CHINA JO-JO DRUGSTORES, INC.
Form 10-Q
February 14, 2012

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

FORM 10-Q

(Mark One)

[X] Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934

For the quarterly period ended: December 31, 2011

or

[ ] Transition Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934

For the transition period from ______________ to _______________

Commission File Number: 001-34711

CHINA JO-JO DRUGSTORES, INC.
(Exact name of registrant as specified in its charter)

Nevada	98-0557852
(State or other jurisdiction of incorporation of origination)	(I.R.S. Employer Identification Number)

Room 507-513, 5th Floor A Building, Meidu Plaza Gongshu District, Hangzhou, Zhejiang Province People's Republic of China	N/A
(Address of principal executive offices)	(Zip code)

+86 (571) 88077078
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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 [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [X]

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 13,531,579 shares issued and outstanding as of February 10, 2012.

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CAUTION REGARDING FORWARD-LOOKING INFORMATION

All statements contained in this Quarterly Report on Form 10-Q ("Form 10-Q") for China Jo-Jo Drugstores, Inc., other than statements of historical facts, that address future activities, events or developments are forward-looking statements, including, but not limited to, statements containing the words "believe," "anticipate," "expect" and words of similar import. These statements are based on certain assumptions and analyses made by us in light of our experience and our assessment of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate under the circumstances. However, whether actual results will conform to the expectations and predictions of management is subject to a number of risks and uncertainties that may cause actual results to differ materially.

Such risks include, among others, the following: national and local general economic and market conditions: our ability to sustain, manage or forecast our growth; raw material costs and availability; new product development and introduction; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; the loss of significant customers or suppliers; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; the ability to protect technology; and other factors referenced in this and previous filings.

Consequently, all of the forward-looking statements made in this Form 10-Q are qualified by these cautionary statements and there can be no assurance that the actual results anticipated by management will be realized or, even if substantially realized, that they will have the expected consequences to or effects on our business operations.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	DECEMBER 31, 2011		MARCH 31, 2011	
ASSETS				
CURRENT ASSETS				
Cash	$	4,339,666	$	6,489,905
Restricted cash		1,451,564		921,876
Trade accounts receivable, net		7,374,177		1,484,850
Inventories		7,361,719		4,617,420
Other receivables		1,214,408		1,049,564
Advances to suppliers, net		14,086,803		16,528,772
Other current assets		2,906,589		8,364,267
Total current assets		38,734,926		39,456,654
PROPERTY AND EQUIPMENT, net		15,303,962		5,471,432
OTHER ASSETS				
Long term deposit		2,635,206		2,540,758
Prepaid - noncurrent		6,752,564		6,075,478
Intangible assets, net		2,881,237		390,302
Total other assets		12,269,007		9,006,538
Total assets	$	66,307,895	$	53,934,624
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Accounts payable, trade	$	5,518,920	$	3,530,204
Notes payable		4,836,702		2,704,680
Other payables		1,651,888		627,734
Other payables - related parties		880,058		880,058
Customer deposits		1,883,966		2,038,608
Taxes payable		1,259,043		1,624,558
Accrued liabilities		305,154		311,639
Total current liabilities		16,335,731		11,717,481
Purchase option derivative liability		36,834		153,226
Total liabilities		16,372,565		11,870,707

COMMITMENTS AND CONTINGENCIES				
EQUITY				
Preferred stock; $0.001 par value; 10,000,000 shares authorized; nil issued and outstanding as of December 31, 2011 and March 31, 2011		-		-
Common stock; $0.001 par value; 250,000,000 shares authorized; 13,559,088 and 13,530,477 shares issued and outstanding as of December 31, 2011 and March 31, 2011, respectively		13,559		13,530
Additional Paid-in capital		16,409,543		16,333,956
Statutory reserves		1,309,109		1,309,109
Retained earnings		29,737,898		23,287,474
Accumulated other comprehensive income		2,466,228		1,119,848
Total stockholder's equity		49,936,337		42,063,917
NONCONTROLLING INTEREST		(1,007)		-
Total equity		49,935,330		42,063,917
Total liabilities and equity	$	66,307,895	$	53,934,624

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

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CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME (UNAUDITED)

	Three months ended December 31,		Nine months ended December 31,	
	2011	2010	2011	2010
REVENUES, NET	$ 25,643,949	$ 18,042,309	$ 69,296,755	$ 48,927,907
COST OF GOODS SOLD	18,817,080	12,713,181	49,342,667	34,576,771
GROSS PROFIT	6,826,869	5,329,128	19,954,088	14,351,136
SELLING EXPENSES	2,498,892	1,337,055	6,588,686	3,339,928
GENERAL & ADMINISTRATIVE EXPENSES	2,175,615	1,227,520	4,570,919	2,758,654
OPERATING EXPENSES	4,674,507	2,564,575	11,159,605	6,098,582
INCOME FROM OPERATIONS	2,152,362	2,764,553	8,794,483	8,252,554
OTHER INCOME (EXPENSE), NET	16,343	112,736	222,929	60,985
CHANGE IN FAIR VALUE OF PURCHASE OPTION DERIVATIVE LIABILITY	19,404	119,595	116,392	91,546
INCOME BEFORE INCOME TAXES	2,188,109	2,996,884	9,133,804	8,405,085
PROVISION FOR INCOME TAXES	610,910	759,431	2,684,463	2,387,719
NET INCOME	1,577,199	2,237,453	6,449,341	6,017,366
ADD: NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTEREST	(3,217)	-	1,083	-
NET INCOME ATTRIBUTABLE TO CHINA JO-JO DRUGSTORES, INC.	1,573,982	2,237,453	6,450,424	6,017,366
OTHER COMPREHENSIVE INCOME				
Foreign currency translation adjustments- China Jo-Jo Drugstores, Inc.	262,892	514,170	1,346,380	1,168,202
Foreign currency translation adjustment- noncontrolling interest	31	-	(10)	-
COMPREHENSIVE INCOME	$ 1,836,905	$ 2,751,623	$ 7,796,794	$ 7,185,568
WEIGHTED AVERAGE NUMBER OF SHARES				
Basic	13,557,379	13,500,002	13,546,570	13,220,002
Diluted	13,557,379	13,500,002	13,546,570	13,220,002
EARNINGS PER SHARES				

