

China Botanic Pharmaceutical  
Form 10-K/A  
March 10, 2011

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

Form 10-K/A  
(Amendment No. 1)

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

For the fiscal year ended October 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

CHINA BOTANIC PHARMACEUTICAL INC.  
(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

88-1273503  
(I.R.S. Employer  
Identification No.)

No. 218, Taiping  
Taiping District, Harbin, Heilongjiang Province, P.R. China 100016  
(Address of principal executive offices)

86-451-5762-03787  
(Registrant's Telephone Number, Including Area Code)

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.  
 Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of April 30, 2010, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$43,821,232 based upon the closing price of \$2.70 as quoted on the Pink Sheet OTC. Shares of common stock held by each executive officer and director and by each person who is known to own 10% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates of the Company. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of January 11, 2011, there were 37,239,536 shares of the registrant's \$0.001 par value common stock issued and outstanding.

No documents are incorporated into the text by reference.

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EXPLANATORY NOTE

We are filing this Amendment No. 1 on Form 10-K/A (this “Amendment”) to our Annual Report on Form 10-K for the year ended October 31, 2010, filed with the U.S. Securities and Exchange Commission (the “SEC”) on January 24, 2011 (the “Original Filing”), for the purpose of correcting an error in the calculation of diluted earnings per share and to Note 12, Notes to the Consolidated Financial Statements, to correct an error in calculating the tax savings amount and the diluted per share calculations for the year ended October 31, 2010 included in Item 15 of Part IV, and correction certain information required by Item 11 of Part III of the Original Filing related to Compensation of Directors. As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications by our Principal Executive Officer and Principal Financial Officer are being filed as exhibits to this Amendment under Item 15 of Part IV. We are also making conforming changes to the Notes to the financial statements and the cover page and the Exhibit Index to this Amendment.

Except as described above, no other changes have been made to the Original Filing, and all other Items of the Original Filing have been omitted from this Amendment. The Original Filing continues to speak as of the date of the Original Filing, and we have not updated the disclosures contained therein to reflect any events which occurred at a date subsequent to the filing of the Original Filing other than as expressly indicated in this Amendment. Accordingly, this Amendment should be read in conjunction with the Original Filing and our other filings made with the SEC on or subsequent to January 24, 2011.

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## PART III

## Item 11. Executive Compensation

## Compensation of Directors

The following table sets forth compensation paid to our non-executive directors for the fiscal year ended October 31, 2010.

| Name<br>(a)    | Fees<br>Paid in<br>Cash<br>(\$)<br>(b)(1) | Stock<br>Awards<br>(\$)<br>(c)(2) | Option<br>Awards<br>(\$)<br>(d)(2) | Nonqualified  |   |  | Total<br>(\$) |
|----------------|---|-----------------------------------|------------------------------------|---|---|--|---------------|
|                |   |                                   |                                    | Non-Equity<br>Incentive Plan<br>Compensation<br>(\$)<br>(e) | Deferred<br>Compensation<br>Earnings<br>(\$)<br>(f) | All Other<br>Compensation<br>(\$)<br>(g) |               |
| Xiaoheng Shao  | 14,862                                    | -0-                               | 70,000 (3)                         | -0-   | -0-   | -0-                                      | -0-           |
| Bingchun Wu    | 2,703                                     | -0-                               | -0-                                | -0-   | -0-   | -0-                                      | -0-           |
| Changxiong Sun | 2,703                                     | -0-                               | -0-                                | -0-   | -0-   | -0-                                      | -0-           |
| Dianjun Pi     | -0-                                       | -0-                               | -0-                                | -0-   | -0-   | -0-                                      | -0-           |

(1) The dollar value reflected is based on a conversion ratio of 1 RMB to every 0.1502 US dollars as of December 1, 2010.

(2) Reflects the grant date fair value of the awards calculated in accordance with FASB ASC Topic 718 – Stock Compensation.

(3) We entered into a independent director agreement with Mr. Shao dated April 13, 2010, pursuant to which we granted Mr. Shao an option to purchase a total amount of 70,000 shares of our common stock under the 2003 Plan at a purchase price of \$2.57 per share. The option will vest on a quarterly basis such that, for the first 11 quarter anniversaries, Mr. Shao will be entitled to purchase 5,833 shares of our common stock and, for the 12th quarter anniversary of the grant, he will be entitled to purchase 5,837 shares of our common stock. As of October 31, 2010, Mr. Shao was entitled to purchase 17,499 shares of our common stock under the option grant. Note that, the dollar amount disclosed in this table relates to a different number of acquirable shares than that in the beneficial ownership table below since the beneficial ownership table reflects that number of shares which are acquirable within 60 days of October 31, 2010. Accordingly, for purposes of the beneficial ownership table, the 5,833 shares that become acquirable on December 13, 2010 are reflected.

## Independent Director Agreements

We currently have agreements with our independent directors.

On April 19, 2010, we entered into an independent director agreement with Mr. Wu, who became a director on April 20, 2010. The agreement provides that Mr. Wu will receive a base salary of approximately RMB 3,000 per month for board meeting attendance as well as expense reimbursement. The Agreement expires on the earlier of (i) the date Mr. Wu ceases to be a member of the board, or (ii) the date of termination of the Agreement.

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On April 19, 2010, we entered into an independent director agreement with Mr. Sun, who became a director on April 20, 2010. The agreement provides that Mr. Sun will receive a base salary of approximately RMB 3,000 per month for board meeting attendance as well as expense reimbursement. The Agreement expires on the earlier of (i) the date Mr. Sun ceases to be a member of the board, or (ii) the date of termination of the Agreement.

