-looking statements. When used in this Quarterly Report, statements which are not historical in nature, including the words “anticipate,” “estimate,” “should,” “expect,” “believe,” “intend,” “may,” “project,” “plan” 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 Quarterly 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. Financial Statements.

RENHUANG PHARMACEUTICALS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

	Note	July 31, 2010 US\$ (Unaudited)	October 31, 2009 US\$ (Audited)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents		28,749,480	8,111,514
Trade receivables, net	7	10,817,824	23,203,410
Due from related parties	11	-	130,199
Inventory, net	9	3,573,349	3,024,016
Deposits	11	1,473,796	-
Prepayments		-	89,281
Other receivables, net	8	144,011	102,613
Total current assets		44,758,460	34,661,033
Property and equipment, net	10	2,090,592	2,352,163
Deposits	11	18,695,870	16,137,000
Total assets		65,544,922	53,150,196
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Current liabilities:			
Accounts payable		256,993	369,329
Value added tax payable		471,282	1,186,642
Accrued employee benefits		1,422,006	1,136,267
Warrant liability		342,770	-
Total current liabilities		2,493,051	2,692,238
Commitments and Contingencies	17		
<b>Shareholders' equity</b>			
Preferred stock (no par value, 1,000,000 shares authorized; none issued and outstanding as of July 31, 2010 and October 31, 2009)	14	-	-
Common stock (\$0.001 par value, 100,000,000 shares authorized; 37,239,536 issued and outstanding as of July 31, 2010 and October 31, 2009)	14	37,240	37,240
Additional paid-in capital		7,651,460	7,596,525
Common stock warrants	15	496,732	496,732
Reserves	16	3,372,697	3,372,697
Accumulated other comprehensive income		3,669,590	3,367,659

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Retained earnings	47,824,152	35,587,105
Total shareholders' equity	63,051,871	50,457,958
Total liabilities and shareholders' equity	65,544,922	53,150,196

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

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RENHUANG PHARMACEUTICALS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Note	Three months ended July 31,		Nine months ended July 31,	
		2010 US\$ (Unaudited)	2009 US\$ (Unaudited)	2010 US\$ (Unaudited)	2009 US\$ (Unaudited)
Sales, net		9,263,892	6,442,197	38,489,012	28,915,072
Cost of goods sold		(4,620,568)	(2,942,649)	(18,151,062)	(13,825,692)
Gross profit		4,643,324	3,499,548	20,337,950	15,089,380
Operating and administrative expenses:					
Sales and marketing		1,284,990	1,109,540	3,689,290	2,534,865
General and administrative		395,131	499,949	2,208,965	1,712,342
Research and development		1,528,933	1,227,411	2,251,854	1,833,391
Total operating expenses		3,209,054	2,836,900	8,150,109	6,080,598
Income from operations		1,434,270	662,648	12,187,841	9,008,782
Other income:					
Interest income		22,039	12,054	49,206	31,204
Income from operations before income tax expenses		1,456,309	674,702	12,237,047	9,039,986
Income tax expenses	5	-	-	-	-
Net income		1,456,309	674,702	12,237,047	9,039,986
Other comprehensive income:					
Cumulative currency translation adjustments		461,820	(93,739)	301,931	(79,568)
Total comprehensive income		1,918,129	580,963	12,538,978	8,960,418
Earnings per common stock-					
Basic		0.04	0.02	0.33	0.26
Earnings per common stock - Diluted		0.04	0.02	0.32	0.26
Weighted average common stock outstanding					
Basic		37,239,536	36,796,990	37,239,536	35,096,680
Diluted		37,901,089	36,796,990	37,793,370	35,096,680

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





RENHUANG PHARMACEUTICALS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the nine months ended July 31,	
	2010 US\$ (Unaudited)	2009 US\$ (Unaudited)
<b>Cash flows from operating activities:</b>		
Net income	12,237,047	9,039,986
<b>Adjustments to reconcile net income to operating activities:</b>		
Depreciation of property and equipment	261,572	265,559
Warrants issued for services	342,770	-
Share compensation	42,759	-
<b>Changes in assets and liabilities:</b>		
Decrease (increase) in trade receivables	12,385,586	(5,868,520)
Decrease (increase) in due from related parties	130,199	(321,010)
Decrease (increase) in inventory, net	(549,333)	43,425
Decrease (increase) in prepayments and in other receivables	(1,425,913)	77,805
Decrease in accounts payable	(112,336)	(93,249)
Decrease in value added tax payable	(715,360)	(270,065)
Increase in accrued employee benefits	285,739	281,611
Decrease in other payables	-	(96,754)
Net cash provided by operating activities	22,882,730	3,058,788
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	-	(16,183)
Deposits for office properties	(2,558,870)	-
Net cash used in investing activities	(2,558,870)	(16,183)
Effect of exchange rate changes on cash	314,106	(22,551)
Net increase in cash and cash equivalents	20,637,966	3,042,605
Cash and cash equivalents, beginning of year	8,111,514	9,747,693
Cash and cash equivalents, end of year	28,749,480	12,767,747
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the year for income taxes	-	-
Interest paid during the year	-	-

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

RENHUANG PHARMACEUTICALS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
July 31, 2010 and 2009

1. ORGANIZATION AND NATURE OF OPERATION

The accompanying consolidated financial statements include the financial statements of Renhuang Pharmaceuticals, Inc. (“Renhuang”) and its subsidiaries. Renhuang and its subsidiaries are collectively referred to as the “Company.”

Renhuang was incorporated in the State of Nevada on August 18, 1988, originally under the corporate name of Solutions, Incorporated. It was inactive until August 16, 1996, when it changed its corporate name to Suarro Communications, Inc, and engaged in the business of providing internet based business services. This line of business was discontinued in 2006, and Renhuang became a non-operating public company. Renhuang underwent a number of corporate name changes as follows:

June 1997	ComTech Consolidation Group, Inc
February 1999	E-Net Corporation
May 1999	E-Net Financial Corporation
January 2000	E-Net.Com Corporation
February 2000	E-Net Financial.Com Corporation
January 2002	Anza Capital, Inc (“Anza”)
June 2006	Renhuang Pharmaceuticals, Inc.

Effective August 28, 2006, Renhuang completed the acquisition of 100% ownership of Harbin Renhuang Pharmaceutical Company Limited, a company incorporated in the British Virgin Islands. As a result, Harbin Renhuang Pharmaceutical Company Limited became a wholly owned subsidiary of Renhuang.

Harbin Renhuang Pharmaceutical Company Limited owns 100% of the registered capital of Harbin Renhuang Pharmaceutical Co. Ltd (“Renhuang China”).

The core activities of subsidiaries included in the consolidated financial statements are as follow:

- Harbin Renhuang Pharmaceutical Company Limited – Investment holding.
- Renhuang China – Development, manufacturing and distribution of pharmaceutical products.

Renhuang China’s principal country of operations is the People’s Republic of China (the “PRC”) and maintains their accounting records in Renminbi (“RMB”). Substantially all of the Company’s assets and operation are located in the PRC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation of financial statements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and related notes. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the year ended October 31, 2009, which are included in the Company’s Form 10-K for the year ended October 31, 2009, filed with the SEC on January 29, 2010.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (which include only normal recurring adjustments) necessary to present fairly the balance sheets of Renhuang Pharmaceuticals, Inc. and its subsidiaries as of July 31, 2010, the results of their operations for the three and nine months ended July 31, 2010 and 2009, and their cash flows for the nine months ended July 31, 2010 and 2009. The results of operations for the three and nine months ended July 31, 2010 and 2009 are not necessarily indicative of the results to be expected for the entire year.

RENHUANG PHARMACEUTICALS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
July 31, 2010 and 2009

The accompanying condensed consolidated financial statements are expressed in terms of US dollars.

In June 2009, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard (“SFAS”) No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162. This statement modifies the Generally Accepted Accounting Principles (“GAAP”) hierarchy by establishing only two levels of GAAP, authoritative and nonauthoritative accounting literature. Effective July 2009, the FASB Accounting Standards Codification (“ASC”), also known collectively as the “Codification,” is considered the single source of authoritative U.S. accounting and reporting standards, except for additional authoritative rules and interpretive releases issued by the SEC. Nonauthoritative guidance and literature would include, among other things, FASB Concepts Statements, American Institute of Certified Public Accountants Issue Papers and Technical Practice Aids and accounting textbooks. The Codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. It is organized by topic, subtopic, section, and paragraph, each of which is identified by a numerical designation. This statement applies beginning in third quarter 2009. All accounting references have been updated, and therefore SFAS references have been replaced with ASC references.

The Company operates in one operating segment in accordance with accounting guidance FASB ASC Topic 280, “Segment Reporting.” Our CEO has been identified as the chief operating decision maker as defined by FASB ASC Topic 280.

#### Principles of consolidation

The condensed consolidated financial statements include the financial statements of Renhuang and its subsidiaries.

All inter-company transactions and balances have been eliminated in consolidation.

Effective beginning third quarter 2009, the FASB Topic 810, “Consolidation Topic,” revised the accounting treatment for noncontrolling minority interests of partially-owned subsidiaries. Noncontrolling minority interests represent the portion of earnings that is not within the parent company’s control. These amounts are now required to be reported as equity instead of as a liability on the balance sheet. In addition this statement requires net income from noncontrolling minority interest to be shown separately on the consolidated statements of operations and comprehensive income. As the Company has no noncontrolling interest at July 31, 2010, this change did not have an impact on the Company’s condensed consolidated financial statements.

#### Use of estimates

The preparation of these consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affected the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of net sales and expenses during the reported periods.

Significant estimates and assumptions by management include, among others, uncollectible accounts receivable, slow moving, obsolete and/or damaged inventory, property and equipment, reserve for employee benefit obligations, stock warrant valuation, and other uncertainties. Actual results may differ from these estimates. The current economic environment has increased the degree of uncertainty inherent in these estimates and assumptions.



RENHUANG PHARMACEUTICALS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
July 31, 2010 and 2009

Foreign currency translation

The Company's principal country of operations is the PRC. The financial position and results of operations of the subsidiaries are determined using the local currency ("Renminbi" or "RMB") as the functional currency.

Translation of amounts from RMB into US dollars for reporting purposes is performed by translating the results of operations denominated in foreign currency at the weighted 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 ruling at that date. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of capital contribution. All translation adjustments resulting from the translation of the financial statements into the reporting currency (US dollars) are reported as a component of accumulated other comprehensive income in shareholders' equity.