Basic - attributable to controlling interest	$	0.12	$	0.17	$	0.48	$	0.46
Diluted - attributable to controlling interest	$	0.12	$	0.17	$	0.48	$	0.46

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

CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine months ended December 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 6,449,341	$ 6,017,366
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,065,451	627,387
Stock compensation	75,616	80,445
Bad debt expense	543,435	130,170
Change in fair value of purchase option derivative liability	(116,392)	(91,546)
Changes in operating assets:		
Accounts receivable, trade	(5,082,547)	(2,292,087)
Inventories	1,497,076	(1,257,608)
Other receivables	(636,952)	(351,317)
Advances to suppliers	3,000,229	(10,724,139)
Other current assets	5,635,292	(501,851)
Long term deposit	(17,790)	-
Prepaid - noncurrent	153,828	(337,058)
Changes in operating liabilities:		
Accounts payable, trade	5,554,243	1,935,978
Other payables and accrued liabilities	(862,802)	(282,608)
Customer deposit	(213,660)	-
Taxes payable	(366,393)	(38,313)
Net cash provided by operating activities	17,677,975	(7,085,181)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments and advance on property and equipment purchases	(11,727,452)	(2,096,497)
Net payments for business acquisitions	(3,297,561)	(593,440)
Net cash provided by (used in) investing activities	(15,025,013)	(2,689,937)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in restricted cash	(496,520)	(417,930)
Payments on notes payable	(4,452,229)	1,149,847
Proceeds from equity financing	-	15,708,608
Proceeds from short-term loans	-	(890,160)
Payments on other payables-related parties	-	(54,942)
Net cash (used in) provided by financing activities	(4,948,749)	15,495,423
EFFECT OF EXCHANGE RATE ON CASH	145,548	332,488
(DECREASE) INCREASE IN CASH	(2,150,239)	6,052,793
CASH, beginning of period	6,489,905	801,593
CASH, end of period	$ 4,339,666	$ 6,854,386

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	$	-	$	23,587
Cash paid for income taxes	$	3,254,843	$	2,474,812
Non-cash financing activities				
Notes payable transferred to accounts payable vendors	$	6,480,692	$	3,649,312

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

CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1 – DESCRIPTION OF BUSINESS AND ORGANIZATION

China Jo-Jo Drugstores, Inc. ("Jo-Jo Drugstores" or the "Company"), was incorporated in Nevada on December 19, 2006, originally under the name "Kerrisdale Mining Corporation." On September 24, 2009, the Company changed its name to "China Jo-Jo Drugstores, Inc." in connection with a share exchange transaction as described below.

On September 17, 2009, the Company completed a share exchange transaction with Renovation Investment (Hong Kong) Co., Ltd. ("Renovation"), whereby 7,900,000 shares of common stock were issued to the stockholders of Renovation in exchange for 100% of the capital stock of Renovation. The completion of the share exchange transaction resulted in a change of control. The share exchange transaction was accounted for as a reverse acquisition and recapitalization and, as a result, the condensed consolidated financial statements of the Company (the legal acquirer) are, in substance, those of Renovation (the accounting acquirer), with the assets and liabilities, and revenues and expenses, of the Company being included effective from the date of the share exchange transaction. Renovation has no substantive operations of its own except for its holdings of Zhejiang Jiuxin Investment Management Co., Ltd. ("Jiuxin Management") and Zhejiang Shouantang Medical Technology Co., Ltd. ("Shouantang Technology"), its wholly-owned subsidiaries.

The Company is primarily in the retail drugstore business in the People's Republic of China ("China" or the "PRC"). A majority of the Company's pharmacies are operated by Hangzhou Jiuzhou Grand Pharmacy Chain Co., Ltd. ("Jiuzhou Pharmacy"), a company which the Company controls through contractual arrangements. Shanghai Lydia Grand Pharmacy Co., Ltd. ("Shanghai Lydia"), a wholly-owned subsidiary of Jiuzhou Pharmacy, operates one store location in Shanghai. On July 29, 2011, Shanghai Lydia obtained control of Shanghai Bieyanghong Zhongxing Grand Pharmacy Co. Ltd. ("Bieyanghong Zhongxing"), which also operates one pharmacy in Shanghai (see Note 16 – Business Combination), and Bieyanghong Zhongxing subsequently changed its name to Shanghai Lydia Zhongxing Grand Pharmacy Co., Ltd. ("Shanghai Zhongxing"). One drugstore is operated by Hangzhou Quannuo Grand Pharmacy Co., Ltd. ("Hangzhou Quannuo"), a wholly-owned subsidiary of Zhejiang Quannuo Internet Technology Co., Ltd. ("Quannuo Technology"), which is wholly-owned by Shouantang Technology.

The Company also operates two medical clinics through Hangzhou Jiuzhou Clinic of Integrated Traditional and Western Medicine ("Jiuzhou Clinic") and Hangzhou Jiuzhou Medical and Public Health Service Co., Ltd. ("Jiuzhou Service"), both of which are also controlled by the Company through contractual arrangements. In addition, Hangzhou Jiuxin Qianhong Agriculture Development Co., Ltd. ("Jiuxin Qianhong"), which is wholly-owned by Jiuxin Management, is operating a cultivation project of herbal plants used for traditional Chinese medicine ("TCM"), and Tonglu Lydia Agriculture Development Co., Ltd. ("Tonglu Lydia"), which is wholly-owned by Shouantang Technology, will do the same in the future.

On August 25, 2011, Jiuzhou Pharmacy completed its acquisition of Zhejiang Jiuxin Medicine Co., Ltd. ("Jiuxin Medicine"), which is licensed to distribute prescription and non-prescription pharmaceutical products throughout China (See Note 16 – Business Combination).