On April 13, 2010, we entered into an independent director agreement with Mr. Shao, who became a director on April 15, 2010. The agreement provides that Mr. Shao, the Chair of our Audit Committee, will receive a base salary of approximately \$3,000 per month for board meeting attendance as well as expense reimbursement which is paid in Renminbi. Additionally, Mr. Shao was granted an option to purchase up to 70,000 shares of our common stock under the 2003 Plan, at an exercise price of \$2.57 per share. The option will vest on a quarterly basis such that Mr. Shao will be entitled to purchase 5,833 shares of our common stock on the first 11 quarter anniversaries of the grant date (April 15, 2010) and 5,837 shares of our common stock on the twelfth quarter anniversary of the grant date. The option has a term of 3 years, starting from the date of grant. The Agreement expires on the earlier of (i) the date Mr. Shao ceases to be a member of the board, or (ii) the date of termination of the Agreement.

There is currently no agreement with Mr. Li or Mr. Pi for compensation. Mr. Li and Mr. Pi are entitled to reimbursement for travel expenses. We do not pay additional amounts for committee participation or special assignments of the board of directors.

## PART IV

## Item 15. Exhibits and Financial Statement Schedules

## Financial Statements

The following documents are filed as part of this Amendment:

## (a) Financial Statements:

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| Report of Windes & McClaughry Accountancy Corporation   | F-2  |
| Consolidated Balance Sheets at October 31, 2010 and 2009  | F-3  |
| Consolidated Statements of Operations and Comprehensive Income for the Years Ended October 31, 2010 and 2009 (Restated) | F-4  |
| Consolidated Statements of Changes in Shareholders' Equity for the Years Ended October 31, 2010 and 2009                | F-5  |
| Consolidated Statements of Cash Flows for the Years Ended October 31, 2010 and 2009                                     | F-6  |
| Notes to Consolidated Financial Statements  | F-7  |

## Exhibits

The following exhibits are filed as a part of this Amendment:

## 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)   |
| 3.4   | Certificate of Amendment to Articles of Incorporation reflecting change of name to China Botanic Pharmaceutical Inc. (3)                                   |
| 10.1  | 2007 Non-Qualified Company Stock Grant and Option Plan(4)  |
| 10.2  | 2003 Omnibus Securities Plan (5)   |
| 10.3  | Loan Conversion Agreement among the Company, Allied Merit International Inc. and Griffin Ventures Ltd. dated May 15, 2009(6)                               |
| 10.4  | Employment Agreements with Weiqiu Dong(3)  |
| 10.5  | English translation of Purchase Agreement for Patents dated September 1, 2009(7)   |
| 10.6  | English translation of Purchase Agreement for Ah City Natural and Biopharmaceutical Plant dated October 12, 2009(7)  |
| 10.7  | English translation of Purchase Agreement with Hongxiangmingyuan of Heilongjiang Yongtai Company dated April 10, 2010(8)                                   |
| 10.8  | Independent Director Agreement with Mr. Xiaoheng (Sean) Shao, dated April 13, 2010(8)  |
| 10.9  | Independent Director Agreement with Mr. Bingchun Wu, dated April 19, 2010(8)   |
| 10.10 | Independent Director Agreement with Mr. Changxiong Sun, dated April 19, 2010(8)  |
| 10.11 | Exclusive Purchase Agreement, with Yichun Red Star Forest Bureau, of Acanthopanax Resources(9)   |
| 21.1  | Subsidiaries of the registrant(2)  |
| 23.2  | Consent Of Windes & McClaughry Accountancy Corporation*  |
| 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* |



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- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*

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\* 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 10-K filed with the SEC on January 24, 2011.
- (4) Incorporated by reference from Form S-8 filed with the SEC on May 2, 2007.
- (5) Incorporated by reference from Form 8-K filed with the SEC on April 22, 2003.

- (6) Incorporated by reference from Form 10-Q filed with the SEC on September 21, 2009.
- (7) Incorporated by reference from Form 10-K filed with the SEC on January 29, 2010.
- (8) Incorporated by reference from Form 10-Q filed with the SEC on June 7, 2010.
- (9) Incorporated by reference from Form 8-K filed with the SEC on July 14, 2010.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: March 10, 2011

CHINA BOTANIC PHARMACEUTICAL INC.

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

Date: March 10, 2011

By: /s/ Weiqiu Dong  
Weiqiu Dong, Chief Financial Officer  
(Principal Accounting and Financial Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following person on behalf of the registrant and in the capacity and on the dates indicated.

Date: March 10, 2011

/s/ Shaoming Li  
Shaoming Li,  
Chief Executive Officer, President, Chairman of the Board

Date: March 10, 2011

/s/ Xiaoheng Shao  
Xiaoheng Shao, Director

Date: March 10, 2011

/s/ Changxiong Sun  
Changxiong Sun, Director

Date: March 10, 2011

/s/ Bingchun Wu  
Bingchun Wu, Director

Date: March 10, 2011

/s/ Dianjun Pi  
Dianjun Pi, Director

Date: March 10, 2011

/s/ Weiqiu Dong  
Weiqiu Dong, Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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| Report of Independent Registered Public Accounting Firm   | F-2 |
| Consolidated Balance Sheets As of October 31, 2010 and 2009   | F-3 |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and  
Stockholders of China Botanic Pharmaceutical Inc.

We have audited the accompanying consolidated balance sheets of China Botanic Pharmaceutical Inc. as of October 31, 2010 and 2009, and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for each of the years in the two-year period ended October 31, 2010. China Botanic Pharmaceutical Inc.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Botanic Pharmaceutical Inc. as of October 31, 2010 and 2009, and the results of their operations and their cash flows for the years in the two-year period ended October 31, 2010 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 21 to the consolidated financial statements, the 2010 consolidated financial statements have been restated to correct a misstatement.