As of July 31, 2010 and October 31, 2009 the exchange rate was RMB6.79 and RMB6.82, respectively. Translation adjustment totaled \$461,820 and (\$93,739) for the three months ended July 31, 2010 and 2009, respectively, and \$301,931 and (\$79,568) for the nine months ended July 31, 2010 and 2009.

Cash and cash equivalents

Cash and cash equivalents represent cash on hand and demand deposits placed with banks or other financial institutions, which have original maturities less than three months. There are no restriction to cash at July 31, 2010 and October 31, 2009. Substantially all of the Company's cash is held in bank accounts in the PRC and is not protected by the Federal Deposit Insurance Corporation ("FDIC") insurance or any other similar insurance. Given the current economic environment and risks in the banking industry, there is a risk that deposits may not be readily available.

Trade receivables, net

Trade receivables are recorded at the invoiced amount and do not bear interest. Trade receivable payment terms vary and amounts due from customers are stated in the financial statements net of an allowance for doubtful accounts and sales rebates. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its trade receivables. Trade receivables outstanding longer than the payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time the trade receivable is past due, the Company's previous loss history, the counter party's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off receivables when they are deemed uncollectible, and payments subsequently received on such trade receivables are credited to the allowance for doubtful accounts. There were no write offs for the three and nine months ended July 31, 2010 and 2009. The Company does not have any off-balance sheet credit exposure related to its customers.

Inventory, net

Inventory consists of raw materials, work-in-progress and finished goods and is valued at the lower of cost or market value. The value of inventory is determined using the weighted average cost method and includes any related production overhead costs incurred in bringing the inventory to their present location and condition. Overhead costs included in finished goods include, direct labor cost and other costs directly applicable to the manufacturing process.

The Company estimates an inventory allowance for excessive, slow moving and obsolete inventories as well as inventory whose carrying value is in excess of net realizable value. Inventory amounts are reported net of such allowances. There were no inventory write offs for the three and nine months ended July 31, 2010 and 2009.

RENHUANG PHARMACEUTICALS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
July 31, 2010 and 2009

Property and equipment, net

Property and equipment are recorded at cost. Expenditures for major additions and improvements are capitalized and minor replacements, maintenance, and repairs are charged to expense as incurred. When property and equipment are retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations for the respective period.

Depreciation is provided over the estimated useful lives of the related assets using the straight-line method. The estimated useful lives for significant property, plant and equipment categories are as follows:

Machinery and equipment	10 years
Office equipment and furnishings	5-10 years
Motor vehicles	5-10 years

Long-lived assets

The Company's long-lived assets and other assets (consisting of property and equipment) are reviewed for impairment in accordance with the guidance of the FASB Topic ASC 360, "Property, Plant, and Equipment," and FASB ASC Topic 205 "Presentation of Financial Statements." The Company tests for impairment losses on long-lived assets used in operations whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Recoverability of an asset to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Impairment evaluations involve management's estimates on asset useful lives and future cash flows. Actual useful lives and cash flows could be different from those estimated by management which could have a material effect on our reporting results and financial positions. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. Through the three and nine months ended July 31, 2010 and 2009, the Company had not experienced impairment losses on its long-lived assets. However, there can be no assurances that demand for the Company's products or services will continue, which could result in an impairment of long-lived assets in the future.

Warrant liability

On March 25, 2010, the Company issued warrants (the "Warrants") for 160,000 common shares to a service provider that have an exercise price of \$2.00 per share and a contractual life of 3 years. The terms of the Warrant agreement include the following factors that in accordance with FASB Topic ASC 815, requires that the Warrants be classified at their fair value to liabilities each reporting period.

- The holder of the Warrants (the "Holder") is entitled to the benefits of Rule 144 promulgated under the Securities Act of 1933, as amended and any other rule or regulation of the SEC that may at any time permit the Holder to sell securities of the Company to the public without registration. Non compliance with such rules and regulations could result in the Company having to settle the Warrant obligation in cash.
- The exercise price and number of shares issuable upon exercise of the Warrants (the "Warrant Shares") are subject to adjustment for standard dilutive events, including the issuance of common stock, or securities convertible into or



exercisable for shares of common stock, that will adversely affect the Holder's rights under the Warrants. There were no dilutive events in the three and nine months ended July 31, 2010, which would have resulted in an adjustment to the exercise price or number of Warrant Shares.

RENHUANG PHARMACEUTICALS, INC.  
 NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 July 31, 2010 and 2009

At July 31, 2010, the fair value of the Company's warrants liability was \$342,770. The Company used the Black-Scholes valuation model to estimate the fair value of the Warrants. The valuation was based on the assumptions noted in the following table.

Expected volatility	205.3%
Expected dividends	0%
Expected term (in years)	3 years
Risk-free rate	1.69%

Fair value of financial instruments

The Company applies the provisions of accounting guidance, FASB Topic ASC 825 that requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value, and defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of July 31, 2010 and October 31, 2009 the carrying value of cash, trade receivables, other receivables, accounts payable, and warrant liability approximated their fair value.

Fair value measurements

Effective April 1, 2009, the FASB ASC Topic 825, "Financial Instruments," requires disclosures about fair value of financial instruments in quarterly reports as well as in annual reports.

The FASB ASC Topic 820, "Fair Value Measurements and Disclosures," clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value and requires additional disclosures about the use of fair value measurements.

Various inputs are considered when determining the fair value of the Company's financial instruments. The inputs or methodologies used for valuing securities are not necessarily an indication of the risk associated with investing in these securities. These inputs are summarized in the three broad levels listed below.

- Level 1 – observable market inputs that are unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 – other significant observable inputs (including quoted prices for similar securities, interest rates, credit risk, etc...).
- Level 3 – significant unobservable inputs (including the Company's own assumptions in determining the fair value of financial instruments).

The Company's adoption of FASB ASC Topic 825 did not have a material impact on the Company's condensed consolidated financial statements.

The carrying value of financial assets and liabilities recorded at fair value is measured on a recurring or nonrecurring basis. Financial assets and liabilities measured on a non-recurring basis are those that are adjusted to fair value when a

significant event occurs. The Company had no financial assets or liabilities carried and measured on a nonrecurring basis during the reporting periods. Financial assets and liabilities measured on a recurring basis are those that are adjusted to fair value each time a financial statement is prepared.

RENHUANG PHARMACEUTICALS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
July 31, 2010 and 2009

The availability of inputs observable in the market varies from instrument to instrument and depends on a variety of factors including the type of instrument, whether the instrument is actively traded, and other characteristics particular to the transaction. For many financial instruments, pricing inputs are readily observable in the market, the valuation methodology used is widely accepted by market participants, and the valuation does not require significant management discretion. For other financial instruments, pricing inputs are less observable in the market and may require management judgment.

#### Revenue recognition

Revenue is recognized in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition," which states that revenue should be recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) the service has been rendered; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured.

Interest income is recognized when earned, taking into account the average principal amounts outstanding and the interest rates applicable.

As of July 31, 2010, the Company has no sales or contracts that included multiple deliverables that would fall under the scope of FASB Topic ASC 605, "Multiple Deliverable Revenue Arrangements – A Consensus of the FASB Emerging Issues Task Force."

The Company provided annual sales rebates to its distributors based upon sales volumes. Sales rebates are recorded as a current liability at the time of the sale based upon the Company's estimates of whether each customer would be entitled to rebates for the period. At quarter end, the accrued rebate amount is adjusted to the actual amount earned and reclassified to trade receivables in accordance with legal right of offset. Sales rebates were deducted from sales in the accompanying consolidated statements of operations and comprehensive income.

As of July 31, 2010 and October 31, 2009, the Company has accrued \$550,217 and \$3,020,898, respectively, for sales rebates. For the three months ended July 31, 2010 and 2009, the Company has deducted sales rebates in the amount of \$1,018,359 and \$1,361,965, respectively, from sales. For the nine months ended July 31, 2010 and 2009, the Company has deducted sales rebates in the amount of \$4,923,196 and \$6,545,697, respectively, from sales. Sales rebates are calculated based on terms specified in contracts with individual distributors.

#### Sales returns and allowances

The Company does not allow return of products except for products that were damaged during shipment. The total amount of returned product is less than 0.05% of total sales. The cost of damaged products is netted against sales and cost of goods sold, respectively.

#### Cost of goods sold

Cost of goods sold primarily consists of direct and indirect manufacturing costs, including production overhead costs, shipping and handling costs for the products sold.

#### Sales and marketing

Sales and marketing costs consist primarily of advertising and market promotion expenses, and other overhead expenses incurred by the Company's sales and marketing personnel. Advertising expenses amounted to \$1,232,000 and \$1,085,756 during the three months ended July 31, 2010 and 2009, respectively and \$3,558,109 and \$2,476,007 during the nine months ended July 31, 2010 and 2009, respectively.

RENHUANG PHARMACEUTICALS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
July 31, 2010 and 2009

Advertising costs are expensed as incurred.

Research and development

Research and development (“R&D”) costs are expensed as incurred.

Employee benefit costs

According to the PRC regulations on pension, a company contributes to a defined contribution retirement plan organized by municipal government in the province in which the Renhuang China was registered and all qualified employees are eligible to participate in the plan. Contributions to the plan are calculated at 20% of the employees’ salaries above a fixed threshold amount, employees contribute 4% and the Renhuang China contributes the balance of 16%.

Share-based compensation

For purposes of determining the variables used in the calculation of stock compensation expense under the provisions of FASB ASC Topic 505, “Equity” and FASB ASC Topic 718, “Compensation — Stock Compensation,” we perform an analysis of current market data and historical Company data to calculate an estimate of implied volatility, the expected term of the option and the expected forfeiture rate. With the exception of the expected forfeiture rate, which is not an input, we use these estimates as variables in the Black-Scholes option pricing model. Depending upon the number of stock options granted, any fluctuations in these calculations could have a material effect on the results presented in our condensed consolidated statement of income and other comprehensive income. In addition, any differences between estimated forfeitures and actual forfeitures could also have a material impact on our financial statements.

Share-based compensation amounted to \$26,165 and \$0 in the three months ended July 31, 2010 and 2009, respectively and \$42,759 and \$0 in the nine months ended July 31, 2010 and 2009, respectively.

Taxation

Taxation on profits earned in the PRC has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the PRC in which the Company operates after taking into effect the benefits from any special tax credits or “tax holidays” allowed in the country of operations.