On December 20, 2011, Renovation established Hangzhou Jiutong Medical Technology Co., Ltd. ("Jiutong Medical") as a wholly-owned subsidiary to process herbal plants, mainly cultivated by Jiuxin Qianhong, into TCM.

The accompanying consolidated financial statements reflect the activities of the Company and each of the following entities:

Entity Name	Background	Ownership
Renovation HK	Incorporated in Hong Kong SAR on September 2, 2008	100%
Jiuxin Management	Established in the PRC on October 14, 2008 Deemed a wholly foreign owned enterprise ("WFOE") under PRC law Registered capital of $4,500,000 fully paid	100%
Shouantang Technology	Established in the PRC on July 16, 2010 by Renovation with registered capital of $20 million Deemed a WFOE under PRC law $11 million of registered capital paid as of March 31, 2011, the balance of $9 million due by July 16, 2012 To carry out internet pharmacy business, is cooperating with the Company's online store in China to develop its business	100%
Jiuxin Qianhong	Established in the PRC on August 10, 2010 by Jiuxin Management Registered capital of RMB 10,000,000 Renminbi ("RMB") fully paid To carry out cultivation of TCM herbal plants	100%
Quannuo Technology	Established in the PRC on July 7, 2009 Registered capital of RMB 10,000,000 fully paid. Acquired by Shouantang Technology in November 2010 To develop software for internet pharmacy business, which is cooperating with the Company's online store in China to develop its business	100%
Hangzhou Quannuo	Established in the PRC on July 8, 2010 by Quannuo Technology Registered capital of RMB 800,000 fully paid Operates one "Quannuo Grand Pharmacy" as a Jiuzhou Pharmacy franchise store in Hangzhou	100%

Tonglu Lydia	Established in PRC on June 24, 2011 by Shouantang Technology Registered capital of RMB 5,000,000 fully paid To carry out cultivation of TCM herbal plants	100%
Jiuzhou Pharmacy (1)	Established in the PRC on September 9, 2003 Registered capital of RMB 5 million fully paid Operates the “Hangzhou Jiuzhou Grand Pharmacy” stores in and around Hangzhou	VIE by contractual arrangements (2)
Jiuzhou Clinic (1)	Established in the PRC as a general partnership on October 10, 2003 Operates a medical clinic adjacent to one of Jiuzhou Pharmacy’s stores	VIE by contractual arrangements (2)
Jiuzhou Service (1)	Established in the PRC on November 2, 2005 Registered capital of RMB 500,000 fully paid Operates a medical clinic adjacent to one of Jiuzhou Pharmacy’s stores	VIE by contractual arrangements (2)
Shanghai Lydia	Established in the PRC on January 31, 2011 by Jiuzhou Pharmacy Registered capital of RMB 1,000,000 fully paid Operates the “Lydia Grand Pharmacy” store in Shanghai	VIE by contractual arrangements as a wholly-owned subsidiary of Jiuzhou Pharmacy (2)
Jiuxin Medicine	Established in the PRC on December 31, 2003 Business license transferred to Jiuzhou Pharmacy in April 2011 Registered capital of RMB 10 million fully paid To carry out pharmaceutical distribution services	VIE by contractual arrangements as a wholly-owned subsidiary of Jiuzhou Pharmacy (2)
Shanghai Zhongxing	Established in the PRC on June 19, 2006 Registered capital of RMB 1 million fully paid on May 23, 2006 Operates the “Zhongxing Grand Pharmacy” store in Shanghai City	VIE by contractual arrangements as a controlled entity of Jiuzhou Pharmacy through Shanghai Lydia (2)
Jiutong Medical	Established in the PRC on December 20, 2011 by Renovation with registered capital of $5 million $2 million of registered capital paid as of December 31, 2011, the balance of $3 million due by December 20, 2013 To process herbal plants, mainly cultivated by Jiuxin Qianhong, into TCM	100%

(1) Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service have been under the common control of the same three owners (the “Owners”) since their respective establishment dates, pursuant to agreements amongst the Owners to vote their interests in concert as memorialized in a voting agreement. Based on such voting agreement, the Company has determined that common control exists among these three companies in accordance with generally

accepted accounting standards. Operationally, the Owners have operated these three companies in conjunction with one another since each company's respective establishment date. Shanghai Lydia, and Jiuxin Medicine are also deemed under the common control of the Owners as they are each wholly-owned by Jiuzhou Pharmacy, while Shanghai Zhongxing is deemed under the common control of the Owners as it is controlled by Jiuzhou Pharmacy through Shanghai Lydia.

(2) To comply with certain foreign ownership restrictions of pharmacy and medical clinic operators, Jiuxin Management entered into a series of contractual arrangements with Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service on August 1, 2009. These contractual arrangements are comprised of five agreements: consulting services agreement, operating agreement, equity pledge agreement, voting rights proxy agreement and option agreement. As a result of these agreements, which obligate Jiuxin Management to absorb all of the risks of loss from the activities of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, and enable the Company (through Jiuxin Management) to receive all of their expected residual returns, the Company accounts for each of these three companies (as well as each subsidiary of Jiuzhou Pharmacy) as a variable interest entity ("VIE") under the accounting standards of the Financial Accounting Standards Board ("FASB"). Accordingly, the financial statements of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, as well as the subsidiaries and entity under the control of Jiuzhou Pharmacy (Shanghai Lydia, Jiuxin Medicine and Shanghai Zhongxing), are consolidated into the financial statements of the Company.

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation and consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial statements. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. These condensed consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and footnotes included in the Company's annual report on Form 10-K for the fiscal year ended March 31, 2011 filed with the SEC on June 29, 2011. Operating results for the three and nine months ended December 31, 2011 may not be necessarily indicative of the results that may be expected for the full year.

The condensed consolidated financial statements include the financial statements of the Company, its subsidiaries and VIEs. All significant inter-company transactions and balances between the Company, its subsidiaries and VIEs are eliminated upon consolidation.