/s/ Windes & McClaughry Accountancy Corporation  
Windes & McClaughry Accountancy Corporation  
Long Beach, California  
March 8, 2011

CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

|   | Note   | As of October 31, |               |
|---|--------|-------------------|---------------|
|   |        | 2010              | 2009          |
| <b>ASSETS</b>   |        |                   |               |
| Current assets:   |        |                   |               |
| Cash and cash equivalents   |        | \$ 27,826,142     | \$ 8,111,514  |
| Trade receivables, net  | 5      | 19,814,438        | 23,203,410    |
| Due from related parties  | 10     | 28,877            | 130,199       |
| Inventory, net  | 7      | 2,645,616         | 3,024,016     |
| Prepayments   |        | -                 | 89,281        |
| Other receivables, net  | 6      | 200,994           | 102,613       |
| Total current assets  |        | 50,516,067        | 34,661,033    |
| Property and equipment, net   | 8      | 2,069,460         | 2,352,163     |
| Intangible assets, net  | 9      | 1,953,617         |               |
| Deposits for properties   | 10, 11 | 18,605,935        | 16,137,000    |
| Total assets  |        | \$ 73,145,079     | \$ 53,150,196 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |        |                   |               |
| Liabilities   |        |                   |               |
| Accounts payable  |        | \$ 333,555        | \$ 369,329    |
| Value added tax payable   |        | 1,064,066         | 1,186,642     |
| Accrued employee benefits   | 14     | 1,645,192         | 1,136,267     |
| Warrant liabilities   | 15     | 342,770           | -             |
| Total liabilities   |        | \$ 3,385,583      | \$ 2,692,238  |
| Shareholders' equity  |        |                   |               |
| Preferred stock (no par value, 1,000,000 shares authorized; none issued and outstanding as of October 31, 2010 and 2009)                          | 16     | -                 | -             |
| Common stock (\$0.001 par value, 100,000,000 shares, authorized; 37,239,536 issued and outstanding as of October 31, 2010 and 2009, respectively) | 16     | 37,240            | 37,240        |
| Additional paid-in capital  |        | 7,627,987         | 7,596,525     |
| Common stock warrants   | 17     | 496,732           | 496,732       |
| Reserves  | 18     | 3,372,697         | 3,372,697     |
| Accumulated other comprehensive income  |        | 4,768,793         | 3,367,659     |
| Retained earnings   |        | 53,456,047        | 35,587,105    |
| Total shareholders' equity  |        | 69,759,496        | 50,457,958    |
| Total liabilities and shareholders' equity  |        | \$ 73,145,079     | \$ 53,150,196 |

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

CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

|   | Note | For the year ended October 31* |               |
|---|------|--------------------------------|---------------|
|   |      | 2010<br>US\$                   | 2009<br>US\$  |
| Sales, net  |      | \$ 55,183,941                  | \$ 43,411,562 |
| Cost of goods sold  |      | 25,765,835                     | 20,311,410    |
| Gross profit  |      | 29,418,106                     | 23,100,152    |
| Operating and administrative expenses:                      |      |                                |               |
| Sales and distribution                                      |      | 4,966,062                      | 3,649,820     |
| General and administrative                                  |      | 3,614,809                      | 2,117,114     |
| Research and development                                    |      | 3,042,815                      | 2,529,085     |
| Total operating expenses                                    |      | 11,623,686                     | 8,296,019     |
| Income from operations                                      |      | 17,794,420                     | 14,804,133    |
| Other income:   |      |                                |               |
| Interest income   |      | 74,522                         | 42,724        |
| Income from operations before income tax expenses           |      | 17,868,942                     | 14,846,857    |
| Income tax expenses   | 12   | -                              | -             |
| Net income  |      | \$ 17,868,942                  | \$ 14,846,857 |
| Other comprehensive income:                                 |      |                                |               |
| Cumulative currency translation adjustments                 |      | 1,401,134                      | 66,345        |
| Total comprehensive income                                  |      | 19,270,076                     | 14,913,202    |
| Earnings per common stock- Basic                            | 13   | \$ 0.48                        | \$ 0.41       |
| Earnings per common stock – Diluted (Restated, see Note 21) |      | \$ 0.47                        | \$ 0.41       |
| Weighted average common stock outstanding                   |      |                                |               |
| Basic   |      | 37,239,536                     | 36,088,853    |
| Diluted (Restated, see Note 21)                             |      | 37,778,028                     | 36,088,853    |

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

CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

|  | Common stock<br>(\$0.001 par value) |                      | Additional<br>Paid-in<br>Capital<br>US\$ | Common<br>Stock<br>Warrants<br>US\$ | Reserves<br>US\$ | Accumulated<br>Other<br>Comprehensive<br>Income<br>US\$ |            | Retained<br>Earnings<br>US\$ | Total<br>Shareholders'<br>Equity<br>US\$ |
|--|-------------------------------------|----------------------|--|-------------------------------------|------------------|---|------------|------------------------------|--|
|  | Number of<br>Shares                 | Par<br>Value<br>US\$ |  |                                     |                  |   |            |                              |  |
| Balance as of<br>October 31,<br>2008<br>(Restated) | 35,096,680                          | 35,097               | 6,595,400                                | -                                   | 2,867,674        | 3,301,314   | 21,245,271 | 34,044,756                   |  |
| Common stock<br>issued                             | 2,142,856                           | 2,143                | 1,001,125                                | -                                   | -                | -   | -          | 1,003,268                    |  |
| Warrants<br>issued                                 | -                                   | -                    | -  | 496,732                             | -                | -   | -          | 496,732                      |  |
| Net income   | -                                   | -                    | -  | -                                   | -                | -   | 14,846,857 | 14,846,857                   |  |
| Appropriation<br>to statutory<br>reserves          | -                                   | -                    | -  | -                                   | 505,023          | -   | (505,023)  | -                            |  |
| Currency<br>translation<br>adjustments             | -                                   | -                    | -  | -                                   | -                | 66,345  | -          | 66,345                       |  |
| Balance as of<br>October 31,<br>2009               | 37,239,536                          | 37,240               | 7,596,525                                | 496,732                             | 3,372,697        | 3,367,659   | 35,587,105 | 50,457,958                   |  |
| Net income   | -                                   | -                    | -  | -                                   | -                | -   | 17,868,942 | 17,868,942                   |  |
| Appropriation<br>to statutory<br>reserves          | -                                   | -                    | -  | -                                   | -                | -   | -          | -                            |  |
| Option Granted                                     |                                     |                      | 31,462                                   |                                     |                  |   |            | 31,462                       |  |
| Currency<br>translation<br>adjustments             | -                                   | -                    | -  | -                                   | -                | 1,401,134   | -          | 1,401,134                    |  |
| Balance as of<br>October 31,<br>2010               | 37,239,536                          | 37,240               | 7,627,987                                | 496,732                             | 3,372,697        | 4,768,793   | 53,456,047 | 69,759,496                   |  |