The Company accounts for income tax under the provisions of FASB ASC Topic 740, “Income Taxes,” which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of the events that have been included in the financial statements or tax returns. Deferred income taxes are recognized for all significant temporary differences between tax and financial statements bases of assets and liabilities. Valuation allowances are established against net deferred tax assets when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The Company does not have any long-term deferred tax assets or liabilities in China that will exist once the tax holiday expires. The Company does not have any significant deferred tax asset or liabilities that relate to tax jurisdictions not covered by the tax holiday.

The Company does not accrue United States income tax 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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Generally, years beginning after fiscal 2006, the Company is open to examination by PRC taxing authorities. In the United States, we are open to examination from 2006 onward.

#### Enterprise income tax

On March 16, 2007, the PRC National People's Congress passed the PRC Enterprise Income Tax Law ("New EIT Law") which became effective on January 1, 2008. Pursuant to the New EIT Law, a unified enterprise income tax rate of 25 percent and unified tax deduction standards will be applied consistently to both domestic-invested enterprises and foreign-invested enterprises. However, the New EIT Law repealed most of the existing preferential tax rates and tax holidays. A five-year transition period is allowed for enterprises that obtained preferential tax treatment under the prior tax regime. Under the prior tax regime, foreign-invested enterprises were generally subject to a 30 percent federal tax rate plus a 3 percent local tax rate for a total tax rate of 33 percent.

Renhuang China secured preferential tax treatment in the jurisdiction where it conducts its manufacturing activity, where it was granted tax holiday from the local government, for being a new and high-technology enterprise.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and noncurrent based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

A provision has not been made at July 31, 2010 for U.S. or additional foreign withholding taxes on approximately \$48,527,354 of undistributed earnings of foreign subsidiaries because it is the present intention of management to reinvest the undistributed earnings indefinitely in foreign operations. Generally, such earnings become subject to U.S. tax upon the remittance of dividends and under certain other circumstances. It is not practicable to estimate the amount of deferred tax liability on such undistributed earnings.

The Company recognizes that virtually all tax positions in the PRC are not free of some degree of uncertainty due to tax law and policy changes by the State. However, the Company cannot reasonably quantify political risk factors and thus must depend on guidance issued by current State officials.

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of July 31, 2010, is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax benefits as of October 31, 2009, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax law and policy, that the unrecognized tax benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company's results of operations, financial condition or cash flows.



Value added tax

The Provisional Regulations of The People's Republic of China 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.

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Value added tax payable in The People's Republic of China 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.

#### Comprehensive Income

Total comprehensive income is defined as all changes in shareholders' equity during a period, other than those resulting from investments by and distributions to shareholders (i.e., issuance of equity securities and dividends). Generally, for the Company, total comprehensive income equals net income plus or minus adjustments for currency translation. Total comprehensive income represents the activity for a period net of related tax and was \$1,918,129 and \$580,963 for the three months ended July 31, 2010 and 2009, respectively and \$12,538,978 and \$8,960,418 for the nine months ended July 31, 2010 and 2009, respectively.

While total comprehensive income is the activity in a period and is largely driven by net earnings in that period, accumulated other comprehensive income or loss ("AOCI") represents the cumulative balance of other comprehensive income as of the balance sheet date. For the Company, AOCI is primarily the cumulative balance related to the currency adjustments and increased overall equity by \$301,931 as of July 31, 2010 and decreased overall equity by \$79,568 as of July 31, 2009.

#### Earnings per share

Basic net earnings per common stock is computed by dividing net earnings applicable to common shareholders by the weighted-average number of common stock outstanding during the period. Diluted net earnings per common stock is determined using the weighted-average number of common stock outstanding during the period, adjusted for the dilutive effect of common stock equivalents, using the treasury stock method, consisting of shares that might be issued upon exercise of common stock warrants. In periods where losses are reported, the weighted-average number of common stock outstanding excludes common stock equivalents, because their inclusion would be anti-dilutive.

Basic earnings per share is based on the weighted-average number of shares of common stock outstanding. Earnings per share, assuming dilution, is based on the weighted-average number of shares of common stock outstanding adjusted for the effects of common stock that may be issued as a result of the following types of potentially dilutive instruments:

- warrants,
- employee stock options, and
- other equity awards, which include long-term incentive awards.

The FASB Topic ASC 260, "Earnings per Share," requires the Company to include additional shares in the computation of earnings per share, assuming dilution. The additional shares included in diluted earnings per share represent the number of shares that would be issued if all of the Company's outstanding dilutive instruments were converted into common stock.



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Diluted earnings per share are based on the assumption that all dilutive options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options are assumed to be exercised at the time of issuance, and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

#### Warrants

The Company evaluates its warrants on an ongoing basis considering the accounting guidance of FASB Topic ASC 825, which establishes standards for issuers of financial instruments with characteristics of both liabilities and equity related to the classification and measurement of those instruments. The warrants are evaluated considering the accounting guidance of FASB Topic ASC 815, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities.

#### Freestanding financial instruments with characteristics of both liabilities and equity

In accordance with accounting guidance FASB Topic ASC 825, the Company accounts for financial instruments as a liability if it embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and that requires or may require the issuer to settle the obligation by transferring assets. Freestanding financial instruments are financial instruments that are entered into separately and apart from any of the entity's other financial instruments or equity transactions, or that is entered into in conjunction with some other transaction and is legally detachable and separately exercisable. The liability recorded is the per share price to be paid and is offset to equity. As of July 31, 2010 and October 31, 2009, there were no financial instruments recorded as liability.

### 3. ACCOUNTING PRONOUNCEMENTS

Accounting Standards Update ("ASU") ASU No. 2010-09 (ASC Topic 855), which amends Subsequent Events Recognition and Disclosures, ASU No. 2009-16 (ASC Topic 860), which amends Accounting for Transfer of Financial Assets, ASU No. 2009-05 (ASC Topic 820), which amends Fair Value Measurements and Disclosures - Overall, ASU No. 2009-08, Earnings per Share, ASU No. 2009-12 (ASC Topic 820), Investments in Certain Entities That Calculate Net Asset Value per Share, and various other ASU's No. 2009-2 through ASU No. 2010-19 which contain technical corrections to existing guidance or affect guidance to specialized industries or entities were recently issued. These updates have no current applicability to the Company, or their effect on the financial statements would not have been significant.

In April 2010, the FASB issued Accounting Standards Update, 2010-17, Revenue Recognition—Milestone Method (Topic 605): "Milestone Method of Revenue Recognition—a consensus of the FASB Emerging Issues Task Force." This is an update regarding the milestone method of revenue recognition. The scope of this update is limited to arrangements that include milestones relating to research or development deliverables. The update specifies criteria that must be met for a vendor to recognize consideration that is contingent upon achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. The criteria apply to milestones in arrangements within the scope of this update regardless of whether the arrangement is determined to have single or multiple deliverables or units of accounting. The update will be effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early application is permitted. Companies can apply this guidance prospectively to milestones achieved after adoption. However, retrospective application to all prior periods is also permitted. This update is not expected to have a material impact on the Company's financial statements.



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In March 2010, the FASB issued Accounting Standards Update, 2010-13, Compensation—Stock Compensation (Topic 718): “Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades—a consensus of the FASB Emerging Issues Task Force.” This is an update regarding the effect of denominating the exercise price of a share-based payment awards in the currency of the market in which the underlying equity securities trades and that currency is different from (1) entity’s functional currency, (2) functional currency of the foreign operation for which the employee provides services, and (3) payroll currency of the employee. The update clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity’s equity securities trades should be considered an equity award assuming all other criteria for equity classification are met. The update will be effective for interim and annual periods beginning on or after December 15, 2010, and will be applied prospectively. Affected entities will be required to record a cumulative catch-up adjustment for all awards outstanding as of the beginning of the annual period in which the guidance is adopted. This update is not expected to have a material impact on the Company’s financial statements.

In March, 2010, the FASB issued Accounting Standards Update, 2010-11, Derivatives and Hedging (Topic 815): “Scope Exception Related to Embedded Credit Derivatives.” This update clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements. Specifically, only one form of embedded credit derivative qualifies for the exemption – one that is related only to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. This update also has transition provisions, which permit entities to make a special one-time election to apply the fair value option to any investment in a beneficial interest in securitized financial assets, regardless of whether such investments contain embedded derivative features. This update is effective on the first day of the first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of any fiscal quarter beginning after March 5, 2010. This update is not expected to have a material impact on the Company’s financial statements

In January 2010, the FASB issued Accounting Standards Update, 2010-06, Fair Value Measurements and Disclosures (Topic 820): “Improving Disclosures about Fair Value Measurements.” This update provides guidance to improve disclosures about fair value measurements. This guidance amends previous guidance on fair value measurements to add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurement on a gross basis rather than on a net basis as currently required. This update also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This guidance is effective for annual and interim periods beginning after December 15, 2009, except for the requirement to provide the Level 3 activities of purchases, sales, issuances, and settlements on a gross basis, which will be effective for annual and interim periods beginning after December 15, 2010. Early application is permitted and, in the period of initial adoption, entities are not required to provide the amended disclosures for any previous periods presented for comparative purposes. The adoption of this update did not have a significant impact on the Company’s financial statements.

In October 2009, the FASB issued Accounting Standards Update, 2009-13, Revenue Recognition (Topic 605): “Multiple Deliverable Revenue Arrangements – A Consensus of the FASB Emerging Issues Task Force.” This update provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not

available, or estimated selling price if neither vendor-specific or third-party evidence is available. The Company will be required to apply this guidance prospectively for revenue arrangements entered into or materially modified after January 1, 2011; however, earlier application is permitted. The Company has not determined the impact that this update may have on its financial statements.

In June 2009, the FASB issued guidance related to accounting for transfers of financial assets. This guidance improves the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance and cash flows; and a continuing interest in transferred financial assets. In addition, this guidance amends various ASC concepts with respect to accounting for transfers and servicing of financial assets and extinguishments of liabilities, including removing the concept of qualified special purpose entities. This guidance must be applied to transfers occurring on or after the effective date. On February 1, 2010, the Company adopted this guidance. The adoption of this guidance did not have a material impact on the Company's financial statements.

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In June 2009, the FASB issued guidance which amends certain ASC concepts related to consolidation of variable interest entities. Among other accounting and disclosure requirements, this guidance replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. On February 1, 2010, the Company adopted this guidance. The adoption of this guidance did not have a material impact on the Company's financial statements.