Consolidation of variable interest entities

In accordance with accounting standards regarding consolidation of variable interest entities, VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders lack adequate decision making ability. All VIEs with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. The primary beneficiary is required to consolidate the VIE for financial reporting purposes.

The Company has concluded, based on its contractual arrangements, that Jiuzhou Pharmacy (including its subsidiaries and controlled entity), Jiuzhou Clinic and Jiuzhou Service are each a VIE and that the Company's wholly-owned subsidiary, Jiuxin Management, absorbs a majority of the risk of loss from the activities of these companies, and enable the Company, through Jiuxin Management, to receive a majority of their expected residual returns.

Additionally, as Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service are under common control, the condensed consolidated financial statements have been prepared as if the transactions had occurred retroactively as to the beginning of the reporting period of these condensed consolidated financial statements.

Control and common control is defined under the accounting standards as "an individual, enterprise, or immediate family members who hold more than 50 percent of the voting ownership interest of each entity." Because the Owners collectively own 100% of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, and have agreed to vote their interests in concert since the establishment of each of these three companies as memorialized the voting rights proxy agreement, the Company believes that the Owners collectively have control and common control of the three companies. Accordingly, the Company believes that Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service were constructively held under common control by Jiuxin Management as of the time the contractual agreements were entered into, establishing Jiuxin Management as their primary beneficiary. Jiuxin Management, in turn, is owned by Renovation, which is owned by the Company.

Although the Company has determined that the accounting standards regarding consolidation of VIEs do not provide for retroactive accounting treatment, Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service in substance were controlled by the Owners on September 9, 2003, October 10, 2003, and November 2, 2005, the establishment dates of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, respectively. Such common control conditions resulted in the share exchange transaction being a capital transaction in substance, reflected as a recapitalization, and the Company has accordingly recorded the consolidation of Renovation at its historical cost.

Risks and uncertainties

The operations of the Company are located in the PRC. Accordingly, the Company's business, financial condition, and results of operations may be influenced by the political, economic, and legal environments in the PRC, as well as by the general state of the PRC economy. The Company's operations in the PRC are subject to special considerations and significant risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, the political, economic and legal environment and foreign currency exchange. The Company's results may be adversely affected by changes in the political, regulatory and social conditions in the PRC, and by changes in governmental policies or interpretations with respect to laws and regulations, anti-inflationary measures, currency conversion, remittances abroad, and rates and methods of taxation, among other things. Although the Company has not experienced losses from these situations and believes that it is in compliance with existing laws and regulations including the organization and structure disclosed in Note 1, this may not be indicative of future results.

The Company has significant cash deposits with suppliers in order to obtain and maintain inventory. The Company's ability to obtain products and maintain inventory at existing and new locations is dependent upon its ability to post and maintain significant cash deposits with its suppliers. In the PRC, many vendors are unwilling to extend credit terms for product sales which require cash deposits to be made. The Company does not generally receive interest on any of its supplier deposits and such deposits are subject to loss as a result of the creditworthiness or bankruptcy of the party who holds such funds, as well as the risk from illegal acts such as conversion, fraud, theft or dishonesty associated with the third party. If these circumstances were to arise, the Company would find it difficult or impossible, due to the unpredictability of legal proceedings in China, to recover all or a portion of the amount on deposit with its vendors.

Members of the current management team own controlling interests in the Company and are also the Owners of the VIEs in the PRC. The Company only controls the VIEs through contractual arrangements which obligate it to absorb the risk of loss and to receive the residual expected returns. As such, the controlling shareholders of the Company and the VIEs could cancel these agreements or permit them to expire at the end of the agreement terms, as a result of which the Company would not retain control of the VIEs.

Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The significant estimates made in the preparation of the accompanying consolidated financial statements relate to the assessment of the carrying values of accounts receivable and related allowance for doubtful accounts, useful lives of property and equipment, lives of intangible assets, business combinations, goodwill, and fair value of purchase option derivative liability. Because of the use of estimates inherent in the financial reporting process, actual results could materially differ from those estimates.

Fair values of financial instruments

The accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy for disclosures of fair value measurement and enhance disclosure requirements for fair value measures. The carrying amounts reported in the accompanying consolidated balance sheets for receivables, payables, notes payable and short-term loans qualify as financial instruments and are a reasonable estimate of fair values because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels of valuation hierarchy are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

Goodwill and other intangible assets

The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed is recognized as goodwill. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the fourth quarter or more frequently if there are indications of impairment. For purposes of the goodwill impairment test, a two-step test is used to identify the potential impairment and to measure the amount of goodwill impairment, if any. The first step is to compare the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. Under step two, the impairment loss is measured by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

Intangibles other than goodwill

Intangible assets that are acquired individually or as part of a group of assets, other than those acquired in a business combination are initially recorded at their fair value. The cost of a group of assets acquired in a transaction is allocated to the individual assets based on their relative fair values. Goodwill does not arise in such a transaction. Intangible assets that are acquired in a business combination are accounted for in accordance with ASC Topic 805, Business Combinations.

The estimated useful lives of the Company's intangible assets are as follows:

	Estimated Useful Life
Goodwill	Indefinite
Licenses and permits	Indefinite
Software	3 years

The Company evaluates intangible assets for impairment whenever events or changes in circumstances indicate that the assets might be impaired.

There was no indication of impairment during the three and nine months ended December 31, 2011.

Revenue recognition

Revenue from sales of prescription medicine at the drugstores is recognized when the prescription is filled and the customer picks up and pays for the prescription.

Revenue from sales of other merchandise at the drugstores is recognized at the point of sale, which is when the customer pays for and receives the merchandise.

Revenue from medical services is recognized after the service has been rendered to the customer.

Revenue from sales of merchandise to non-retail customers is recognized when the following conditions are met: (1) persuasive evidence of an arrangement exists (sales agreements and customer purchase orders are used to determine the existence of an arrangement); (2) delivery of goods has occurred and risks and benefits of ownership have been transferred, which is when the goods are received by the customer at its designated location in accordance with the sales terms; (3) the sales price is fixed or determinable; and (4) collectability is probable. Historically, sales returns have been de minimis.

