CHINA JO-JO DRUGSTORES, INC.
Form 10-Q
November 14, 2011

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: September 30, 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 (State or other jurisdiction of incorporation of origination)	98-0557852 (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 (Address of principal executive offices)	N/A (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 issuer's classes of common stock, as of the latest practicable date: 13,548,603 shares issued and outstanding as of November 11, 2011.

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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)

	SEPTEMBER 30, 2011	MARCH 31, 2011
ASSETS		
CURRENT ASSETS		
Cash	$4,590,274	$6,489,905
Restricted cash	749,015	921,876
Trade accounts receivable, net	4,705,866	1,484,850
Inventories	7,529,108	4,617,420
Other receivables	1,096,201	1,049,564
Advances to suppliers	15,166,494	16,528,772
Other current assets	2,862,349	8,364,267
Total current assets	36,699,307	39,456,654
PROPERTY AND EQUIPMENT, net	15,470,148	5,471,432
OTHER ASSETS		
Long term deposit	2,620,910	2,540,758
Prepaid - noncurrent	6,830,221	6,075,478
Intangible assets, net	2,866,539	390,302
Total other assets	12,317,670	9,006,538
Total assets	$64,487,125	$53,934,624
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable, trade	$7,275,302	$3,530,204
Notes payable	2,494,643	2,704,680
Other payables	1,299,284	627,734
Other payables - related parties	939,490	880,058
Customer deposits	2,770,868	2,038,608
Taxes payable	1,119,423	1,624,558
Accrued liabilities	460,152	311,639
Total current liabilities	16,359,162	11,717,481
Purchase option derivative liability	56,238	153,226
Total liabilities	16,415,400	11,870,707

COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock; $0.001 par value; 10,000,000 shares authorized; nil issued and outstanding as of September 30, 2011 and March 31, 2011	–	–
Common stock; $0.001 par value; 250,000,000 shares authorized; 13,548,603 and 13,530,477 shares issued and outstanding as of September 30, 2011 and March 31, 2011, respectively	13,548	13,530
Additional Paid-in capital	16,386,071	16,333,956
Statutory reserves	1,309,109	1,309,109
Retained earnings	28,163,916	23,287,474
Accumulated other comprehensive income	2,203,336	1,119,848
Total equity	48,075,980	42,063,917
NONCONTROLLING INTEREST	(4,255)	-
Total liabilities and equity	$64,487,125	$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 September 30,		Six months ended September 30,	
	2011	2010	2011	2010
REVENUES, NET	$22,224,947	$15,678,170	$43,652,806	$30,885,598
COST OF GOODS SOLD	15,967,051	11,270,058	30,525,587	21,863,590
GROSS PROFIT	6,257,896	4,408,112	13,127,219	9,022,008
SELLING EXPENSES	2,711,494	1,179,515	4,089,794	2,002,873
GENERAL & ADMINISTRATIVE EXPENSES	1,320,521	757,372	2,395,304	1,531,134
OPERATING EXPENSES	4,032,015	1,936,887	6,485,098	3,534,007
INCOME FROM OPERATIONS	2,225,881	2,471,225	6,642,121	5,488,001
OTHER INCOME (EXPENSE), NET	187,166	5,781	206,586	(51,751)
CHANGE IN FAIR VALUE OF PURCHASE OPTION DERIVATIVE LIABILITY	34,356	(85,993)	96,988	(28,049)
INCOME BEFORE INCOME TAXES	2,447,403	2,391,013	6,945,695	5,408,201
PROVISION FOR INCOME TAXES	817,990	763,564	2,073,553	1,628,288
NET INCOME	1,629,413	1,627,449	4,872,142	3,779,913
ADD: NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTEREST	4,300	-	4,300	-
NET INCOME ATTRIBUTABLE TO CONTROLLING INTEREST	1,633,713	1,627,449	4,876,442	3,779,913
OTHER COMPREHENSIVE INCOME				
Foreign currency translation adjustments	508,923	554,610	1,083,488	654,032
COMPREHENSIVE INCOME	$2,142,636	$2,182,059	$5,959,930	$4,433,945
WEIGHTED AVERAGE NUMBER OF SHARES				
Basic	13,547,157	13,500,002	13,541,136	13,079,237
Diluted	13,547,157	13,504,247	13,541,136	13,086,959
EARNINGS PER SHARES				
Basic - attributable to controlling interest	$0.12	$0.12	$0.36	$0.29
Diluted - attributable to controlling interest	$0.12	$0.12	$0.36	$0.29

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)