#### 4. CONCENTRATIONS OF BUSINESS AND CREDIT RISK

The Company conducts all of its primary trade in the PRC. There can be no assurance that the Company will be able to successfully conduct its trade, and failure to do so would have a material adverse effect on the Company's financial position, results of operations and cash flows. Also, the success of the Company's operations is subject to numerous contingencies, some of which are beyond management's control. These contingencies include general economic conditions, price of raw material, competition, governmental and political conditions, and changes in regulations. Because the Company is dependent on foreign trade in the PRC, the Company is subject to various additional political, economic and other uncertainties. Among other risks, the Company's operations will be subject to risk of restrictions on transfer of funds, domestic and international customs, changing taxation policies, foreign exchange restrictions, and political and governmental regulations.

##### (1) Cash and cash equivalents

The Company maintains certain bank accounts in the PRC which are not protected by FDIC insurance or other insurance. Cash balance held in PRC bank accounts to \$28,749,480 and \$8,111,514, as of July 31, 2010 and October 31, 2009, respectively. No cash balances were restricted as at July 31, 2010 and October 31, 2009.

As of July 31, 2010 and October 31, 2009, substantially all of the Company's cash and cash equivalents were held by major financial institutions located in the PRC which management believes are of high credit quality.

##### (2) Sales and trade receivables

The Company provides credit in the normal course of business and substantially all customers are located in the PRC. 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. Three individual customers accounted for 10%-12% of net revenues during the three and nine months ended July 31, 2010 and 2009.

The Company's products are sold throughout the PRC. For three months ended July 31, 2010 and 2009, Siberian Ginseng (Acanthopanax) Series accounted for 43% and 55.3%, respectively, of total sales. For nine months ended July 31, 2010 and 2009, Siberian Ginseng (Acanthopanax) Series accounted for 44% and 54.3%, respectively, of total sales.

##### (3) Foreign currency



The Company operates in China, which may give rise to significant foreign currency risks from fluctuations and the degree of volatility of foreign exchange rates between U.S. dollars and the Chinese currency RMB.

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## (4) Dividends

Payments of dividends may be subject to some restrictions due to the fact that the operating activities are conducted in a subsidiary residing in the PRC.

## (5) Price control

The retail prices of certain pharmaceuticals sold in China, primarily those included in the national and provincial Medical Insurance Catalogs are subject to price controls in the form of fixed prices or price ceilings. As such, the retail prices for certain of the Company's pharmaceutical products can be adjusted downward or upward from time to time. Price controls did not have a material impact on the Company's operation in the three and nine months ended July 31, 2010 and 2009.

## (6) Cost of goods sold

Cost of goods sold is subject to price fluctuations due to various factors beyond the Company's control, including, among other pertinent factors, inflation and changes in governmental regulations and programs. The Company expects cost of goods sold will continue to fluctuate and be affected by inflation in the future. The Company's raw materials are purchased from various independent suppliers, and do not rely on any one supplier.

## 5. INCOME TAXES

Taxation on profits earned in the PRC has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the PRC in which the Company operates after taking into effect the benefits from any special tax credits or "tax holidays" allowed in the country of operations. If the Company did not have tax holiday, the effects of the tax per share were as follows:

	Three months ended		Nine months ended	
	July 31,		July 31,	
	2010	2009	2010	2009
	US\$	US\$	US\$	US\$
Tax savings	364,077	168,676	3,059,262	2,259,997
Benefit per share:				
Basic	0.01	0.01	0.08	0.06
Diluted	0.01	0.01	0.08	0.06

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Had the tax exemption not been in place for the three and nine months ended July 31, 2010 and 2009, the Company estimates the following proforma financial statement impact:

	Three months ended July 31,		Nine months ended July 31,	
	2010 US\$	2009 US\$	2010 US\$	2009 US\$
Net income before tax provision, as reported	1,456,309	674,702	12,237,047	9,039,986
Less Tax savings	(364,077)	(168,676)	(3,059,262)	(2,259,997)
Proforma Net income	1,092,232	506,026	9,177,785	6,779,989
Proforma Net income per share:				
Basic	0.03	0.01	0.25	0.19
Diluted	0.03	0.01	0.24	0.19

#### 6. EARNINGS PER SHARE

When calculating diluted earnings per share for common stock equivalents, the Earnings Per Share Topic, ASC 260, requires the Company to include the potential shares that would be outstanding if all outstanding stock options or warrants were exercised. This is offset by shares the Company could repurchase using the proceeds from these hypothetical exercises to obtain the common stock equivalent.

The following reconciles the components of the EPS computation:

	Income (Numerator) US\$	Shares (Denominator)	Per Share Amount US\$
For the three months ended July 31, 2010:			
Net income	1,456,309		
Basic EPS income available to common shareholders	1,456,309	37,239,536	0.04
Effect of dilutive securities:			
Share options		26,392	
Warrants	-	635,161	
Diluted EPS income available to common shareholders	1,456,309	37,901,089	0.04
For the three months ended July 31, 2009:			
Net income	674,702		
Basic EPS income available to common shareholders	674,702	36,796,990	0.02
Effect of dilutive securities:			
Share options	-	-	
Warrants	-	-	
Diluted EPS income available to common shareholders	674,702	36,796,990	0.02

For the three months ended July 31, 2010, 70,000 share options were excluded from the calculation of diluted earnings per share because the exercise price exceeded the average price of the Company's common stock.

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For the three months ended July 31, 2009, there were no securities or other contracts to issue common stock that need to be considered in the diluted earnings per share calculation.

	Income (Numerator) US\$	Shares (Denominator)	Per Share Amount US\$
<b>For the nine months ended July 31, 2010:</b>			
Net income	12,237,047		
Basic EPS income available to common shareholders	12,237,047	37,239,536	0.33
Effect of dilutive securities:			
Share options		21,416	
Warrants	-	532,418	
Diluted EPS income available to common shareholders	12,237,047	37,793,370	0.32
<b>For the nine months ended July 31, 2009:</b>			
Net income	9,039,986		
Basic EPS income available to common shareholders	9,039,986	35,096,680	0.26
Effect of dilutive securities:			
Share options	-	-	
Warrants	-	-	
Diluted EPS income available to common shareholders	9,039,986	35,096,680	0.26

For the nine months ended July 31, 2010, 70,000 share options and 160,000 warrants were excluded from the calculation of diluted earnings per share because the exercise price exceeded the average price of the Company's common stock.

For the nine months ended July 31, 2009, there were no securities or other contracts to issue common stock that need to be considered in the diluted earnings per share calculation.

#### 7. TRADE RECEIVABLES, NET

The trade receivables amount included in the condensed consolidated balance sheets as at July 31, 2010 and October 31, 2009 were as follows:

	2010 US\$	2009 US\$
Trade receivables	11,813,603	26,667,816
Less: Sales rebates	(550,217)	(3,020,898)
Less: Allowance for doubtful accounts	(445,562)	(443,508)
Trade receivables, net	10,817,824	23,203,410

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## 8. OTHER RECEIVABLES, NET

The other receivables amount included in the condensed consolidated balance sheets as at July 31, 2010 and October 31, 2009 were as follows:

	2010 US\$	2009 US\$
Other receivables	506,047	462,980
Less: Allowance for doubtful accounts	(362,036)	(360,367)
Other receivables, net	144,011	102,613

## 9. INVENTORY, NET

The inventory amounts included in the condensed consolidated balance sheets for as at July 31, 2010 and October 31, 2009 comprised of:

	2010 US\$	2009 US\$
Raw materials	1,657,063	1,530,283
Work-in-progress	1,162,093	1,006,984
Finished goods	818,724	550,982
Less: Inventory reserves	(64,531)	(64,233)
Inventory, net	3,573,349	3,024,016

## 10. PROPERTY AND EQUIPMENT, NET

Property and equipment and related accumulated depreciation as of July 31, 2010 and October 31, 2009 were as follows:

	2010 US\$	2009 US\$
Machinery and equipment	3,435,421	3,435,421
Office equipment and furnishings	54,505	53,086
Motor vehicles	53,332	54,749
	3,543,257	3,543,256
Less: Accumulated depreciation	(1,452,665)	(1,191,093)
Net book value	2,090,592	2,352,163

Depreciation expense for the three months ended July 31, 2010 and 2009 was \$80,496 and \$88,335, respectively, of which \$76,622 and \$84,552 were included as a component of cost of goods sold in the respective periods.

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Depreciation expense for the nine months ended July 31, 2010 and 2009 was \$261,572 and \$265,559, respectively, of which \$249,996 and \$254,396 were included as a component of cost of goods sold in the respective periods.

No assets were pledged for borrowings as at July 31, 2010 and October 31, 2009.

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11. RELATED PARTY TRANSACTIONS

Due from related parties included in the condensed consolidated balance sheets as at July 31, 2010 and October 31, 2009 comprised of:

	2010 US\$	2009 US\$
Due from related parties:		
Advances (1)	-	130,199
Deposits (2)	20,169,666	16,137,000
<b>Total</b>	<b>20,169,666</b>	<b>16,267,199</b>

(1) Advances

Mr. Li Shaoming, our chairman, chief executive officer and president, is also chairman and a 50% shareholder of Harbin Renhuang Pharmaceutical Stock Co. Ltd (“Stock Co”).

As of October 31, 2009, the Company has a net amount due from Stock Co, of \$130,199. This amount consists of \$539,130 of repair and maintenance work performed on property and plant leased from Stock Co and paid for on Stock Co’s behalf. This is offset by \$408,931 of professional fees in connection with the acquisition of Harbin Renhuang Pharmaceutical Company Limited in 2006, paid for by Stock Co on the Company’s behalf. During the quarter ended January 31, 2010, the Company received from Stock Co, a cash payment of \$539,130 resulting in a balance of \$408,931 due to Stock Co, which was settled in the quarter ended April 30, 2010.

(2) Deposits

On September 1, 2009, the Company through its wholly own subsidiary, Renhuang China, entered into a Purchase Agreement with Stock Co, to acquire two production patents, for a total consideration of \$2,340,619. Pursuant to the Purchase Agreement, a payment of \$1,467,000 was made to Stock Co, in October 2009 and \$1,473,796 and \$1,467,000 was recorded as deposits on the condensed consolidated balance sheet as at July 31, 2010 and October 31, 2009, respectively. Pursuant to the Purchase Agreement, final payment of \$877,732 is due by December 31, 2010, at which time title for the assets will be transferred. Accordingly the transaction is considered incomplete as at July 31, 2010.