The Company's revenue is net of value added tax ("VAT") collected on behalf of PRC tax authorities in respect of the sale of merchandise. VAT collected from customers, net of VAT paid for purchases, is recorded as a liability in the accompanying consolidated balance sheets until it is paid to the relevant PRC tax authorities.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, cash on deposit with banks and credit and debit card sales transactions which settle within seven days of the fiscal year-end. The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Restricted cash

The Company's restricted cash consists of cash in a bank as security for its notes payable. The Company has notes payable outstanding with the bank and is required to keep certain amounts on deposit that are subject to withdrawal restrictions. The notes payable are generally short term in nature due to their short maturity period of six to nine months; thus, restricted cash is classified as a current asset.

Accounts receivable

Accounts receivable represent amounts due from banks relating to retail sales that are paid or settled by the customers' debit or credit cards, amounts due from government social security bureaus relating to retail sales of drugs, prescription medicine, and medical services that are paid or settled by the customers' medical insurance cards, and amounts due from non-retail customers for sales of merchandise.

Accounts receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts, as needed. The Company uses the aging method to estimate the allowance for anticipated uncollectible receivable balances. Under the aging method, bad debt percentages determined by management, based on historical experience and current economic climate, are applied to customers' balances categorized by the number of months the underlying invoices have remained outstanding. At each reporting period, the allowance balance is adjusted to reflect the amount computed as a result of the aging method. When facts subsequently become available to indicate that the allowance provided requires an adjustment, a corresponding adjustment is made to the allowance account as a change in estimate. The ultimate collection of the Company's accounts receivable may take one year. Delinquent account balances are reserved after management determines that the likelihood of collection is not probable, and known bad debts are written-off against allowance for doubtful accounts when identified. No allowance was reserved as of December 31, 2011 and March 31, 2011, respectively.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first in first out method ("FIFO"). Market is the lower of replacement cost or net realizable value. The Company records write-downs to inventories for shrinkage losses and damaged merchandise that are identified. Historically, these amounts have not been material to the consolidated financial statements.

Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation or amortization. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets, taking into consideration the assets' estimated residual value. Leasehold improvements are amortized over the shorter of lease term or remaining lease period of the underlying assets. Following are the estimated useful lives of the Company's property and equipment:

	Estimated Useful Life
Buildings	35 years
Leasehold improvements	3-5 years
Motor vehicles	5 years
Office equipment and furniture	3-5 years

Maintenance, repairs and immaterial renewals are charged to expense as incurred. Material additions and betterment to property and equipment are capitalized.

Impairment of long-lived assets

The Company evaluates long-lived tangible and intangible assets for impairment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable from its estimated future cash flows. Recoverability is measured by comparing the asset's net book value to the related projected undiscounted cash flows from these assets, considering a number of factors including past operating results, budgets, economic projections, market trends and product development cycles. If the net book value of the asset exceeds the related undiscounted cash flows, the asset is considered impaired, and a second test is performed to measure the amount of impairment loss. No indication of impairment was noted as of December 31, 2011.

Notes payable

During the normal course of business, the Company issues Bank Acceptance Bills as a payment method to settle outstanding accounts payables to various material suppliers. The Company recorded such Bank Acceptance Bills as notes payables. The notes payable are generally short term in nature due to their short maturity period of six to nine months.

Income taxes

The Company records income taxes pursuant to the accounting standards for income taxes. These standards require the recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between income tax basis and financial reporting basis of assets and liabilities. Provision for income taxes consists of taxes currently due and the net change in deferred taxes. A valuation allowance is recognized if it is more likely than not that some portion, or all of, a deferred tax asset will not be realized. As of December 31, 2011 and March 31, 2011, the Company's deferred tax assets amount to $230,046 and $0, respectively.

No significant penalties or interest relating to income taxes were incurred during the three and nine months ended December 31, 2011 and 2010.

All of the tax returns of the Company, since inception, are subject to examination by the tax authorities.

Stock-based compensation

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with the FASB's accounting standards regarding accounting for stock-based compensation and accounting for equity instruments that are issued to other than employees for acquiring or in conjunction with selling goods or services. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably determinable. The value of equity instruments issued for consideration other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services as defined by these accounting standards. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement.

Advertising and promotion costs

Advertising and promotion costs are expensed as incurred, and amounted to $388,051 and $169,609 for three months ended December 31, 2011 and 2010, respectively, and $636,848 and $312,267 for the nine months ended December 31, 2011 and 2010. Advertising and promotion costs consist primarily of print and television advertisements.

Pre-opening costs

Expenditures related to the opening of new drugstores, other than expenditures for property and equipment, are expensed as incurred.

Vendor allowances

The Company accounts for vendor allowances by reducing the carrying value of inventories which are subsequently transferred to cost of goods sold when the inventories are sold, unless those allowances are specifically identified as reimbursements for advertising, promotion and other services, in which case they are recognized as a reduction of the related advertising and promotion or other service costs.

Distribution costs

Distribution costs represent the costs of transporting merchandise from warehouse to stores. These costs are expensed as incurred and are included in sales and marketing costs.

Foreign currency translation

The Company uses the United States dollar ("U.S. dollars" or "USD") for financial reporting purposes. The Company's subsidiaries and VIEs maintain their books and records in their functional currency the Renminbi ("RMB"), being the currency of the PRC.

In general, for consolidation purposes, the Company translates the assets and liabilities of its subsidiaries and VIEs into U.S. dollars using the applicable exchange rates prevailing at the balance sheet date, and the statements of income and cash flows are translated at average exchange rates during the reporting period. As a result, amounts related to assets and liabilities reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet. Equity accounts are translated at historical rates. Adjustments resulting from the translation of the financial statements of the subsidiaries and VIEs are recorded as accumulated other comprehensive income.