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



CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | For the years ended October 31, |               |
|---|---------------------------------|---------------|
|   | 2010                            | 2009          |
|   | US\$                            | US\$          |
| <b>Cash flows from operating activities:</b>                        |                                 |               |
| Net income  | 17,868,942                      | 14,846,857    |
| <b>Adjustments to reconcile net income to operating activities:</b> |                                 |               |
| Depreciation  | 363,567                         | 356,440       |
| Amortization  | 435,653                         | -             |
| Warrants issued for service   | 342,770                         | -             |
| Option granted to directors   | 31,462                          | -             |
| Forgiven rent   | 367,224                         | -             |
| <b>Changes in assets and liabilities:</b>                           |                                 |               |
| Increase in trade receivables                                       | 3,814,889                       | (2,328,833 )  |
| Decrease in due from related parties                                | (28,300 )                       | (275,476 )    |
| Decrease (Increase) in inventory, net                               | 423,480                         | (394,750 )    |
| Decrease (Increase) in prepayments                                  | 89,397                          | (55,491 )     |
| Decrease in other receivables, net                                  | (94,232 )                       | 31,180        |
| Increase in accounts payable  | (44,546 )                       | 174,979       |
| Increase in value added tax payable                                 | (145,371 )                      | 491,666       |
| Increase in accrued employee benefits                               | 442,040                         | 414,433       |
| (Decrease) increase in other payable                                | (31,413 )                       | (193,472 )    |
| Net cash provided by (used in) operating activities                 | 23,835,562                      | 13,067,533    |
| <b>Cash flows from investing activities:</b>                        |                                 |               |
| Deposits for land use right and properties                          | (3,944,749 )                    | (14,670,000 ) |
| Deposits for patents  | (717,926 )                      | (1,467,000 )  |
| Purchase of property and equipment                                  | (36,473 )                       | (84,371 )     |
| Net cash used in investing activities                               | (4,699,148 )                    | (16,221,371 ) |
| <b>Cash flows from financing activities:</b>                        |                                 |               |
| Proceeds from share issues  | -                               | 1,500,000     |
| Net cash provided by financing activities                           | -                               | 1,500,000     |
| Effect of exchange rate changes on cash                             | 578,214                         | 17,659        |
| Net decrease in cash and cash equivalents                           | 19,714,628                      | (1,636,179 )  |
| Cash and cash equivalents, beginning of year                        | 8,111,514                       | 9,747,693     |
| Cash and cash equivalents, end of year                              | 27,826,142                      | 8,111,514     |
| <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.

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND NATURE OF OPERATION

The accompanying consolidated financial statements include the financial statements of China Botanic Pharmaceutical Inc. (“CBP”) and its subsidiaries. CBP and its subsidiaries are collectively referred to as the “Company.”

CBP 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 CBP became a non-operating public company. CBP 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.    |
| October 2010  | China Botanic Pharmaceutical Inc. |

Effective August 28, 2006, CBP 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 CBP

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

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

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

CBP 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

a. Basis of presentation of financial statements

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) and 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.

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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.

b. Principles of consolidation

The consolidated financial statements include the financial statements of CBP 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 October 31, 2010, this change did not have an impact on the Company's condensed consolidated financial statements.

c. 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.

d. Foreign currency translation

The Company's principal country of operations is in 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 October 31, 2010 and 2009, the exchange rate was RMB 6.67 and RMB 6.82, respectively. Translation adjustments totaled \$1,401,134 and \$66,345 for the year ended October 31, 2010 and 2009, respectively.

e.

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 October 31, 2010 and 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.

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

f. 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 years ended October 31, 2010 and 2009. The Company does not have any off-balance sheet credit exposure related to its customers.

g. 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 years ended October 31, 2010 and 2009.

h. 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 |

i. Intangible assets, net

Intangible assets consist of purchased patents. Intangible assets are carried at cost less accumulated amortization and any impairment. Intangible assets with a finite useful life are amortized using the straight-line method over valid periods varied from 10 to 20 years, which is the estimated economic life of the intangible assets.

j. Accounting for the impairment of 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," FASB Topic ASC 360, "Intangibles - Goodwill and Others," 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 years ended October 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.



CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

k. 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 October 31, 2010 and 2009 the carrying value of cash, trade receivables, other receivables, accounts payable, approximated their fair value. All derivatives are recorded at fair value evaluated based on Black-Scholes option model.

l. 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.

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.

m.

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.