On October 12, 2009, the Company through its wholly own subsidiary, Renhuang China, entered into a Purchase Agreement with Stock Co, to acquire the land use right, property and plant, for a total consideration of \$23,406,185. Pursuant to the Purchase Agreement, a payment of \$14,670,000 was made to Stock Co, in October 2009 and \$14,737,959 and \$14,670,000 was recorded as deposits on the condensed consolidated balance sheet as at July 31, 2010 and October 31, 2009, respectively. Pursuant to the Purchase Agreement, final payment of \$8,777,319 is due by December 31, 2011, at which time title for the assets will be transferred. Accordingly the transaction is considered incomplete as at July 31, 2010.

On April 10, 2010, the Company through its wholly own subsidiary, Renhuang China, entered into a Purchase Agreement with Hongxiangmingyuan of Heilongjiang Yongtai Company, to acquire two office floors for a total consideration of \$5,612,306. Pursuant to the Purchase Agreement, a payment of \$3,957,911 was made in April 2010



and recorded as deposits on the condensed consolidated balance sheet. Pursuant to the Purchase Agreement, final payment of \$1,683,692 is due by December 20, 2012, at which time title for the assets will be transferred. Accordingly the transaction is considered incomplete as at July 31, 2010.

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## (3) Related party transactions

The Company leases property and plant from Stock Co. Rental expenses related to this lease, incurred and expensed to condensed consolidated statements of operations and comprehensive income during the three months ended July 31, 2010 and 2009 amounted to \$153,738 and \$153,600, respectively, during the nine months ended July 31, 2010 and 2009 amounted to \$461,214 and \$460,800, respectively.

During the three and nine months ended July 31, 2010 and 2009, the Company sold goods in the amount of \$0 and \$374,301, respectively, to Heilongjiang Renhuang Pharmaceutical Limited, a company where Mr. Li Shaoming is a major shareholder.

## 12. EMPLOYEE BENEFITS

The full-time employees of the Company's subsidiary that is incorporated in the PRC are entitled to staff welfare benefits, including medical care, welfare subsidies, unemployment insurance and pension benefits. The PRC companies are required to accrue for these benefits based on certain percentages of the employees' salaries in accordance with the relevant regulations, and to make contributions to the state-sponsored pension and medical plans out of the amounts accrued for medical and pension benefits. The total amounts expensed to the condensed consolidated statements of operations and comprehensive income for such employee benefits amounted to approximately \$84,783 and \$92,946 for the three months ended July 31, 2010 and 2009, respectively and \$289,118 and \$293,437 for the nine months ended July 30, 2010 and 2009, respectively. The PRC government is responsible for the medical benefits and ultimate pension liability to these employees.

## 13. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

At July 31, 2010, the Company had no assets measured at fair value and the following liabilities measured at fair value:

	Fair value measurement		
	Quoted prices in active markets of identical assets (Level 1) US\$	Significant other observable inputs (Level 2) US\$	Significant unobservable inputs (Level 3) US\$
Warrants liability	-	342,770	

At October 31, 2009, the Company had no assets and liabilities measured at fair value.

## 14. PREFERRED STOCK, COMMON STOCK AND EQUITY TRANSACTIONS

## (1) Preferred Stock

The Company's articles of incorporation provide that our board of directors will be authorized to issue from time to time, without further stockholder approval, up to 1,000,000 additional shares of preferred stock in one or more series and to fix or alter the designations, preferences, rights and any qualifications, limitations or restrictions of the shares of each series, including the dividend rights, dividend rates, conversion rights, voting rights, rights of redemption, including sinking fund provisions, redemption price or prices, liquidation preferences and the number of shares constituting any series or designations of any series. Such shares of preferred stock could have preferences over our common stock with respect to dividends and liquidation rights. As at July 31, 2010 and October 31, 2009, there is no preferred stock outstanding.

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## (2) Common Stock and Equity Transactions

During the three and nine months ended July 31, 2010, the Company recorded \$11,882 and \$25,815, respectively, of share-based compensation expense in connection with an option to purchase 50,000 shares valued at \$47,527 granted to an employee on January 13, 2010.

During the three and nine months ended July 31, 2010, the Company recorded \$14,283 and \$16,944 of share-based compensation expense in connection with an option to purchase 70,000 shares valued at \$171,397 granted to an independent director on April 13, 2010.

## 15. OPTION PLAN AND WARRANTS

## (1) 2003 Omnibus Plan

On February 28, 2003, our board of directors approved the Renhuang Pharmaceuticals, Inc. 2003 Omnibus Securities Plan (the "2003 Plan"), which was approved by our shareholders on April 11, 2003. The 2003 Plan offers selected employees, directors, and consultants an opportunity to acquire our common stock, and serves to encourage such persons to remain employed by us and to attract new employees. The 2003 Plan allows for the award of stock and options, up to 25,000 (after giving effect to the 1-for-30 reverse stock split in 2006) shares of our common stock. On May 1, of each year, the number of shares in the 2003 Securities Plan is automatically adjusted to an amount equal to ten percent of our outstanding stock on July 31, of the immediately preceding year. As of July 31, 2010, the number of shares of common stock outstanding was 37,239,536 making 3,723,954 shares of common stock subject to the 2003 Plan.

On April 13, 2010, an option to purchase 70,000 shares was granted under the 2003 Plan to an independent director that vests on a quarterly basis beginning three months from the date of grant, conditioned upon continued service on such quarterly dates, and has a contractual life of 3 years. The fair value of the option award is estimated on the date of grant using the Black-Scholes option valuation model to be \$171,397, of which \$14,283 and \$16,944 was recorded as compensation expense in the three and nine months ended July 31, 2010. The valuation was based on the assumptions noted in the following table.

Expected volatility	227.9%
Expected dividends	0%
Expected term (in years)	3 years
Risk-free rate	1.65%

The risk-free interest rate is based on the U.S. Treasury yield curve in effect for the expected term of the option at the time of grant. The dividend yield on our common stock is assumed to be zero since we do not pay dividends and have no current plans to pay them in the future. The market price volatility of our common stock was based on historical volatility since April 13, 2009. Our methodology is consistent with prior period volatility assumptions. The expected life of the options is based upon our anticipated expectations of exercise behavior since no options have been exercised in the past to provide relevant historical data.

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## (2) 2007 Non-Qualified Company Stock Grant and Option Plan

On March 19, 2007, our board of directors approved the 2007 Non-Qualified Company Stock Grant and Option Plan (the "2007 Plan"). The 2007 Plan is intended to serve as an incentive to and to encourage stock ownership by our directors, officers, and employees, and certain persons rendering service to us, so that such persons may acquire or increase their proprietary interest in our success, and to encourage them to remain in our service. Under the 2007, up to 200,000 shares of our common stock may be subject to options.

On January 13, 2010, an option to purchase 50,000 shares was granted under the 2007 Plan to an employee that vests on the 12-month anniversary of the date of grant, conditioned upon continued employment on such date, and has a contractual life of 3 years. The fair value of the option award is estimated on the date of grant using the Black-Scholes option valuation model to be \$47,527, of which \$11,882 and \$25,815 was recorded as compensation expense in the three and nine months ended July 31, 2010, respectively. The valuation was based on the assumptions noted in the following table.

Expected volatility	236.5%
Expected dividends	0%
Expected term (in years)	3 years
Risk-free rate	1.5%

The risk-free interest rate is based on the U.S. Treasury yield curve in effect for the expected term of the option at the time of grant. The dividend yield on our common stock is assumed to be zero since we do not pay dividends and have no current plans to pay them in the future. The market price volatility of our common stock was based on historical volatility since January 13, 2009. Our methodology is consistent with prior period volatility assumptions. The expected life of the options is based upon our anticipated expectations of exercise behavior since no options have been exercised in the past to provide relevant historical data.

A summary of option activity under the Company's option plan as of July 31, 2010 and movement during the nine months then ended are as follow:

	Options	Weighted average exercise price US\$	Aggregate intrinsic value US\$	Weighted average remaining contractual term
Outstanding at November 1, 2009	-	-	-	-
Granted	120,000	1.92	16,100	2.60
Exercised	-	-	-	-
Forfeited or expired	-	-	-	-
Outstanding at July 31, 2010	120,000	1.92	16,100	2.60

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A summary of the status of the Company's non-vested options as of July 31, 2010 and movements during the nine months then ended are as follow:

	Options	Weighted average granted date fair value US\$
Non-vested at November 1, 2009	-	-
Granted	120,000	1.91
Vested	-	-
Forfeited or expired	-	-
Non-vested at July 31, 2010	120,000	1.91

As of July 31, 2010, there was \$202,330 of unrecognized compensation cost related to non-vested share-based compensation granted under the Company's option plan. The cost is expected to be recognized over a period of 2.96 years.

### (3) Warrants

As of July 31, 2010, the Company has 1,231,428 warrants outstanding at an average exercise price of \$1.25 per warrant for one share each of the Company's common stock. The warrants expire in 2012 and 2013.

	Warrants	Average exercise price US\$
Outstanding warrants at November 1, 2009	1,071,428	0.88
Warrants granted	160,000	2.00
Exercised	-	-
Expired/cancelled	-	-
Outstanding warrants at July 31, 2010	1,231,428	1.25

Information regarding the warrants outstanding at July 31, 2010 is summarized as below:

Exercise Prices US\$	Warrants Outstanding	Warrants outstanding at July 31, 2010	
		Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price US\$
0.88	1,071,428		
2.00	160,000		
	1,231,428	1.91	1.02



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16. STATUTORY RESERVES

The reserve funds as of July 31, 2010 and October 31, 2009 were comprised of the following:

	2010 US\$	2009 US\$
Statutory surplus reserve	3,090,320	3,090,320
Public welfare fund	282,377	282,377
<b>Total</b>	<b>3,372,697</b>	<b>3,372,697</b>

(1) Statutory reserves

Pursuant to the relevant laws and regulations of the PRC, the Company is required to annually transfer 10% of its after tax profit as reported on financial statements prepared under the accounting principles of the PRC to a statutory surplus reserve fund until the balance reaches 50% of the registered share capital. This reserve can be used to make up any losses incurred or to increase share capital. Except for reducing losses incurred, any other application may not result in this reserve balance falling below 25% of the registered capital.

(2) Public welfare funds

Prior to January 1, 2007, the Company was required each year to transfer 5% of its after tax profit as reported on consolidated financial statements prepared under the accounting principles of the PRC to the public welfare funds. This reserve was restricted to capital expenditure for employees' collective welfare facilities that are owned by the Company. The public welfare funds are not available for distribution to the stockholders (except in liquidation). Once capital expenditures for staff welfare facilities have been made, an equivalent amount must be transferred from the public welfare funds to the discretionary common reserve funds. Due to a change in PRC law, appropriation of profit to the public welfare funds is no longer required.