The balance sheet amounts with the exception of equity at December 31, 2011 and March 31, 2011 were translated at 1 RMB to $0.1573 USD and at 1 RMB to $0.1527 USD, respectively. The average translation rates applied to income and cash flow statement amounts for the nine months ended December 31, 2011 and 2010 were at 1 RMB to $0.1556 USD and at 1 RMB to $0.1484 USD, respectively.

Concentrations and credit risk

Certain financial instruments, which subject the Company to concentration of credit risk, consist of cash and restricted cash. The Company has cash balances at financial institutions located in Hong Kong and the PRC. Balances at financial institutions in Hong Kong may, from time to time, exceed Hong Kong Deposit Protection Board’s insured limits. Balances at financial institutions and state-owned banks within the PRC are not covered by insurance. As of December 31, 2011 and March 31, 2011, the Company had deposits totaling $5,520,222 and $7,068,093 that were not covered by insurance, respectively. To date, the Company has not experienced any losses in such accounts.

For the three months ended December 31, 2011, two vendors collectively accounted for 34% of the Company’s total purchases and 4% of total advances to suppliers. For the three months ended December 31, 2010, three vendors collectively accounted for 28% of the Company’s total purchases and 11% of total advances to suppliers.

For the nine months ended December 31, 2011, two vendors collectively accounted for 25% of the Company’s total purchases and 4% of total advances to suppliers. For the nine months ended December 31, 2010, three vendors collectively accounted for 35% of the Company’s total purchases and 27% of total advances to suppliers.

Noncontrolling interest

As of December 31, 2011, 1% of the equity interests of Shanghai Zhongxing was owned by Shanghai Bieyanghong Grand Pharmacy Co., Ltd. and not under the Company's control.

Business combinations

The Company accounts for business combinations using the acquisition method of accounting. The acquisition method requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications have no effect on net income or cash flows.

Note 3 – OTHER CURRENT ASSETS

Other current assets consist of the following:

	December 31, 2011	March 31, 2011
Prepaid rental expenses	$ 2,134,165	$ 1,316,626
Lease rights transfer fees (1)	400,697	380,981
Security deposit with vendor	-	4,581,132
Prepaids and other current assets	371,727	166,148
Advance to contractor	-	1,919,380
Total	$ 2,906,589	$ 8,364,267

(1) Lease rights transfer fees are paid by the Company to secure store rentals in coveted areas. These additional costs of acquiring the right to lease new store locations are capitalized and amortized over the period of the initial lease term.

Note 4 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	December 31, 2011	March 31, 2011
Buildings	$ 1,104,310	$ -
Leasehold improvements	12,268,543	3,481,773
Office equipment and furniture	3,782,326	867,304
Motor vehicles	388,824	269,275
Total	17,544,003	4,618,352
Less: Accumulated depreciation	(4,479,843)	(2,661,615)
Construction-in-progress	2,239,802	3,514,695
Property and equipment, net	$ 15,303,962	$ 5,471,432

Construction-in-progress as of December 31, 2011, included leasehold improvements in progress at the newly leased store locations. These stores are currently under remodeling and are not in operation. For the three and nine months ended December 31, 2011, $1,104,310 and $8,214,368 were transferred from CIP to buildings and leasehold improvements. No such transfer occurred for the three and nine months ended December 31, 2010. No depreciation is provided for construction-in-progress until such time as the assets are completed and placed into service.

Total depreciation expense for property and equipment was $900,759 and $89,006 for the three months ended December 31, 2011 and 2010, respectively, and $1,719,343 and $393,708 for the nine months ended December 31, 2011 and 2010, respectively.

Note 5 – ADVANCES TO SUPPLIERS

Advances to suppliers consist of deposits with or advances to outside vendors for future inventory purchases. Most of the Company's vendors require a certain amount of money to be deposited with them as a guarantee that the Company will receive its purchase on a timely basis. This amount is refundable and bears no interest. As of December 31, 2011 and March 31, 2011, the allowance for advances to suppliers amounted to $340,965 and $0, respectively.

Note 6 – LONG TERM DEPOSITS, LANDLORDS

Long term deposits are funds deposited with or advanced to landlords for securing retail store leases for which the Company does not anticipate applying or being returned within the next twelve months. Most of the Company's landlords require a minimum of nine months' rent being paid upfront plus additional deposits.

Note 7 – PREPAID - NONCURRENT

Prepaid – noncurrent consist of the following:

	December 31, 2011	March 31, 2011
Prepayment for lease of land use right – noncurrent (1)	$ 5,387,525	$ 5,497,358
Lease rights transfer fees-noncurrent (2)	440,010	578,120
Prepayment made for equipment	786,500	-
Other prepaid – noncurrent	138,529	-
Total	$ 6,752,564	$ 6,075,478

(1) This is a payment made to the local government in connection with entering into a 30-year operating land lease agreement.

(2) Lease rights transfer fees are paid by the Company to secure store rentals in coveted areas. These additional costs of acquiring the right to lease new store locations are capitalized and amortized over the period of the initial lease term.

Note 8 – INTANGIBLE ASSETS

Net intangible assets consist of the following at:

	December 31, 2011	March 31, 2011
Goodwill on acquisition of Jiuxin Medicine	$ 1,394,360	$ -
Goodwill on acquisition of Shanghai Zhongxing	69,197	-
Licenses and permits	1,130,503	-
Software	459,483	446,059
Total goodwill and other intangible assets	3,053,543	446,059
Less: accumulated amortization	(172,306)	(55,757)
Intangible assets, net	$ 2,881,237	$ 390,302

Amortization expense for the three months ended December 31, 2011 and 2010 amounted to $38,217 and $0, respectively, and $113,629 and $0 for the nine months ended December 31, 2011 and 2010, respectively.