	Six months ended September 30, 2011	Six months ended September 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$4,872,142	$3,779,913
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,118,932	404,080
Stock compensation	52,133	58,615
Bad debt expense	182,398	-
Change in fair value of purchase option derivative liability	(96,988)	28,049
Changes in operating assets:		
Accounts receivable, trade	(2,435,921)	(353,528)
Inventories	1,282,841	(766,479)
Other receivables	(523,817)	(157,814)
Advances to suppliers	2,173,332	(3,347,523)
Other current assets	5,610,337	(755,209)
Long term deposit	(18,485)	-
Prepaid - noncurrent	106,115	(418,806)
Changes in operating liabilities:		
Accounts payable, trade	4,279,623	2,217,876
Other payables and accrued liabilities	(1,046,197)	(336,074)
Customer deposit	676,373	-
Taxes payable	(495,891)	(195,176)
Net cash provided by operating activities	15,736,927	157,924
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(2,155,443)	(206,478)
Advance payments on equipment purchase	(774,500)	-
Additions to leasehold improvements	(1,373,605)	(503,219)
Payments on construction-in-progress	(6,729,437)	-
Net payments for business acquisitions	(3,282,727)	-
Net cash used in investing activities	(14,315,712)	(709,697)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in restricted cash	193,300	(201,092)
Payments on notes payable	(3,703,942)	(1,470,429)
Proceeds from shareholder	58,862	-
Proceeds from equity financing	-	15,708,608
Proceeds from short-term loans	-	(883,920)
Payments on other payables-related parties	-	(54,942)
Net cash (used in) provided by financing activities	(3,451,780)	13,098,225
EFFECT OF EXCHANGE RATE ON CASH	130,934	196,988

(DECREASE) INCREASE IN CASH	(1,899,631)	12,743,440
CASH, beginning of period	6,489,905	801,593
CASH, end of period	$4,590,274	$13,545,033
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$-	$23,587
Cash paid for income taxes	$2,428,768	$1,700,826
Non-cash financing activities		
Notes payable transferred to accounts payable vendors	$3,431,091	$1,892,631

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

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"), where by 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).

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)

(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 six months ended September 30, 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 to be 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 they are 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.

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, live 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 six months ended September 30, 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 September 30, 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
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 September 30, 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 September 30, 2011 and March 31, 2011, the Company did not have any net deferred tax assets or liabilities.

The FASB's accounting standards clarify the accounting and disclosure for uncertain tax positions and prescribe a recognition threshold and measurement attribute for recognition and measurement of a tax position taken or expected to be taken in a tax return. The accounting standards also provide guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. Under these standards, a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. Penalties or interest incurred relating to underpayment of income taxes are classified as income tax expense in the period incurred. No significant penalties or interest relating to income taxes were incurred during the three and six months ended September 30, 2011 and 2010.

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

Value added tax

Sales revenue represents the invoiced value of goods, net of VAT. All of the Company's products are sold in the PRC and are subject to a VAT on the gross sales price. The VAT rates range up to 17%, depending on the type of products sold. The VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing or acquiring its finished products. The Company recorded a VAT payable and VAT receivable net of payments in the accompanying financial statements. The VAT tax return is filed offsetting the payables against the receivables.

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 $117,197 and $103,239 for three months ended September 30, 2011 and 2010, respectively; and $248,797 and $142,658 for the six months ended September 30, 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.

The Company recognized vendor allowances of $102,963 and $111,659 in cost of goods sold for the three months ended September 30, 2011 and 2010, respectively, and $175,768 and $381,638 in cost of goods sold for the six months ended September 30, 2011 and 2010, respectively.

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.

Operating leases

The Company leases premises for retail drugstores and offices under non-cancelable operating leases. Operating lease payments are expensed over the term of lease. A majority of the Company's retail drugstore leases have a 3- to 10-year term with a renewal option upon the expiration of the lease. The Company has historically been able to renew a majority of its drugstores leases. Under the terms of the lease agreements, the Company has no legal or contractual asset retirement obligations at the end of the lease. Land leased from government is amortized on a straight-line basis over a 30-year term.

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 People's Republic of China.

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 September 30, 2011 and March 31, 2011 were translated at 1 RMB to $0.1564 USD and at 1 RMB to $0.1527 USD, respectively. The average translation rates applied to income and cash flow statement amounts for the six months ended September 30, 2011 and 2010 were at 1 RMB to $0.1549 USD and at 1 RMB to $0.14732 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 September 30, 2011 and March 31, 2011, the Company had deposits totaling $5,040,786 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 and six months ended September 30, 2011 and 2010, all of the Company's sales and purchases arose in the PRC.