17. COMMITMENTS AND CONTINGENCIES

The Company has various purchase commitments for materials, supplies and services incident to the ordinary conduct of business, generally for quantities required for the Company's business and at prevailing market prices. No material annual loss is expected from these commitments and there are no minimum purchase commitments.

The Company and its subsidiaries are self-insured, and they do not carry any property insurance, general liability insurance, or any other insurance that covers the risks of their business operations. As a result any material loss or damage to its properties or other assets, or personal injuries arising from its business operations would have a material adverse effect on the Company's financial condition and operations.

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





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(1) Operating lease arrangements

The Company leases office premise from a third party, Heilongjiang Jiusanyouzhi Co., Ltd. The lease is from May 1, 2007 to April 30, 2010, with monthly rental payment of \$10,484.

The Company also leases property and plant from a related party, Harbin Renhuang Pharmaceutical Stock Co. Ltd. The lease is from April 30, 2009 to May 1, 2010, with monthly rental payment of \$51,246.

As of July 31, 2010, there is no minimum lease payment in future years.

During the three months ended July 31, 2010 and 2009, the Company incurred rental expenses in the amount of \$186,301 and \$153,659, respectively.

During the nine months ended July 31, 2010 and 2009, the Company incurred rental expenses in the amount of \$366,977 and \$374,416, respectively.

(2) Capital commitments

As of July 31, 2010, the Company has capital commitments for purchase of land use right, property and equipment, office floors and production patents of approximately \$11,338,743.

18. SUBSEQUENT EVENT

In May 2009, the FASB issued accounting guidance now codified as FASB ASC Topic 855, "Subsequent Events," which establishes general standards of accounting for, and disclosures of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. FASB ASC Topic 855 is effective for interim or fiscal periods ending after June 15, 2009.

Management has evaluated subsequent events from July 31, 2010 to September 17, 2010, the date which the Company's condensed consolidated financial statements have been issued and were available to be issued. As of August 3, 2010, Ms. Yan Yi Chen, the Company's Chief Financial Officer, resigned for personal reasons. Subsequent events that may occur after September 17, 2010 have not been evaluated in the condensed consolidated financial statements as of July 31, 2010.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and related notes appearing elsewhere in this Quarterly Report. In addition to historical financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Quarterly Report. See also Risk Factors contained in our Form 10-K for the year ended October 31, 2009.

### Overview

We are a high-tech enterprise engaged in the development, manufacturing, and distribution of botanical products, bio-pharmaceutical products, and traditional Chinese medicines, or TCM, in the People's Republic of China. We have three 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 OTC Chinese medicines. Botanical anti-depression and nerve-regulation products account for over 50% of our revenues and we intend to strengthen our developments in this area. We have entered into sales agency agreements with sales agents in 19 provinces and four municipalities, through which our products are sold to over 3,000 distributors and over 70 sales centers across 24 provinces in China.

### Factors Affecting our Results of Operations

Our operating results are primarily affected by the following factors

- **Pharmaceutical Industry Growth.** We believe the market for pharmaceutical products in China is growing rapidly driven by China's economic growth, increased pharmaceutical expenditure, an aging population, increased lifestyle-related diseases, government support of the pharmaceutical industry, as well as the increased availability of funding for medical insurance in China. In particular, in January 2009, the PRC's State Council passed a far-reaching medical reform plan ("Health Reform") to help provide universal primary medical insurance coverage and increased access to medical facilities to a greater majority of its citizens. We expect these factors to continue to drive industry growth.
- **Production Capacity.** We believe much of the pharmaceutical market in China is still underserved, particularly with respect to treatment of depression, melancholy and nerve regulation. In 2009 the demand for our products that treat depression, melancholy and regulate nerves, increased and we were able to increase our production of such products to capture much of this growth. We believe our facilities with the ability to manufacture 18 dosage forms and over 200 products will allow us to capture future market growth and increase our revenue and market share accordingly.
- **Perceptions of Product Quality.** We believe that rising health concerns in China have contributed to a greater demand for health-care products with perceived health benefits. We believe many consumers in China tend to prefer natural health care products with, we believe, limited side effects. Accordingly, we believe our reputation for quality and leadership position in a number of our products allow our products to command a higher average selling price and generate higher gross margins than our competitors.
- **Raw Material Supply and Prices.** The per unit costs of producing our products are subject to the supply and price volatility of raw materials, which are affected by various market factors such as market demands, fluctuations in

production and competition.

- Expenses Associated with Research and Development. In order to enhance our existing products and develop new products for the market, we have devoted significant resources to R&D.

- **Expenses Associated with Sales and Marketing.** In order to promote our product brand and gain greater market awareness, we have devoted significant resources to sales and marketing, in particular advertising activities.
- **Pricing of Our Products.** Seven of our products, which accounted for 36% of our total revenues in fiscal year 2009, are subject to government pricing control. We do not believe pricing control will influence our sales significantly and expect that the health care reform will help increase our sales.
- **Demand for Our Products.** We expect the market demand for our botanic anti-depression and nerve-regulation products will increase along with the growth of the general market for such products.

## Results of Operations

Three-Month Period Ended July 31, 2010 Compared to Three-Month Period Ended July 31, 2009

The following table sets forth certain information regarding our results of operation.

	Three Months Ended July 31	
	2010	2009
	(\$ in thousands)	
<b>Statements of Operations Data</b>		
Sales, net	9,264	6,442
Cost of goods sold	4,621	2,942
Gross profit	4,643	3,500
<b>Operating and administrative expenses</b>		
Sales and marketing	1,285	1,110
General and administrative	395	500
Research and development	1,529	1,227
Other income	22	12
Income from operation before income tax expenses	1,456	675
Income tax expenses	-	-
Net income	1,456	675
<b>Other comprehensive income:</b>		
Cumulative currency translation adjustments	462	(94)
<b>Total comprehensive income</b>	<b>1,918</b>	<b>581</b>

## Total Comprehensive Income

Total comprehensive income increased by approximately \$1,337 thousand, or 230.1%, from approximately \$581 thousand in 2009 to approximately \$1,918 thousand in 2010. This increase was mainly attributable to the increased sale of our Botanical antibiotic products, Banlangen Granules and Compound Honeysuckle Granules that were introduced to the market in the last quarter of 2009 and an increase in average selling prices across our products. Our gross profit margin decreased from 54.3% in 2009 to 50.1% in 2010, as a result of reduced sales rebates and price increases of a number of our products.

## Sales

Our sales consist primarily of revenues generated from sales of Botanical anti-depression and nerve-regulation products, Biopharmaceutical products and Botanical antibiotics and traditional OTC Chinese medicines. Sales increased by approximately \$2,822 thousand, or 43.8%, from approximately \$6,442 thousand in 2009 to approximately \$9,264 thousand in 2010. This increase in sales was primarily attributable to strong demands for our Botanical antibiotic products, Banlangen Granules and Compound Honeysuckle Granules that were introduced to the

market in the last quarter of 2009, in addition to an increase in average selling prices across our products.

We provide incentive sales rebates to our sales agents. The rebate rate, which is determined on a product basis, averaged 11% and 21% of sales for the three months ended July 31, 2010 and 2009, respectively. Sales rebates are netted against total sales. For the three months ended July 31, 2010 and 2009, the Company has deducted sales rebates in the amount of \$1,018,359 and \$1,361,965, respectively, from sales. Sales rebates are calculated based on terms specified in contracts with individual distributors. In addition, the Company is using different sales channels and relying less on the use of sales agents.

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The following table sets forth information regarding the sales of our principal products before sales rebate during the three months ended July 31, 2010 and 2009:

Product name	2010			2009			2010 over 2009		
	Quantity (Pack'000)	Amount (\$'000)	% of Sales	Quantity (Pack'000)	Amount (\$'000)	% of Sales	Quantity (Pack'000)	Amount (\$'000)	% of Sales
Siberian Ginseng (Acanthopanax) Series	53	4,439	43.9	67	4,333	55.3	(14)	106	2.4
Tianma Series	9	763	7.5	10	754	9.6	(1)	9	1.2
Compound Yangjiao Tablets	13	1,352	13.4	17	1,322	16.9	(4)	30	2.3
Shark Vital Capsules	1	235	2.3	2	759	9.7	(1)	(524)	(69)
Shengmai Granules	16	677	6.7	18	663	8.5	(2)	14	2.1
Banlangen Granules	9	290	2.9	-	-	-	9	290	100
Compound Honeysuckle Granules	39	2,350	23.3	-	-	-	39	2,350	100
Total	140	10,106	100.0	114	7,831	100.0			

We experienced a slight decrease in the demand of a number of our products mainly from reduced order volumes as the effect of the Health Reform filters through the chain drug stores. The chain drug stores reacting to the potential competition that the Health Reform may bring are being cautious and maintaining lower than usual stock levels. As the PRC government moves forward with the Health Reform, hospitals, health clinics and institutions will be established in villages, remote regions and under-developed cities, creating additional channels for the rural population to purchase drugs aside from the chain drug stores. We expect the Health Reform, when fully in place, will greatly improve the rural population's access to healthcare, and therefore increase the demand for our products. We have established Medical Reform Sales Department as a dedicated resource focused on capturing this tremendous growth opportunity.

This quarter ended July 31, 2010, we introduced two new products to the market, Qing Re Jie Du Oral Liquid, which detoxified and removing heat from intestines, and Compound Schisandra Tablets, also known as magnolia vine, has been clinically proven to have significant benefits to the functioning and regulation of the central nervous system and for upper body respiration.

In the last quarter of 2009, we introduced two new products to the market, Banlangen Granules and Compound Honeysuckle Granules, both of which have well accepted anti-viral qualities, and were in great demand during and post the H1N1 pandemic and the winter season.

In 2010, we experienced an increase in the average sales price per pack of our products, as demonstrated in the table below:

2010                      2009

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Sales revenues (in thousands)	\$	10,106	\$	7,831
Total sales quantity (pack in thousands)		140		114
Average selling prices/pack (in thousands)	\$	72.19	\$	68.69

The increase in average sales price per pack, as reflected in the table, is primarily attributable to a change in sale mix, with more products with lower average price per pack sold, namely Banlangen Granules and Compound Honeysuckle Granules. Overall, the average price of individual products sold in both 2010 and 2009 increased as demonstrated in the following table, which reflects the average sales price per pack by product for 2010 and 2009 and the percentage change in the sales price per pack.