Note 9 – TAXES

Income tax

Entity	Income Tax Jurisdiction
Jo-Jo Drugstores	United States
Renovation	Hong Kong
All other entities	PRC

The following table reconciles the U.S. statutory tax rates to the Company's effective tax rate for the three and nine months ended December 31, 2011 and 2010:

	For the three months ended December 31		For the nine months ended December 31	
	2011	2010	2011	2010
U.S. Statutory rates	34%	34%	34%	34%
Foreign income not recognized in the U.S.	(34)	(34)	(34)	(34)
China income taxes	25	25	25	25
Non deductible expenses	3	-	4	3
Effective tax rate	28%	25%	29%	28%

Jo-Jo Drugstores is incorporated in the U.S. and incurred a net operating loss for income tax purposes for 2010. As of December 31, 2011, the estimated net operating loss carryforwards for U.S. income tax purposes amounted to $1,200,000 which may be available to reduce future years' taxable income. These carryforwards will expire, if not utilized by 2031. Management believes that the realization of the benefits arising from this loss appears to be uncertain due to the Company's limited operating history and continuing losses for U.S. income tax purposes. Accordingly, the Company has provided a 100% valuation allowance at December 31, 2011. The net change in the valuation allowance for the nine months ended December 31, 2011 and 2010 was an increase of approximately $131,000 and $232,000, respectively. Management reviews this valuation allowance periodically and makes adjustments as necessary.

The Company had cumulative undistributed earnings of foreign subsidiaries of approximately $31 million as of December 31, 2011, which are included in consolidated retained earnings and will continue to be indefinitely reinvested in international operations. Accordingly, no provision has been made for U.S. deferred taxes related to future repatriation of these earnings.

Taxes payable at December 31, 2011 and March 31, 2011 consist of the following:

	December 31, 2011	March 31, 2011
VAT	$ 369,984	$ 421,562
Income tax	840,096	1,146,453
Others	48,963	56,543
Total taxes payable	$ 1,259,043	$ 1,624,558

Note 10 – POSTRETIREMENT BENEFITS

Regulations in the PRC require the Company to contribute to a defined contribution retirement plan for all permanent employees. The contribution for each employee is based on a percentage of the employee's current compensation as required by the local government. The Company contributed $157,247 and $34,686 for the three months ended December 31, 2011 and 2010, respectively, and $373,474 and $75,446 for the nine months ended December 31, 2011 and 2010, respectively, in employment benefits and pension.

Note 11 – RELATED PARTY TRANSACTIONS AND ARRANGEMENTS

Amounts receivable from and payable to related parties are summarized as follows:

	December 31, 2011	March 31, 2011
Amount due to directors (1):	$ 880,058	$ 800,058

(1) As of December 31, 2011 and March 31, 2011, amount due to directors represents advances from the Owners to the Company to meet its approved PRC registered capital requirements and for operating cash flow.

As of December 31, 2011 and March 31, 2011, notes payable totaling $4,836,702 and $1,609,336 were secured by the personal properties of certain of the Company's shareholders, respectively.

One of the Company's retail spaces and its corporate office are leased from Lei Liu, a director of the Company, under long-term operating lease agreements from August 2010 to August 2012 and from January 2011 to December 2012, respectively. The rent expense amounted to $47,100 and $45,000 for the three months ended December 31, 2011 and 2010, respectively. The rent expense amounted to $140,040 and $133,524 for the nine months ended December 31, 2011 and 2010, respectively. Rent paid to Mr. Liu amounted to $0 for the three months ended December 31, 2011 and 2010; and $0 and $44,190 for the nine months ended December 31, 2011 and 2010, respectively.

Note 12 – PURCHASE OPTION DERIVATIVE LIABILITY

In connection with the public offering of the Company's common stock that closed on April 28, 2010, the Company issued to its underwriters, Madison Williams and Company and Rodman & Renshaw, LLC, an option for $100 to purchase up to a total of 105,000 shares of common stock (3% of the shares sold in the public offering) at $6.25 per share (125% of the price of the shares sold in the public offering). The option is exercisable commencing on October 23, 2010 and expires on April 22, 2015.

The Company is treating the common shares underlying the option as a derivative liability as the strike price of the option is denominated in U.S. dollars, a currency other than the Company's functional currency, the Chinese RMB. As a result, the option is not considered indexed to the Company's own stock, and as such, all future changes in the fair value of the option are recognized currently in earnings until such time as the option is exercised or expired.

On April 22, 2010, the issue date of the option, the Company classified the fair value of this option as a liability resulting in a decrease of additional paid-in capital of $402,451 and the establishment of $402,451 in liability to recognize the option's fair value. The Company recognized a gain of $19,404 and $116,392 from the change in fair value of the option liability for the three and nine months ended December 31, 2011, respectively, and a gain of $119,595 and $91,546 for the three and nine months ended December 31, 2010, respectively.

This option does not trade in an active securities market, and as such, the Company estimates its fair value using the Black-Scholes Option Pricing Model (the "Black-Scholes Model") as of December 31, 2011 using the following assumptions:

	Underwriter Purchase Option December 31, 2011 (1)	
Stock price	$	1.14
Exercise price	$	6.25
Annual dividend yield		0%
Expected term (years)		3.30
Risk-free interest rate		0.36%
Expected volatility		99%

(1) As of December 31, 2011, the option to purchase 105,000 shares of common stock had not been exercised.

Expected volatility is based on historical volatility. Historical volatility was computed using daily pricing observations for recent periods that correspond to the term of the option. The Company believes this method produces an estimate that is representative of future volatility over the expected term of this option. The expected life is based on the remaining term of the option. The risk-free interest rate is based on U.S. Treasury securities according to the remaining term of the option.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Depending on the product and the terms of the transaction, the fair values of option liability are modeled using a series of techniques, including closed-form analytic formula, such as the Black-Scholes Model, which does not entail material subjectivity because the methodology employed does not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets.

The fair value of the 105,000 shares underlying the option outstanding as of December 31, 2011 was determined using the Black-Scholes Model, with certain inputs significant to the valuation methodology as level 2 inputs, and the Company recorded the change in fair value in earnings. As a result, the option liability is carried on the consolidated balance sheets at fair value.