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As of October 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 October 31, 2010 and, 2009, the Company has accrued \$2,141,055 and \$3,020,898, respectively, for sales rebates, which offset the balance of account receivables. For the years ended October 31, 2010 and 2009, the Company has deducted sales rebates in the amount of \$7,516,231 and \$8,848,658, respectively, from sales. Sales rebates are calculated based on terms specified in contracts with individual distributors.

n. 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.

o. 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.

p. 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 are expensed as incurred and amounted to \$4,803,286 and \$3,590,965 during the years ended October 31, 2010 and 2009 respectively.

q. Research and development

Research and development ("R&D") consists primarily of cost of materials and overhead expenses r by research and development staff. Research and development costs are expensed as incurred. Research and development expenses amounted to \$3,042,815 and \$2,529,085 during the years ended October 31, 2010 and 2009 respectively.

r. 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 CBP 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 CBP China contributes the balance of 16%.

s. 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.

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

t. 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.

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.

CBP 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 October 31, 2010 for U.S. or additional foreign withholding taxes on approximately \$53,456,047 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.

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of October 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.

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.

u. 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 \$19,270,076 and \$14,913,202 for the years ended October 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 \$1,401,134 and \$66,345 as of October 31, 2010 and 2009 respectively.

v. 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.



CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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.

w. 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.

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 fair market value per Black-Scholes option model.

On May 15, 2009, we have issued warrants to purchase 1,071,428 shares of common stock to certain investors, associated with an offering of our common stock. The warrants were recognized at fair value and were recorded as equity.

On March 25, 2010, we issued warrants to a certain investor relation service provider. The warrants were recognized at fair value and were 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 July 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2010-20, Receivables – Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses ("ASU No. 2010-20"). ASU No. 2010-20 will require a company to provide more information about the credit quality of its financing receivables in the disclosures to the financial statements, including aging information and credit quality indicators. Both new and existing disclosures must be disaggregated by portfolio segment or class. The disaggregation of information is based on both how a company develops its allowance for credit losses and it manages its credit exposure. ASU No. 2010-20 is effective for interim and annual reporting periods after December 15, 2010. The adoption of ASU 2010-20 is not expected to have a material effect on our financial

statements.

In May, 2010, the FASB issued ASU 2010-19, "Foreign Currency" (Topic 830): Foreign Currency Issues: Multiple Foreign Currency Exchange Rates (SEC Update). The purpose of this Update is to codify the SEC Staff Announcement made at the March 18, 2010 meeting of the FASB Emerging Issues Task Force (EITF) by the SEC Observer to the EITF. The Staff Announcement provides the SEC staff's view on certain foreign currency issues related to investments in Venezuela. The Company does not expect the provisions of ASU 2010-19 to have a material effect on the financial position, results of operations, or cash flows of the Company.

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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.

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.

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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.

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 \$ 27,826,142 and \$8,111,514, as of October 31, 2010 and 2009, respectively. No cash balances were restricted as at October 31, 2010 and 2009.

As of October 31, 2010 and 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. Prior to deduction of sales rebates, one individual customer accounted for 11% of net revenues during the year ended October 31, 2010

The Company's products are sold throughout the PRC. For years ended October 31, 2010 and 2009, Botanical anti-depression and nerve-regulation products accounted for 71.1% and 81.1%, 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 during the years ended October 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. TRADE RECEIVABLES, NET

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

|                                       | 2010<br>US\$ | 2009<br>US\$ |
|---------------------------------------|--------------|--------------|
| Trade receivables                     | 22,408,628   | 26,667,816   |
| Less: Sales rebates                   | (2,141,055 ) | (3,020,898 ) |
| Less: Allowance for doubtful accounts | (453,135 )   | (443,508 )   |
| Trade receivables, net                | 19,814,438   | 23,203,410   |

## 6. OTHER RECEIVABLES, NET

Other receivables are travel and business advances to employees. As of October 31, 2010 and 2009, amount included in the consolidated balance sheets as at October 31, 2010 and 2009 were as follows:

|                                       | 2010<br>US\$ | 2009<br>US\$ |
|---------------------------------------|--------------|--------------|
| Other receivables                     | 569,184      | 462,980      |
| Less: Allowance for doubtful accounts | (368,190 )   | (360,367 )   |
| Other receivables, net                | 200,994      | 102,613      |





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## 7. INVENTORY, NET

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

|                          | 2010<br>US\$ | 2009<br>US\$ |
|--------------------------|--------------|--------------|
| Raw materials            | 1,951,185    | 1,530,283    |
| Work-in-progress         | 52,411       | 1,006,984    |
| Finished goods           | 707,648      | 550,982      |
| Less: Inventory reserves | (65,628 )    | (64,233 )    |
| Inventory, net           | 2,645,616    | 3,024,016    |

## 8. PROPERTY AND EQUIPMENT, NET

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

|                                  | 2010<br>US\$ | 2009<br>US\$ |
|----------------------------------|--------------|--------------|
| Machinery and equipment          | 3,545,146    | 3,435,421    |
| Office equipment and furnishings | 58,006       | 53,086       |
| Motor vehicles                   | 54,237       | 54,749       |
|                                  | 3,657,389    | 3,543,256    |
| Less: Accumulated depreciation   | (1,587,929)  | (1,191,093)  |
| Net book value                   | 2,069,460    | 2,352,163    |

Depreciation expense for the years ended October 31, 2010 and 2009 was \$363,567 and \$356,440, respectively, of which \$374,973 and \$341,429 were included as a component of cost of goods sold in the respective periods.

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

## 9. INTANGIBLE ASSETS, NET

|                                | 2010<br>US\$ | 2009<br>US\$ |
|--------------------------------|--------------|--------------|
| Intangible assets              |              |              |
| Product patents                | 2,398,153    | -            |
| Less: Accumulated amortization | (444,536 )   | -            |
| Intangible assets, net         | 1,953,617    | -            |

## 10. RELATED PARTY TRANSACTIONS

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

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|                           | 2010<br>US\$ | 2009<br>US\$ |
|---------------------------|--------------|--------------|
| Due from related parties: |              |              |
| Advances (1)              | 28,877       | 130,199      |
| Deposits (2)              | 18,605,935   | 16,137,000   |
| Total                     | 18,634,812   | 16,267,199   |

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES  
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(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, 2010, the Company has a net amount due from Mr. Li Shaoming of \$28,877, which is advance for travelling and business.