Product	Average Price Per Pack		Percentage Change
	2010	2009	
Siberian Ginseng (Acanthopanax) Series	\$ 83.75	\$ 64.67	29.5
Tianma Series	84.78	75.40	12.4
Compound Yangjiao Tablets	104.00	77.76	33.74
Shark Vital Capsules	235.00	379.50	(38.08)
Shengmai Granules	42.31	36.83	14.9
Banlangen Granules	32.22	-	100.0
Compound Honeysuckle Granules	60.26	-	100.0

In addition to increasing the price of Shengmai Granules, we recently introduced new dosage forms to our existing Botanical anti-depression and nerve-regulation product category, which contain less sugar content and are suitable for diabetic patient consumption. We were able to demand a higher price for these new dosage forms, namely in our Siberian Ginseng (Acanthopanax) Series and Compound Yangjiao Tablets. We plan to launch our latest product, Badger Oil, a natural medicine for the treatment of burns with no known toxic side effects or allergic reactions in the last quarter of the year. Based on market research, we anticipate positive market acceptance to the new product.

#### Cost of Goods Sold

Our costs of goods sold consist primarily of direct and indirect manufacturing costs, including production overhead costs, and shipping and handling costs for the products sold. Cost of goods sold increased approximately \$1,679 thousand, or 57.1%, from approximately \$2,942 thousand in 2009 to approximately \$4,621 thousand in 2010.

Although we anticipate that the cost of goods will increase due to inflationary price increases, we do not believe that such increases will be material for fiscal year 2010. We anticipate that beyond 2010, our price for raw materials and other production costs will continue to increase due to inflation. If our costs of goods increase, this may have a negative effect on our net income because, due to market conditions and competitive conditions, we may not be able to increase the price for our products in proportion to the increase of our costs of goods sold.

#### Operating and Administrative Expenses

Our total operating expenses increased by approximately \$372 thousand, or 13.1%, from approximately \$2,837 thousand in 2009 to approximately \$3,209 thousand in 2010. This increase was primarily attributable to an increase of approximately \$175 thousand, or 15.8%, in sales and marketing expenses from approximately \$1,110 thousand for 2009 to approximately \$1,285 thousand for 2010, as we continued to invest in our distribution network and increase TV advertising to increase product market share and create greater consumer awareness of our premium quality products. This increase was also attributable to a decrease of approximately \$105 thousand, or 21% in general and administrative expenses from approximately \$500 thousand for 2009 to approximately \$395 thousand for 2010, and an increase of research and development expenses of approximately \$302 thousand, or 24.6% from approximately \$1,227 thousand for 2009 to approximately \$1,529 thousand for 2010. We expect research and development expenses to continue to increase in the coming quarters as our pipeline projects advance and our pipeline size grows.

#### Income from Operations

As a result of the foregoing, our income from operations increased by approximately \$781 thousand, or 115.7%, from approximately \$675 thousand in 2009 to approximately \$1,456 thousand in 2010.

#### Income Tax Expenses

We are subject to U.S. federal and state income taxes. Our subsidiary registered in the PRC is subject to enterprise income taxes. For the fiscal year of 2010 and 2009, our PRC subsidiary was granted a tax holiday and is entitled to full exemption from enterprise income taxes of 25%.



### Cumulative Currency Translation Adjustments

Our principal country of operations is the PRC and our functional currency is the Renminbi, but our reporting currency is the U.S. dollar. All translation adjustments resulting from the translation of our financial statements into U.S. dollars are reported as cumulative currency translation adjustments. Our cumulative currency translation adjustments increased by approximately \$556 thousand, or 591.5%, from approximately negative \$94 thousand in 2009 to approximately \$462 thousand in 2010.

### Nine-Month Period Ended July 31, 2010 Compared to Nine-Month Period Ended July 31, 2009

The following table sets forth certain information regarding our results of operation.

	Nine Months Ended July 31	
	2010	2009
	(\$ in thousands)	
<b>Statements of Operations Data</b>		
Sales, net	38,489	28,915
Cost of goods sold	18,151	13,826
Gross profit	20,338	15,089
<b>Operating and administrative expenses</b>		
Sales and marketing	3,689	2,535
General and administrative	2,209	1,712
Research and development	2,252	1,833
Other income	49	31
Income from operation before income tax expenses	12,237	9,040
Income tax expenses	-	-
Net income	12,237	9,040
<b>Other comprehensive income:</b>		
Cumulative currency translation adjustments	302	(80)
Total comprehensive income	12,539	8,960

### Total Comprehensive Income

Total comprehensive income increased by approximately \$3,579 thousand, or 39.9%, from approximately \$8,960 thousand in 2009 to approximately \$12,539 thousand in 2010. This increase was mainly attributable to the increased sales of our Botanical antibiotic products, Banlangen Granules and Compound Honeysuckle Granules that were introduced to the market in the last quarter of 2009 and an increase in average selling prices across our products. Our gross profit margin increased from 52.2% in 2009 to 52.8% in 2010, as a result of reduced sales rebates and price increases of a number of our products.

### Sales

Our sales consist primarily of revenues generated from sales of Botanical anti-depression and nerve-regulation products, Biopharmaceutical products and Botanical antibiotics and traditional OTC Chinese medicines. Sales increased by approximately \$9,574 thousand, or 33.1%, from approximately \$28,915 thousand in 2009 to approximately \$38,489 thousand in 2010. This increase in sales was primarily attributable to strong demands for our Botanical antibiotic products, Banlangen Granules and Compound Honeysuckle Granules that were introduced to the market in the last quarter of 2009, in addition to an increase in average selling prices across our products.

We provide incentive sales rebates to our sales agents. The rebate rate, which is determined on a product basis, averaged 13% and 23% of sales for the nine months ended July 31, 2010 and 2009, respectively. Sales rebates are netted against total sales. For the nine months ended July 31, 2010 and 2009, the Company has deducted sales rebates in the amount of \$4,923,196 and \$6,545,697, respectively, from sales. Sales rebates are calculated based on terms

specified in contracts with individual distributors. In addition, the Company is using different sales channels and relying less on the use of sales agents.

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The following table sets forth information regarding the sales of our principal products before sales rebate during the nine months ended July 31, 2010 and 2009:

Product name	2010			2009			2010 over 2009		
	Quantity (Pack'000)	Amount (\$'000)	% of Sales	Quantity (Pack'000)	Amount (\$'000)	% of Sales	Quantity (Pack'000)	Amount (\$'000)	% of Sales
Siberian Ginseng (Acanthopanax) Series	236	19,121	44.3	296	19,272	54.3	(60)	(151)	(0.8)
Tianma Series	46	3,553	8.2	47	3,509	9.9	(1)	44	1.3
Compound Yangjiao Tablets	59	5,528	12.8	65	5,175	14.6	(6)	353	6.8
Shark Vital Capsules	4	1,973	4.6	10	4,814	13.6	(6)	(2,841)	(59.0)
Shengmai Granules	68	2,772	6.4	79	2,692	7.6	(11)	80	3.0
Banlangen Granules	45	1,230	2.8	-	-	-	45	1,230	100.0
Compound Honeysuckle Granules	152	9,028	20.9	-	-	-	152	9,028	100.0
Total	610	43,205	100.0	497	35,462	100.0			

In the first quarter of 2010, we increased the price of a number of our products namely, Siberian Ginseng (Acanthopanax) Series and Shengmai Granules, which has led to a temporary softening in demand for these products as a result of the price increases. Although sales declined slightly in these product categories in the first quarter, we show volume rebounded in the second and third quarter, however, this was offset by a slight decrease in the demand of a number of our products mainly from reduced order volumes as the effect of the Health Reform filters through the chain drug stores. The chain drug stores reacting to the potential competition that the Health Reform may bring are being cautious and maintaining lower than usual stock levels. As the PRC government moves forward with the Health Reform, hospitals, health clinics and institutions will be established in villages, remote regions and under-developed cities, creating additional channels for the rural population to purchase drugs aside from the chain drug stores. We expect the Health Reform, when fully in place, will greatly improve the rural population's access to healthcare, and therefore increase the demand for our products. We have established Medical Reform Sales Department as a dedicated resource focused on capturing this tremendous growth opportunity.

This quarter ended July 31, 2010, we introduced two new products to the market, Qing Re Jie Du Oral Liquid, which detoxified and removing heat from intestines, and Compound Schisandra Tablets, also known as magnolia vine, has been clinically proven to have significant benefits to the functioning and regulation of the central nervous system and for upper body respiration.

In the last quarter of 2009, we introduced two new products to the market, Banlangen Granules and Compound Honeysuckle Granules, both of which have well accepted anti-viral qualities, and were in great demand during and post the H1N1 pandemic and the winter season.

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In 2010, we experienced a decrease in the average sales price per pack of our products, as demonstrated in the table below:

	2010	2009
Sales revenues (in thousands)	\$ 43,205	\$ 35,462
Total sales quantity (pack in thousands)	610	497
Average selling prices/pack (in thousands)	\$ 70.83	\$ 71.35

The decrease in average sales price per pack, as reflected in the table, is primarily attributable to a change in sale mix, with more products with lower average price per pack sold, namely Banlangen Granules and Compound Honeysuckle Granules. Overall, the average price of individual products sold in both 2010 and 2009 increased as demonstrated in the following table, which reflects the average sales price per pack by product for 2010 and 2009 and the percentage change in the sales price per pack.

Product	Average Price Per Pack		Percentage Change
	2010	2009	
Siberian Ginseng (Acanthopanax) Series	\$ 81.02	\$ 65.11	24.4
Tianma Series	77.24	74.66	3.5
Compound Yangjiao Tablets	93.69	79.62	17.7
Shark Vital Capsules	493.25	481.40	2.5
Shengmai Granules	40.76	34.08	19.6
Banlangen Granules	27.33	-	100.0
Compound Honeysuckle Granules	59.40	-	100.0

In addition to increasing the price of a number of our products in the first quarter of 2010, namely Siberian Ginseng (Acanthopanax) Series and Shengmai Granules, we recently introduced new dosage forms to our existing Botanical anti-depression and nerve-regulation product category, which contain less sugar content and are suitable for diabetic patient consumption. We were able to demand a higher price for these new dosage forms, namely in our Siberian Ginseng (Acanthopanax) Series and Compound Yangjiao Tablets. We plan to launch our latest product, Badger Oil, a natural medicine for the treatment of burns with no known toxic side effects or allergic reactions in the last quarter of the year. Based on market research, we anticipate positive market acceptance to the new product.