Note 13 – STOCKHOLDER’S EQUITY

Common stock

On April 9, 2010, the Company effected a 1-for-2 reverse split of its issued and outstanding shares of common stock and a proportional reduction of its authorized shares of common stock. All share and per share amounts used in the Company’s consolidated financial statements and accompanying notes have been retroactively restated to reflect the 1-for-2 reverse stock split.

On April 28, 2010, the Company closed a public offering of 3.5 million shares of common stock at $5.00 per share with gross proceeds of approximately $17.5 million.

Stock-based compensation

On March 15, 2010, the Company entered into a service agreement with a non-executive director and agreed to issue 6,897 shares of restricted common stock for his annual service. The terms of the service agreement was continued on March 15, 2011, and 11,268 shares of restricted common stock to be issued accordingly. The trading value of the Company’s common stock on March 15, 2011 and 2010 was $3.55 and $5.80, respectively. Accordingly, $10,082 and $10,080 were charged to general and administrative expense for the three months ended December 31, 2011 and 2010, respectively, and $30,137 and $30,137 were charged for the nine months ended December 31, 2011 and 2010, respectively.

On May 1, 2010, the Company agreed to issue 2,340 shares of common stock to its legal counsel as partial payment for six months of legal services. The trading value of the Company's common stock on May 1, 2010 was $4.80. Accordingly, $7,488 and $11,232 was charged to general and administrative expense for the three and nine months ended December 31, 2010, respectively.

On May 1, 2010, the Company agreed to issue 6,000 shares of common stock to an employee as partial payment for compensation. The trading value of the Company's common stock on May 1, 2010 was $4.80. Accordingly, $0 and $4,800 were charged to general and administrative expense for the three months ended December 31, 2011 and 2010, respectively, and $2,400 and $12,000 were charged for the nine months ended December 31, 2011 and 2010, respectively.

On May 14, 2010, the Company entered into an agreement pursuant to which the Company agreed to issue 10,000 shares of restricted common stock in connection with the services of Mr. Bennet P. Tchaikovsky as chief financial officer through April 27, 2011, upon the adoption of a stock incentive plan (the "Plan"). The trading value of the Company's common stock on May 14, 2010 was $4.66. Accordingly, $0 and $3,444 were charged to general and administrative expense for the three and nine months ended December 31, 2011, respectively, and $11,748 and $31,665 were charged for the three and nine months ended December 31, 2010, respectively.

On May 14, 2010, the Company also agreed to issue to Mr. Tchaikovsky 4,000 shares of restricted common stock from the Plan as a bonus. The trading value of the Company's common stock on May 14, 2010 was $4.66. Accordingly, $18,640 was charged to general and administrative expense for the three and nine months ended December 31, 2010, respectively.

On November 1, 2010, the Company agreed to issue 2,340 shares of common stock to its legal counsel as partial payment for six months of legal services. On May 1, 2011, the Company agreed to issue an additional 2,340 shares of common stock to its legal counsel as partial payment for another six months of legal services. The terms of the service agreement was continued on November 1, 2011, and 2,340 shares of restricted common stock to be issued accordingly. The trading value of the Company's common stock on November 1, 2011, May 1, 2011 and November 1, 2010 were $1.66, $2.71 and $5.00, respectively. Accordingly, $2,363 and $9,576 was recorded as service compensation expense for the three and nine months ended December 31, 2011.

On August 1, 2011, the Company appointed Mr. Ming Zhao as its chief financial officer, and in connection therewith, entered into an agreement pursuant to which the Company agreed to issue to Mr. Zhao 40,000 shares of restricted common stock under the Plan, to be vested in eight equal quarterly installments over two years. The trading value of the Company's common stock on August 1, 2011 was $1.70. Accordingly, $8,500 and $14,136 was charged to general and administrative expense for the three and nine months ended December 31, 2011, respectively.

On August 1, 2011, the Company appointed Mr. Tchaikovsky to its board of directors, and in connection therewith, entered into an agreement pursuant to which the Company agreed to issue to Mr. Tchaikovsky 5,883 shares of its restricted common stock under the Plan. The trading value of the Company's common stock on August 1, 2011 was $1.70. Accordingly, $2,501 and $4,159 was charged to general and administrative expense for the three and nine months ended December 31, 2011, respectively.

On August 1, 2011, the Company entered into an agreement pursuant to which the Company agreed to issue 4,613 shares of restricted common stock under the Plan in connection with Mr. Tchaikovsky's services as chief financial officer from April 28, 2011 to August 1, 2011. The trading value of the Company's common stock on April 28, 2011 was $2.71. Accordingly, $0 and $12,500 was charged to general and administrative expense for the three and nine months ended December 31, 2011, respectively.

Statutory reserve

Statutory reserves represent restricted retained earnings. Based on their legal formation, each of the Company's subsidiaries and VIEs in the PRC is required to set aside 10% of its net income as reported in their statutory accounts on an annual basis to the Statutory Surplus Reserve Fund (the "Reserve Fund"). Once the total amount set aside in the Reserve Fund reaches 50% of the entity's registered capital, further appropriations become discretionary. The Reserve Fund can be used to increase the entity's registered capital upon approval by relevant government authorities or eliminate its future losses under PRC GAAP upon a resolution by its board of directors. The Reserve Fund is not distributable to shareholders, as cash dividend or otherwise, except in the event of liquidation.

Appropriations to the Reserve Fund are accounted for as a transfer from unrestricted earnings to statutory reserves. During the nine months ended December 31, 2011 and 2010, no appropriation was made to the statutory reserves by any of the Company's operating subsidiaries and VIEs in the PRC. Any subsidiary or VIE still in developmental stage also did not allocate any contribution to the Reserve Fund during such periods.

There are no legal requirements in the PRC to fund the Reserve Fund by transfer of cash to any restricted accounts, and the Company does not do so.

Note 14 – EARNINGS PER SHARE

The Company reports earnings per share in accordance with the provisions of the FASB's related accounting standard. This standard requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution, but includes vested restricted stocks and is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

The following is a reconciliation of the basic and diluted earnings per share computation: