China Botanic Pharmaceutical
Form 10-Q
September 19, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended July 31, 2012

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

For the transition period from______ to_______

Commission File Number: 001-34808

CHINA BOTANIC PHARMACEUTICAL INC.

(Exact name of registrant as specified in its charter)

Nevada	**88-1273503**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

Level 11, Changjiang International Building

No. 28, Changjiang Road, Nangang District, Harbin

Heilongjiang Province, China 150090

(Address of principal executive offices)

<u>86-451-5762-03787</u>

(Registrant's Telephone Number, Including Area Code)

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

x Yes o 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).

x Yes o No

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

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

o Yes x No

As of September 4, 2012, there were 37,239,536 shares of the registrant's $0.001 par value common stock issued and outstanding.

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

This Quarterly Report contains certain forward-looking statements. When used in this Quarterly Report, statements which are not historical in nature, including the words “anticipate,” “estimate,” “should,” “expect,” “believe,” “intend,” “m “project,” “plan” or “continue,” and similar expressions are intended to identify forward-looking statements. They also include statements containing anticipated business developments, a projection of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

The forward-looking statements in this Quarterly Report are based upon management’s beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to them. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. These forward-looking statements are based on our current plans and expectations and are subject to a number of uncertainties and risks that could significantly affect current plans and expectations and our future financial condition and results.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this filing might not occur. We qualify any and all of our forward-looking statements entirely by these cautionary factors. As a consequence, current plans, anticipated actions and future financial conditions and results may differ from those expressed in any forward-looking statements made by or on our behalf. You are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented herein.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets

	Note	July 31, 2012 (Unaudited)	October 31, 2011 (Audited)
ASSETS			
Current assets			
Cash		$41,308,177	$ 15,283,583
Trade receivables, net	5	17,129,544	21,548,325
Inventory, net	7	15,301,659	7,416,720
Other receivables, net	6	180,211	6,823,410
Total current assets		73,919,591	51,072,038
Property and equipment, net	8	4,254,975	1,778,984
Intangible assets, net	9	16,739,514	17,146,700
Construction-in-progress	10	1,952,353	1,937,103
Deposits for properties	12	33,818,763	37,822,113
Deferred tax assets	13	140,322	139,226
Total assets		$130,825,518	$ 109,896,164
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Liabilities			
Accounts payable		$1,785,043	$ 2,098,256
Tax payable		2,358,644	5,976,417
Accrued employee benefits	16	2,710,301	2,131,565
Warrant Liabilities	17	1,086	23,443
Total liabilities		6,855,074	10,229,681
Shareholders' equity			
Preferred stock (no par value, 1,000,000 shares authorized; none issued and outstanding as of July 31, 2012 and October 31, 2011,respectively)	18	-	-
Common stock ($0.001 par value, 100,000,000 shares authorized; 37,239,536 issued and outstanding as of July 31, 2012 and October 31, 2011, respectively)	18	37,240	37,240
Additional paid-in capital		8,332,212	7,763,987
Common stock warrants	19	0	496,732
Reserves	20	3,372,697	3,372,697

Accumulated other comprehensive income	9,440,272	8,620,695
Retained earnings	102,788,023	79,375,132
Total shareholders’ equity	123,970,444	99,666,483
Total liabilities and shareholders’ equity	$130,825,518	$ 109,896,164

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

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income and Comprehensive Income (Unaudited)

	Note	For the three months ended July 31, 2012	2011	For the nine months ended July 31, 2012	2011
Sales, net		$15,076,663	12,376,352	66,239,139	53,875,101
Cost of goods sold		6,190,688	4,908,939	27,399,579	21,450,356
Gross profit		8,885,975	7,467,413	38,839,560	32,424,745
Operating and administrative expenses:					
Sales and marketing		1,832,351	1,559,863	5,247,122	4,430,053
General and administrative		1,365,805	1,233,288	3,221,192	2,744,932
Research and development		1,900,363	1,686,677	2,928,875	2,585,863
Total operating expenses		5,098,519	4,479,828	11,397,189	9,760,848
Income from operations		3,787,456	2,987,585	27,442,371	22,663,897
Other income:					
Interest income, net		44,153	34,144	109,079	81,286
Income before income tax expenses		3,831,609	3,021,729	27,551,450	22,745,183
Income tax expenses	14	576,071	501,884	4,138,559	2,195,987
Net income		$3,255,538	2,519,845	23,412,891	20,549,196
Other comprehensive income:					
Unrealized currency translation adjustments		143,931	828,537	819,577	3,004,411
Total comprehensive income		3,399,469	3,348,382	24,232,468	23,553,607
Earnings per common stock- Basic	15	$0.09	0.07	0.63	0.55
Earnings per common stock - Diluted		$0.09	0.07	0.63	0.54
Weighted average common stock outstanding	15				
Basic		37,239,536	37,239,536	37,239,536	37,239,536
Diluted		37,239,536	37,473,911	37,239,536	37,749,587

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

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CHINA BOTANIC PHARMACEUTICAL INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Note	For the nine months ended July 31, 2012	2011
Cash flows from operating activities:			
Net income		$ 23,412,891	$ 20,549,196
Adjustments to reconcile net income to operating activities:			
Depreciation		367,173	286,379
Amortization		541,380	368,782
Share compensation		71,493	96,981
Noncash rental expenses		760,652	572,065
Warrants liability reevaluation		(22,357)	(305,797)
Deferred tax assets		-	(135,409)
Changes in assets and liabilities:			
Decrease in trade receivables, net		4,581,688	6,891,867
(Increase) in due from related parties		-	(98,049)
(Increase) in inventory, net		(7,815,061)	(3,815,951)
Decrease (Increase) in other receivables, net		6,687,086	(115,187)
(Decrease) in accounts payable		(329,248)	(159,845)
(Decrease) Increase in tax payable		(3,659,443)	1,898,697
Increase in accrued employee benefits		561,130	391,128
Net cash provided by operating activities		25,157,384	26,424,857
Cash flows from investing activities:			
Deposits for land use right, property and patents		(908,396)	(15,255,064)
Refunds from patents deposit		2,525,651	-
Increase in construction-in-progress		-	(1,884,000)
Purchase of property and equipment		(908,396)	(5,862)
Net cash provided by (used in) investing activities		708,859	(17,144,926)
Effect of exchange rate changes on cash		158,351	1,215,171
Net increase in cash		26,024,594	10,495,102
Cash, beginning of year		15,283,583	27,826,142
Cash, end of year		$ 41,308,177	$ 38,321,244
Supplemental disclosure of cash flow information:			
Noncash investing activities in office building	8	1,917,149	-
Cash paid during the year for income taxes		8,595,354	-
Interest paid during the year		-	-

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

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CHINA BOTANIC PHARMACEUTICAL INC.

Notes to Unaudited Condensed Consolidated Financial Statements

July 31, 2012 and 2011

NOTE 1 – DESCRIPTION OF THE BUSINESS

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

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

June 1997	ComTech Consolidation Group, Inc
February 1999	E-Net Corporation
May 1999	E-Net Financial Corporation
January 2000	E-Net.Com Corporation
February 2000	E-Net Financial.Com Corporation
January 2002	Anza Capital, Inc ("Anza")
June 2006	Renhuang Pharmaceuticals, Inc.
October 2010	China Botanic Pharmaceutical Inc.

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

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

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

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

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

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company has included all adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the result of operations for the three and nine months ended July 31, 2012 and 2011. The condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and notes for the year ended October 31, 2011 included in the Company's Annual Report on Form 10-K. Interim results are not necessarily indicative of results for the full year due to seasonal and other factors.

This summary of significant accounting policies of the Company is presented to assist in understanding the Company's condensed consolidated financial statements. The condensed consolidated financial statements and notes are representation of the Company's management, which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the consolidated financial statements for July 31, 2012 and October 31, 2011.

a. Basis of presentation of financial statements

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

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

b. Principles of consolidation

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

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

FASB ASC Topic 810, “*Consolidation”,* requires noncontrolling minority interests to represent the portion of earnings that is not within the parent company’s control. The noncontrolling minority interests are required to be reported as equity instead of as a liability on the balance sheet. In addition this statement requires net income from noncontrolling minority interest to be shown separately on the condensed consolidated statements of income and comprehensive income. The Company has no noncontrolling interest as of July 31, 2012 and October 31, 2011.

c. Use of estimates

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

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

d. Foreign currency translation

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

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

As of July 31, 2012 and October 31, 2011, the exchange rates were RMB 6.33 and RMB 6.38, respectively. For the three months ended July 31, 2012 and 2011, the average exchange rates were RMB 6.33 and RMB 6.48, and the net income translation adjustments totaled $143,931 and $828,537, respectively. For the nine months ended July 31, 2012 and 2011, the average exchange rates were RMB 6.34 and RMB 6.56, and the net income translation adjustments totaled $819,577 and $3,004,411, respectively.

e. Cash

There are no restriction to cash at July 31, 2012 and October 31, 2011. Substantially all of the Company's cash is held in bank accounts in the PRC and is not protected by the Federal Deposit Insurance Corporation ("FDIC") insurance or any other similar insurance. Given the current economic environment and risks in the banking industry, there is a risk that deposits may not be readily available.

f. Trade receivables, net

Trade receivables are recorded at the invoiced amount and do not bear interest. Trade receivable payment terms vary and amounts due from customers are stated in the condensed consolidated financial statements net of an allowance for doubtful accounts and sales rebates. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its trade receivables. Trade receivables outstanding longer than the payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time the trade receivable is past due, the Company's previous loss history, the counter party's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off receivables when they are deemed uncollectible, and payments subsequently received on such trade receivables are credited to the allowance for doubtful accounts. There were no trade receivables write offs for the three and nine months ended July 31, 2012 and 2011. The Company does not have any off-balance sheet credit exposure related to its customers.

g. Inventory, net

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

The Company estimates an inventory provision for excessive, slow moving and obsolete inventories as well as inventory whose carrying value is in excess of net realizable value. Inventory amounts are reported net of such allowances. There were no inventory write offs for the three and nine months ended July 31, 2012 and 2011.

h. Property and equipment, net

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

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

Machinery and equipment	10 years
Office equipment and furnishings	5-10 years
Motor vehicles	5-10 years
Office buildings	30 years

i. Intangible assets, net

Intangible assets consist of purchased patents and resource using right. Intangible assets are carried at cost less accumulated amortization and any impairment. Intangible assets with a finite useful life are amortized using the straight-line method over valid periods varied from 10 to 30 years, which is the estimated economic life of the intangible assets.

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j. Accounting for the impairment of long-lived assets

The Company's long-lived assets and other assets (consisting of property and equipment) are reviewed for impairment in accordance with the guidance of the FASB ASC Topic 360, "*Property, Plant, and Equipment,"* FASB ASC Topic 350, *"Intangibles - Goodwill and Others,"* and FASB ASC Topic 205 "*Presentation of Financial Statements*." The Company tests for impairment losses on long-lived assets used in operations whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Recoverability of an asset to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Impairment evaluations involve management's estimates on asset useful lives and future cash flows. Actual useful lives and cash flows could be different from those estimated by management which could have a material effect on our reporting results and financial positions. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. As of July 31, 2012 and October 31, 2011, the Company had not experienced impairment losses on its long-lived assets. However, there can be no assurances that demand for the Company's products or services will continue, which could result in an impairment of long-lived assets in the future.

k. Fair value of financial instruments

The Company applies the provisions of accounting guidance, FASB ASC Topic 825, "*Financial Instruments,*" that requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value, and defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of July 31, 2012 and October 31, 2011 the carrying value of cash, trade receivables, other receivables and accounts payable, approximated their fair value. All derivatives are recorded at fair value evaluated based on Black-Scholes option model.

l. Fair value measurements

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

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

- Level 1 – observable market inputs that are unadjusted quoted prices for identical assets or liabilities in active markets.

- Level 2 – other significant observable inputs (including quoted prices for similar securities, interest rates, credit risk, etc.).