#### Cost of Goods Sold

Our costs of goods sold consist primarily of direct and indirect manufacturing costs, including production overhead costs, and shipping and handling costs for the products sold. Cost of goods sold increased approximately \$4,325 thousand, or 31.3%, from approximately \$13,826 thousand in 2009 to approximately \$18,151 thousand in 2010. This increase was primarily attributable to increased products sold and increase in raw material prices, namely sugar, which had a price increase in March 2010 of approximately 32%.

Although we anticipate that the cost of goods will increase due to inflationary price increases, we do not believe that such increases will be material for fiscal year 2010. We anticipate that beyond 2010, our price for raw materials and other production costs will continue to increase due to inflation. If our costs of goods increase, this may have a negative effect on our net income because, due to market conditions and competitive conditions, we may not be able to increase the price for our products in proportion to the increase of our costs of goods sold.

#### Operating and Administrative Expenses

Our total operating expenses increased by approximately \$2,070 thousand, or 34.0%, from approximately \$6,080 thousand in 2009 to approximately \$8,150 thousand in 2010. This increase was primarily attributable to an increase of approximately \$1,154 thousand, or 45.5%, in sales and marketing expenses from approximately \$2,535 thousand for 2009 to approximately \$3,689 thousand for 2010, as we continued to invest in our distribution network and increase TV advertising to increase product market share and create greater consumer awareness of our premium quality products. This increase was also attributable to an increase of approximately \$497 thousand, or 29.0% in general and administrative expenses from approximately \$1,712 thousand for 2009 to approximately \$2,209 thousand for 2010, and an increase of approximately \$419 thousand, or 22.9% in research and development expenses from approximately \$1,833 thousand for 2009 to approximately \$2,252 thousand for 2010. We expect research and development expenses to continue to increase in the coming quarters as our pipeline projects advance and our pipeline size grows.

Income from Operations

As a result of the foregoing, our income from operations increased by approximately \$3,197 thousand, or 35.4%, from approximately \$9,040 thousand in 2009 to approximately \$12,237 thousand in 2010.



### Income Tax Expenses

We are subject to U.S. federal and state income taxes. Our subsidiary registered in the PRC is subject to enterprise income taxes. For the fiscal year of 2010 and 2009, our PRC subsidiary was granted a tax holiday and is entitled to full exemption from enterprise income taxes of 25%.

### Cumulative Currency Translation Adjustments

Our principal country of operations is the PRC and our functional currency is the Renminbi, but our reporting currency is the U.S. dollar. All translation adjustments resulting from the translation of our financial statements into U.S. dollars are reported as cumulative currency translation adjustments. Our cumulative currency translation adjustments increased by approximately \$382 thousand, or 477.5%, from approximately negative \$80 thousand in 2009 to approximately \$302 thousand in 2010.

### Liquidity and Capital Resources

We had retained earnings of approximately \$47,824 thousand and \$35,587 thousand as of July 31, 2010 and October 31, 2009, respectively. As of July 31, 2010, we had cash and cash equivalents of approximately \$28,749 thousand and total current assets of approximately \$44,758 thousand. As of July 31, 2010, we had a working capital surplus of approximately \$42,265 thousand. We believe our cash and cash equivalents are adequate to satisfy our working capital needs and sustain our ongoing operations for the next twelve months.

Our summary cash flow information is as follows:

Net cash provided by (used in):	Nine months ended July 31	
	2010	2009
	(\$ in thousands)	
Operating activities	22,883	3,059
Investing activities	(2,559)	(16)
Financing activities	-	-

### Net Cash Provided by Operating Activities

Net cash provided by operating activities increased approximately \$19,824 thousand, from net cash provided by operating activities of approximately \$3,059 thousand in 2009 to net cash provided by operating activities of approximately \$22,883 thousand in 2010. This increase was primarily attributable to an increase in net income from operations of approximately \$12,237 thousand, and a reduction in trade receivables of approximately \$12,386 thousand, as average days sales outstanding fell to 118 days in 2010 from 186 days in 2009, which included a period of sales term incentives. We have recently tightened our credit terms with our customers to be within 100 days and will continue to increase our collection efforts to reduce our days sales outstanding. This increase in net cash provided by operating activities was also attributable to a reduction in amounts due from related parties by approximately \$130 thousand, and a decrease in inventory level by approximately \$549 thousand. Furthermore, this increase in net cash provided by operating activities was offset in part by a decrease in value added tax payable of approximately \$715 thousand.

### Net Cash Used in Investing Activities

Net cash used in investing activities increased approximately \$2,543 thousand, from approximately \$16 in 2009 to approximately \$2,559 thousand in 2010. This increase was primarily attributable to approximately \$2,559 thousand of payments made to purchase office floors from a third party during the period ending April 30, 2010.

### Outstanding Long-Term Indebtedness

None.

Off-balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

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#### Capital commitments

We have capital commitments for purchase of land use right, property and equipment and production patents from a related party, Stock Co, of approximately \$9,655,051. In addition, on April 10, 2010, the Company, through its wholly own subsidiary, Harbin Renhuang Pharmaceutical Co. Ltd, entered into a Property Sale and Purchase Contract (“Purchase Agreement”) with Hongxiangmingyuan of Heilongjiang Yongtai Company, to acquire two office floors in a building located in the Nangang District, Harbin, PRC, for total consideration of \$5,612,306. Pursuant to the Purchase Agreement, a payment of \$3,928,614 was made in April 2010, and the final payment of approximately \$1,683,692 is due by December 20, 2012, at which time title to the property will be transferred to the Company. We expect to fund these commitments with cash provided from operations.

#### Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Because we are a smaller reporting company, this Item 3 is not applicable.

#### Item 4. Controls and Procedures.

##### Evaluation of Disclosure Controls and Procedures

As of July 31, 2010, we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. We did not timely file our quarterly reports on Form 10-Q for the quarters ended January 31, April 30, and July 31, 2008 which were filed in January 2010. In addition, we did not timely file a Form 8-K, Item 4. Non-Reliance on Previously Issued Financial Statement or a Related Audit Report or Completed Interim Review. Accordingly, based upon that evaluation, the chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were not effective to ensure that information required to be disclosed in our periodic reports filed under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified by the Securities and Exchange Commission’s rules and regulations.

##### Changes in Internal Controls Over Financial Reporting

As previously disclosed in our Form 10-K for the year ended October 31, 2009, as of July 31, 2010, we have not yet completed documentation of controls placed in operation to adequately address our financial reporting risks. Accordingly, we have not yet had the opportunity to assess the effectiveness of our procedures to determine whether our internal control over financial reporting is effective. Further, as discussed above, in light of our failure to timely file our periodic reports, we did not believe that our disclosure controls and procedures were effective at July 31, 2010. Accordingly, management has concluded that we did not maintain effective internal control over financial reporting as of July 31, 2010.

As a result of the above, since the third quarter of our 2009 fiscal year, we have begun the implementation of remedial measures including hiring of a new chief financial officer in January 2010 (which resigned on August 3, 2010 for personal reason and replaced by an interim chief financial officer), adding additional staff, appointing three independent Directors to our Board of Directors, engaging consultants to advise management on the preparation of Sarbanes-Oxley Section 404 compliance with internal controls over financial reporting for fiscal year 2010, providing relevant training to our staff, implementing more rigorous policies and procedures relating to period-end financial reporting and other key processes, strengthening key controls such as journal-entry approval, reconciliation procedures and maintaining relevant supporting documentation. We expect to continue to implement additional

financial and management controls and procedures going forward. As a result of these measures and until we have completed the remediation process, there has been and will be changes and further improvement to our internal controls over financial reporting.

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PART II

Item 1. Legal Proceedings.

As of August 30, 2010, we are not a party to, or threatened by, any legal proceedings.

Item 1A. Risk Factors.

Because we are a smaller reporting company, this Item 1A is not applicable.

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

None.

Item 3. Defaults upon Senior Securities.

In the nine-month period ended July 31, 2010, and subsequent period through the date hereof, we did not default upon any senior securities.

Item 4. [REMOVED AND RESERVED].

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit

No.	Description
3.1	Restated Articles of Incorporation(1)
3.2	Second Restated Bylaws(1)
3.3	Certificate of Amendment to Articles of Incorporation(2)
10.1	Renhuang Pharmaceuticals, Inc. 2007 Non-Qualified Company Stock Grant and Option Plan(3)
10.2	2003 Omnibus Securities Plan (4)
10.4	English translation of Purchase Agreement for Patents, dated September 1, 2009(5)
10.5	English translation of Purchase Agreement for Ah City Natural and Biopharmaceutical Plant, dated October 12, 2009(5)
10.6	English translation of Purchase Agreement with Hongxiangmingyuan of Heilongjiang Yongtai Company, dated April 10, 2010(6)
10.7	Independent Director Agreement with Mr. Xiaoheng (Sean) Shao, dated April 13, 2010(6)
10.8	Independent Director Agreement with Mr. Bingchun Wu, dated April 19, 2010(6)
10.9	Independent Director Agreement with Mr. Changxiong Sun, dated April 19, 2010(6)
10.10	Acquisition Agreement with Yichun Red Star Forest Bureau of Acanthopanax Resources, dated July 8, 2010(7)
21.1	Subsidiaries of the registrant(2)
31.1	Certification of Principal Executive Officer pursuant to Rules 13a-14 and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification of Principal Financial Officer pursuant to Rules 13a-14 and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certification of Principal Executive and Financial Officers pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*

\* Filed herewith.

- (1) Incorporated by reference from Form 8-K filed with the SEC on April 22, 2003.
- (2) Incorporated by reference from Form 10-K filed with the SEC on February 13, 2007.
- (3) Incorporated by reference from Form 8-K filed with the SEC on May 2, 2007.
- (4) Incorporated by reference from Form 8-K filed with the SEC on April 22, 2003.
- (5) Incorporated by reference from Form 10-K filed with the SEC on January 29, 2010.
- (6) Incorporated by reference from Form 10-Q filed with the SEC on June 7, 2010.
- (7) Incorporated by reference from Form 8-K filed with the SEC on July 14, 2010.



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on our behalf by the undersigned, thereunto duly authorized.

Date: September 17, 2010

RENHUANG PHARMACEUTICALS, INC.

By: /s/ Li Shaoming  
Li Shaoming, Chief Executive Officer and  
President  
(Principal Executive Officer)

Date: September 17, 2010

By: /s/ Lu Xiaoying  
Lu Xiaoying, Interim Chief Financial  
Officer  
(Principal Accounting and Financial  
Officer)