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. As of October 31, 2010, the Company has no amount was due to or from Stock Co.

(2) Deposits

On September 1, 2009, the Company through its wholly own subsidiary, CBP China, entered into a Purchase Agreement with Stock Co, to acquire two production patents, for a total consideration of \$2,398,153. Pursuant to the Purchase Agreement, a payment of \$1,467,000 was made to Stock Co, in October 2009 and \$1,467,000 was recorded as deposits on the consolidated balance sheet as at October 31, 2009. In October 2010, the considerations for the patents are fully paid, and \$2,398,153 was recognized as intangible assets. The intangible assets was recognized at historical value. For the year 2010, \$435,653 was recognized as amortization expenses.

On October 12, 2009, the Company through its wholly own subsidiary, CBP 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 \$14,988,459 and \$14,670,000 was recorded as deposits on the consolidated balance sheet as at October 31, 2010 and 2009, respectively. Pursuant to the Purchase Agreement, final payment of \$8,417,726 is due by December 31, 2011, at which time title for the assets will be transferred. Accordingly the transaction is considered incomplete as at October 31, 2010.

(3) Related party transactions

The Company leases property and plant from Stock Co. Rental expenses related to this lease, incurred and expensed to consolidated statements of operations and comprehensive income during the years ended October 31, 2010 and 2009 amounted to \$734,448 and \$ 615,594, respectively. A noncash rental expenses of \$367,224 was recognized to account for the rental exemption pursuant to the Purchase Agreement for the ended October 31, 2010, and the deposits for the property was reduced accordingly..

During the years ended October 31, 2010 and 2009, the Company sold goods at market price in the amount of \$0 and \$430,889, respectively, to Heilongjiang Renhuang Pharmaceutical Limited, a company where Mr. Li Shaoming is a major shareholder.

11. DEPOSIT

On April 10, 2010, the Company through its wholly own subsidiary, CBP China, entered into a Purchase Agreement with Hongxiangmingyuan of Heilongjiang Yongtai Company, to acquire two office floors for a total consideration of \$5,750,263. Pursuant to the Purchase Agreement, a payment of \$4,025,184 was made in April 2010 and recorded as deposits on the condensed consolidated balance sheet. Pursuant to the Purchase Agreement, final payment of \$1,725,079 is due by December 20, 2012, at which time title for the assets will be transferred. Accordingly the transaction is considered incomplete as at October 31, 2010.

12. INCOME TAXES (Restated, see Note 21)

The Company adopted FIN No. 48 on January 1, 2007. There were no unrecognized tax benefits as of the date of adoption and there are no unrecognized tax benefits included in the balance sheet at October 31, 2010, that would, if recognized, affect the effective tax rate.

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The following table reconciles the U.S. statutory rates to the Company's effective tax rate for the years ended October 31, 2010 and 2009:

|                              | 2010  |    | 2009  |    |
|------------------------------|-------|----|-------|----|
| US statutory rates           | 34.00 | %  | 34.00 | %  |
| Foreign tax rate difference  | (9.0  | )% | (9.0  | )% |
| Income tax holiday           | (25.0 | )% | (25.0 | )% |
| Tax per financial statements | 0.00  | %  | 0.00  | %  |

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:

|                    | Year ended October 31, |           |
|--------------------|------------------------|-----------|
|                    | 2010                   | 2009      |
|                    | US\$                   | US\$      |
| Tax savings        | 4,749,398              | 3,711,714 |
| Benefit per share: |                        |           |
| Basic              | 0.13                   | 0.10      |
| Diluted            | 0.13                   | 0.10      |

Had the tax exemption not been in place for the years ended October 31, 2010 and 2009, the Company estimates the following proforma financial statement impact:

|  | For the years ended October 31, |              |
|--|---------------------------------|--------------|
|  | 2010                            | 2009         |
|  | US\$                            | US\$         |
| Net income before tax provision, as reported | 17,868,942                      | 14,846,857   |
| Less Tax savings                             | (4,749,398 )                    | (3,711,714 ) |
| Proforma Net income                          | 13,119,544                      | 11,135,143   |
| Proforma Net income per share:               |                                 |              |
| Basic  | 0.35                            | 0.31         |
| Diluted                                      | 0.35                            | 0.31         |

### 13. EARNINGS PER SHARE (Restated, see Note 21)

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.



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The following is the revised EPS computation:

|   | Income<br>(Numerator)<br>US\$ | Shares<br>(Denominator) | Per Share<br>Amount<br>US\$ |
|---|-------------------------------|-------------------------|-----------------------------|
| For the year ended October 31, 2010:                |                               |                         |                             |
| Net income  |                               |                         |                             |
| Basic EPS income available to common shareholders   | 17,868,942                    | 37,239,536              | 0.48                        |
| Effect of dilutive securities:                      |                               |                         |                             |
| Warrants issued in certain offering                 | -                             | 538,492                 | -                           |
| Warrants Liability                                  | -                             | -                       | -                           |
| Options   | -                             | -                       | -                           |
| Diluted EPS income available to common shareholders | 17,868,942                    | 37,778,028              | 0.47                        |
| For the year ended October 31, 2009:                |                               |                         |                             |
| Net income  |                               |                         |                             |
| Basic EPS income available to common shareholders   | 14,846,857                    | 36,088,853              | 0.41                        |
| Effect of dilutive securities:                      |                               |                         |                             |
| Warrants  | -                             | -                       | -                           |
| Diluted EPS income available to common shareholders | 14,846,857                    | 36,088,853              | 0.41                        |

For the year ended October 31, 2010, warrants of 160,000 shares and option of 70,000 shares were excluded from calculation of diluted earnings, because the exercise prices exceeded the average price of the Company's common stock.

For the year ended October 31, 2009, warrants of 1,071,428 shares were excluded from calculation of diluted earnings, because the exercise prices exceeded the average price of the Company's common stock

#### 14. 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 consolidated statements of operations and comprehensive income for such employee benefits amounted to approximately \$401,543 and \$ 414,437 for the years ended October 31, 2010 and 2009, respectively.

#### 15. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

On March 25, 2010, the Company issued warrants (the "Warrants") for 160,000 common shares to an investor relation 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.

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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 for the year ended October 31, 2010, which would have resulted in an adjustment to the exercise price or number of Warrant Shares.



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At October 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    | % |

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

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

## 16. 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 October 31, 2010 and 2009, there is no preferred stock outstanding.

### Common Stock and Equity Transactions

On May 15, 2009, the Company issued an aggregate of 2,142,856 shares of the Company's common stock and 1,071,428 warrants with an exercise price of \$0.875 per share to Allied Merit International Investments, Inc. and Griffin Ventures Ltd. Total consideration of the issuance was \$ 1,500,000.

The fair value of the warrants is estimated on the date of grant using the Black-Scholes option valuation model to be \$496,732. The valuation was based on the assumptions noted in the following table.

|                     |        |   |
|---------------------|--------|---|
| Expected volatility | 175.80 | % |
|---------------------|--------|---|

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|                          |         |   |
|--------------------------|---------|---|
| Expected dividends       | 0       | % |
| Expected term (in years) | 3 years |   |
| Risk-free rate           | 1.375   | % |

The risk-free interest rate is based on the U.S. Treasury yield curve in effect for the expected term of the warrants 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 May 15, 2008. Our methodology is consistent with prior period volatility assumptions. The expected life of the warrants 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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17. OPTION PLAN AND WARRANTS

Share-based compensation amounted to \$31,462 and \$0 in the years ended October 31, 2010 and 2009, respectively.

(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 October 31, of the immediately preceding year. As of October 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 \$31,462 was recorded as compensation expense for the year ended October 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.

(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

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Black-Scholes option valuation model to be \$47,527. The valuation was based on the assumptions noted in the following table. The options was forfeited at departure of the employee on August 6, 2010.

|                          |       |       |
|--------------------------|-------|-------|
| 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.

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

|                                 | Options   | Weighted<br>average<br>exercise price<br>US\$ | Aggregate<br>intrinsic<br>value<br>US\$ | Weighted<br>average<br>remaining<br>contractual<br>term |
|---------------------------------|-----------|---|---|---|
| Outstanding at November 1, 2009 | -         | -   | -                                       | -   |
| Granted                         | 120,000   | 1.92  | 63,000                                  | 2.35  |
| Exercised                       | -         | -   | -                                       | -   |
| Forfeited or expired            | (50,000 ) | 1.00  | (63,000 )                               | 2.21  |
| Outstanding at October 31, 2010 | 70,000    | 2.57  | -                                       | 2.45  |

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

|                                | Options | Weighted average<br>granted date fair<br>value<br>US\$ |
|--------------------------------|---------|--|
| Non-vested at November 1, 2009 | -       | -  |
| Granted                        | 70,000  | 1.91   |
| Vested                         | -       | -  |
| Forfeited or expired           | -       | -  |
| Non-vested at October 31, 2010 | 70,000  | 1.91   |

As of October 31, 2010, there was \$139,935 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 2.45 years.

### (3) Warrants

As of October 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<br>Price<br>US\$ |
|--|-----------|-----------------------------------|
| Outstanding warrants at November 1, 2009 | 1,071,428 | 0.88                              |
| Warrants granted                         | 160,000   | 2.00                              |
| Exercised                                | -         | -                                 |
| Expired/cancelled                        | -         | -                                 |
| Outstanding warrants at October 31, 2010 | 1,231,428 | 1.25                              |



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

| Exercise Prices<br>US\$ | Warrants<br>Outstanding | Warrants outstanding at<br>October 31, 2010                     |  |
|-------------------------|-------------------------|---|--|
|                         |                         | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (years) | Weighted<br>Average<br>Exercise<br>Price<br>US\$ |
| 0.88                    | 1,071,428               |   |  |
| 2.00                    | 160,000                 |   |  |
|                         | 1,231,428               | 1.65  | 1.02   |

## 18. STATUTORY RESERVES

### (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.

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

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

## 19. 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 \$10,527. No payment is to be made in the future years.

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 \$51,411. No payment is to be made in the future years.

During the years ended October 31, 2010 and 2009, the Company incurred rental expenses in the amount of \$367,224 and \$750,219, respectively.

## (2) Capital commitments

On October 12, 2009, we entered into a purchase agreement with Stock Co. to acquire the land use right, property and plant located at our Ah City Natural and Biopharmaceutical plant for a total consideration of \$23,472,000. Pursuant to the purchase agreement, a payment of \$14,670,000 was made to Stock Co. in October 2009, with a final payment of \$8,802,000 due by December 31, 2011, at which time title for the assets will be transferred. According to the agreement, we were exempted from lease payments for the underlying assets starting from May 1, 2010.

Our PRC subsidiary entered into a Property Purchase Contract dated April 10, 2010 with Heilongjiang Yongtai Co, pursuant to which our PRC subsidiary entered into a Property Purchase Contract dated April 10, 2010 with Heilongjiang Yongtai Co, pursuant to which our PRC subsidiary may purchase the 10th and 11th floors of the building located at No. 28, Changjiang St., Nangang District of Harbin Municipal. Our PRC subsidiary has paid the 1st installment of the total purchase price pursuant to such Property Purchase Contract and upon the full payment of the purchase price, Heilongjiang Yongtai Co. will transfer the ownership of such property to our PRC subsidiary.

Our PRC subsidiary may purchase the 10th and 11th floors of the building located at No. 28, Changjiang St., Nangang District of Harbin Municipal. Our PRC subsidiary has paid the 1st installment of the total purchase price pursuant to such Property Purchase Contract and upon the full payment of the purchase price, Heilongjiang Yongtai Co. will transfer the ownership of such property to our PRC subsidiary.

As of October 31, 2010, the Company has capital commitments for purchase of land use rights, property and equipment, office floors and production patents from related parties of approximately \$10,718,154. The amounts to be paid in the future years are as follows:

| Year         | Payment for properties |
|--------------|------------------------|
| 2010         | \$ -                   |
| 2011         | -                      |
| 2012         | 8,993,075              |
| 2013         | 1,725,079              |
| 2014         | -                      |
| Thereafter   | -                      |
| <b>Total</b> | <b>\$ 10,718,154</b>   |

## 20. SUBSEQUENT EVENT

On December 14, 2010, we appointed Mr. Weiqiu Dong as our chief financial officer. Base on the employment agreement, Mr. Dong will receive an annual base salary of approximately \$88,134. In accordance with the appointment, Mr. Dong received, on December 14, 2010, an option to purchase 200,000 shares of the Company's common stock under the 2003 Omnibus Plan. The option vests 60,000 shares on the first anniversary of the date of grant and 70,000 shares on each of the second and third anniversaries of the date of grant. The Option is conditioned upon continued employment on such date, and has a contractual life of 3 years.

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The fair value of the option award is estimated on the date of grant using the Black-Scholes option valuation model to be \$259,251. The valuation was based on the assumptions noted in the following table.

|                          |       |       |
|--------------------------|-------|-------|
| Expected volatility      | 96.46 | %     |
| Expected dividends       | 0     | %     |
| Expected term (in years) | 3     | years |
| Risk-free rate           | 1.06  | %     |

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.

The fair value of the option granted will be expensed according to following schedule:

| Year       | Expensed   |
|------------|------------|
| 2011       | 68,400     |
| 2012       | 89,205     |
| 2013       | 90,708     |
| 2014       | 10,938     |
| Thereafter | -          |
| Total      | \$ 259,251 |

## 21. Restatement

On February 3, 2011, the Company concluded, after a review of the pertinent facts, that the previously issued financial statements contained in the Company's Annual Report on Form 10-K for the year ended October 31, 2010 should not be relied upon due to an error in calculating the weighted average common stock outstanding on a diluted basis as of October 31, 2010 which affected the calculation of the diluted earnings per share. The Company's management has determined that as a result of such error, its reported diluted earnings per share was understated by \$0.03 for the year ended October 31, 2010. The diluted earnings per share for year ended October 31, 2010 should have been \$0.47 based on the weighted average common stock outstanding on a diluted basis of 37,778,028.

As a result of the above, the Company has restated its previously issued consolidated financial statements for the year ended October 31, 2010 to correct the error noted above and file an amendment to the Company's Form 10-K for the year ended October 31, 2010 with the Securities and Exchange Commission. Accordingly, the accompanying consolidated statements of operations and comprehensive income for the year ended December 31, 2010 have been retroactively adjusted as summarized below:

|   | As Reported<br>10/31/2010 | Corrected<br>10/31/2010 | Difference |
|---|---------------------------|-------------------------|------------|
| Net Income  | \$ 17,868,942             | \$ 17,868,942           | -          |
| Weighted average common stock outstanding – Diluted | 40,174,637                | 37,778,028              | 2,396,609  |

|                                     |        |        |        |
|-------------------------------------|--------|--------|--------|
| Earnings per common stock – Diluted | \$0.44 | \$0.47 | \$0.03 |
|-------------------------------------|--------|--------|--------|

In addition, the error in calculating the weighted average common stock outstanding on a diluted basis as of October 31, 2010 also impacted Note 12, Notes to the Consolidated Financial Statements, in connection with the income tax. Upon our review of Note 12, the Company noticed and corrected an error in the tax savings calculations for the year ended October 31, 2010. Accordingly the effects of the tax per share if the Company did not have the tax holiday were corrected as follows:

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|                    | As Reported<br>10/31/2010 | Corrected<br>10/31/2010 | Difference |
|--------------------|---------------------------|-------------------------|------------|
| Tax Savings        | \$ 4,467,236              | \$ 4,749,398            | \$ 282,162 |
| Benefit per share: |                           |                         |            |
| Basic              | \$ 0.13                   | \$ 0.13                 | \$ -       |
| Diluted            | \$ 0.12                   | \$ 0.13                 | \$ 0.01    |

The estimated impact on the Company's proforma financial statements if the tax exemption had not been in place for year ended October 31, 2010 is corrected as follows:

|  | As Reported<br>10/31/2010 | Corrected<br>10/31/2010 | Difference |
|--|---------------------------|-------------------------|------------|
| Net income before tax provision, as reported | \$ 17,868,942             | \$ 17,868,942           | \$ -       |
| Benefit per share:                           | \$ 4,467,236              | \$ 4,749,398            | \$ 282,162 |
| Proforma Net income                          | \$ 13,401,706             | \$ 13,119,544           | \$ 282,162 |
| Proforma Net income per share:               |                           |                         |            |
| Basic  | \$ 0.35                   | \$ 0.35                 | \$ -       |
| Diluted                                      | \$ 0.33                   | \$ 0.35                 | \$ 0.02    |