For the three months ended September 30, 2011, two vendors collectively accounted for 22% of the Company's total purchases, 3% of total purchase deposits. For the three months ended September 30, 2010, three vendors collectively accounted for 39% of the Company's total purchases and 60% of total purchase deposits.

For the six months ended September 30, 2011, two vendors collectively accounted for 27% of the Company’s total purchases, 3% of total purchase deposits. For the six months ended September 30, 2010, three vendors collectively accounted for 40% of the Company’s total purchases and 60% of total purchase deposits.

Noncontrolling interest

As of September 30, 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. The provisions of the acquisition method related to income tax adjustments apply to all business combinations regardless of consummation date.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This is an exit price concept for the valuation of the asset or liability. In addition, market participants are assumed to be buyers and sellers in the principal market for the asset or liability. Fair value measurements for an asset assume the highest and best use by these market participants.

Recently issued accounting pronouncements

In May 2011, the FASB and International Accounting Standards Board (“IASB”) issued Accounting Standard Update (“ASU”) No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 created a uniform framework for applying fair value measurement principles for companies around the world and clarified existing guidance in US GAAP. ASU 2011-04 is effective for the first reporting annual period beginning after December 15, 2011 and shall be applied prospectively. The Company does not expect the adoption of this ASU to have any material effect on its consolidated financial statements.

In June 2011, the FASB issued Comprehensive Income (Topic 220) — Presentation of Comprehensive Income (ASU No. 2011-05), which updates the Codification to require the presentation of the components of net income, the components of other comprehensive income (OCI) and total comprehensive income in either a single continuous statement of comprehensive income or in two separate, but consecutive statements of net income and comprehensive income. These updates do not affect the items reported in OCI or the guidance for reclassifying such items to net income. These updates to the Codification are effective for interim and annual periods beginning after December 15, 2011. The Company does not expect the implementation of this guidance to have a material impact on its consolidated financial statements.

In September 2011, the FASB issued Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment (ASU No. 2011-08), which amends ASC 350 to first assess qualitative factors before performing the quantitative goodwill impairment testing. The ASU provides the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the results of the qualitative analysis indicate it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative two-step impairment test, which is required under current U.S. GAAP, would not be necessary. The ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The implementation of the ASU is not expected to have a material impact on the Company’s financial statements.

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:

	September 30, 2011	March 31, 2011
Prepaid rental expenses	$ 2,325,499	$ 1,316,626
Lease rights transfer fees (1)	402,447	380,981
Security deposit with vendor	-	4,581,132
Prepaids and other current assets	134,403	166,148
Advance to contractor	-	1,919,380
Total	$ 2,862,349	$ 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 consisted of the following:

	September 30, 2011	March 31, 2011
Leasehold improvements	$ 5,105,253	$ 3,481,773
Office equipment and furniture	3,155,360	867,304
Motor vehicles	367,749	269,275
Total	8,628,361	4,618,352
Less: Accumulated depreciation	(3,552,540)	(2,661,615)
Construction-in-progress	10,394,357	3,514,695
Property and equipment, net	$ 15,470,178	$ 5,471,432

Construction-in-progress as of September 30, 2011, included leasehold improvements in progress at two newly purchased and three newly leased store locations. These stores are currently under remodeling and are not in operation. 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 $593,866 and $156,118 for the three months ended September 30, 2011 and 2010, respectively, and $818,584 and $304,702 for the six months ended September 30, 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. Historically, the Company has not experienced any losses as a result of these advances.

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:

	September 30, 2011	March 31, 2011
Prepayment for lease of land use right – noncurrent (1)	$ 5,395,800	$ 5,497,358
Lease rights transfer fees-noncurrent (2)	484,969	578,120
Prepayment made for equipment	782,000	-
Other prepaid – noncurrent	167,452	-
Total	$ 6,830,221	$ 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:

	September 30, 2011	March 31, 2011
Goodwill on acquisition of Jiuxin Medicine	$ 1,386,382	$ -
Goodwill on acquisition of Shanghai Zhongxing	68,801	-
Licenses and permits	1,087,751	-
Software	456,854	446,059
Total goodwill and other intangible assets	2,999,788	446,059
Less: accumulated amortization	(133,249)	(55,757)
Intangible assets, net	$ 2,866,539	$ 390,302

Amortization expense for the three months ended September 30, 2011 and 2010 amounted to $37,949 and $0, respectively, $75,412 and $0 for the six months ended September 30, 2011 and 2010, respectively.

Note 9 – TAXES

Income tax

Entity	Income Tax Jurisdiction
Jo-Jo Drugstores	United States
Renovation	Hong Kong
Jiuxin Management	PRC
Shouantang Technology	PRC
Jiuxin Qianhong	PRC