- Level 3 – significant unobservable inputs (including the Company’s own assumptions in determining the fair value of financial instruments).

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

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

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

m. Revenue recognition

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

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

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

As of July 31, 2012 and October 31, 2011, the Company has accrued $1,225,303 and $1,681,721, respectively, for sales rebates, which offset the balance of trade receivables. For the three months ended July 31, 2012 and 2011, the Company has deducted sales rebates in the amount of $1,408,448 and $790,792, respectively, from sales. For the nine months ended July 31, 2012 and 2011, the Company has deducted sales rebates in the amount of $6,061,247 and $4,995,396, respectively, from sales.

n. Sales returns and allowances

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

o. Cost of goods sold

Cost of goods sold primarily consists of direct and indirect manufacturing costs, including raw material, packaging material, production overhead costs, city construction tax and educational tax for the products sold.

p. Sales and marketing

Sales and marketing costs consist primarily of advertising and market promotion expenses, and other overhead expenses incurred by the Company's sales and marketing personnel. Sales and marketing expenses are expensed as incurred and amounted to $1,832,351 and $1,559,863 during the three months ended July 31, 2012 and 2011, respectively, and $5,247,122 and $4,430,053 during the nine months ended July 31, 2012 and 2011, respectively.

q. Research and development

Research and development ("R&D") consists primarily of cost of materials and overhead expenses incurred by research and development staff. Research and development costs are expensed as incurred. Research and development expenses amounted to $1,900,363 and $1,686,677 during the three months ended July 31, 2012 and 2011, respectively, and $2,928,875 and $2,585,863 for the nine months ended July 31, 2012 and 2011, respectively.

r. Employee benefit costs

According to the PRC regulations on pension, a company contributes to a defined contribution retirement plan organized by municipal government in the province in which the CBP China was registered and all qualified employees are eligible to participate in the plan. Contributions to the plan are calculated at 22% of the employees' salaries above a fixed threshold amount.

s. Share-based compensation

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

t. Taxation

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

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

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

The Company does not accrue United States income tax on unremitted earnings from foreign operations, as it is the Company's intention to invest these earnings in the foreign operations indefinitely.

Generally, years beginning after fiscal 2007, the Company is open to examination by PRC taxing authorities. In the United States, we are open to examination from 2008 onward.

Enterprise income tax

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

CBP China secured preferential tax treatment in the jurisdiction where it conducts its manufacturing activity, where it was granted tax exemption of 10% from the government, for being a new and high-technology enterprise. The Company currently pays 15% enterprise income tax.

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

A provision has not been made at July 31, 2012 and October 31, 2011 for U.S. or additional foreign withholding taxes on the undistributed earnings of foreign subsidiaries because it is the present intention of management to reinvest the undistributed earnings indefinitely in foreign operations. Generally, such earnings become subject to U.S. tax upon the remittance of dividends and under certain other circumstances. It is not practicable to estimate the amount of deferred tax liability on such undistributed earnings.

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

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of July 31, 2012 and October 31, 2011 are not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax benefits as of July 31, 2012 and October 31, 2011, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax law and policy, that the unrecognized tax benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company’s results of operations, financial condition or cash flows.

Value added tax

The Provisional Regulations of The People’s Republic of China Concerning Value Added Tax promulgated by the State Council came into effect on January 1, 1994. Under these regulations and the Implementing Rules of the Provisional Regulations of the PRC Concerning Value Added Tax, value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

Value added tax payable in The People’s Republic of China is charged on an aggregated basis at a rate of 13% or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided, but excluding, in respect of both goods and services, any amount paid in respect of value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year to get the net value added tax payable in the period.

u. Comprehensive Income

Total comprehensive income is defined as all changes in shareholders' equity during a period, other than those resulting from investments by and distributions to shareholders (i.e., issuance of equity securities and dividends). Generally, for the Company, total comprehensive income equals net income plus or minus adjustments for currency translation. Total comprehensive income represents the activity for a period net of related tax and was $3,399,469 and $3,348,382 for the three months ended July 31, 2012 and 2011, respectively, and $24,232,468 and $23,553,607 for the nine months ended July 31, 2012 and 2011, respectively.

While total comprehensive income is the activity in a period and is largely driven by net earnings in that period, accumulated other comprehensive income or loss ("AOCI") represents the cumulative balance of other comprehensive income as of the balance sheet date. For the Company, AOCI is primarily the cumulative balance related to the currency adjustments and increased overall equity by $9,440,272 and $8,620,695 as of July 31, 2012 and October 31, 2011, respectively.

v. Earnings per share

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

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

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

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

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

w. Warrants

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

In accordance with accounting guidance FASB ASC Topic 825, the Company accounts for financial instruments as a liability if it embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and that requires or may require the issuer to settle the obligation by transferring assets. Freestanding financial instruments are financial instruments that are entered into separately and apart from any of the entity's other financial instruments or equity transactions, or that is entered into in conjunction with some other transaction and is legally detachable and separately exercisable. The liability recorded is at fair market value per Black-Scholes option model.

On March 25, 2010, we issued warrants to purchase 160,000 shares of our common stock to a certain investor relation service provider. The warrants were recognized at fair value and were recorded as liability.

NOTE 3 – RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the FASB issued ASU No. 2011-10, "Property, Plant and Equipment (Topic 360): Derecognition of in Substance Real Estate – a Scope Clarification (a consensus of the FASB Emerging Issues Task Force). The ASU No. 2011-10 requires that a parent deconsolidate a subsidiary if the parent ceases to have a controlling financial interest in the subsidiary (except for a sale of in substance real estate). However, in situations other than a sale of in substance real estate, differing views exist in practice on whether the parent of an in substance real estate subsidiary must satisfy the criteria in Subtopic 360-20, Property, Plant, and Equipment – Real Estate Sales, in order to derecognize the in substance real estate. For public entities, the amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. Early adoption is permitted. The adoption of this ASU is not expected to have a material impact on the Company's condensed consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11 Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities: The amendments in this Update will enhance disclosures required by U.S. GAAP by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this Update. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. It is not expected to have a material impact on the Company's condensed consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12 Comprehensive Income (Topic 220): In order to defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this Update supersede certain pending paragraphs in Update 2011-05. The amendments are being made to allow the Board time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the Board is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report 2 reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05. All other requirements in Update 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this ASU is not expected to have a material impact on the Company's condensed consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment, which allows an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. If an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, it will not be required to perform a quantitative impairment test for that asset. Entities are required to test indefinite-lived assets for impairment at least annually, and more frequently if indicators of impairment exist. This ASU will be effective for the Company on February 3, 2013, with early adoption permitted. The adoption of this ASU is not expected to have a significant effect on our results of operations or financial position.

Other recently issued accounting pronouncements did not, or are not believed by management to, have a material effect on the Company's present or future consolidated financial statements.

NOTE 4 - CONCENTRATIONS OF BUSINESS AND CREDIT RISK

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

(1) Cash

The Company maintains certain bank accounts in the PRC which are not protected by FDIC insurance or other insurance. Cash balance held in PRC bank accounts amounted to $41,308,177 and $15,283,583, as of July 31, 2012 and October 31, 2011, respectively. No cash balances were restricted as of July 31, 2012 and October 31, 2011.

As of July 31, 2012 and October 31, 2011, substantially all of the Company's cash were held by major financial institutions located in the PRC which management believes are of high credit quality.

(2) Sales and trade receivables

The Company provides credit in the normal course of business and substantially all customers are located in the PRC. The Company performs ongoing credit evaluations of its customers and maintains allowances for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends, and other information. Prior to deduction of sales rebates, there is one individual customer accounted for 12% of total sales and there is none accounted for over 10% of total sales during the three months ended July 31, 2012 and 2011, respectively. This individual customer is accounted for 12% of accounting receivables as of July 31, 2012. There is one individual customer accounted for 10% of total sales and there is none accounted for over 10% of total sales during nine months ended July 31, 2012 and 2011, respectively. This individual customer is accounted for 12% of account receivables as of July 31, 2012.

The Company's products are sold throughout the PRC. For three months ended July 31, 2012 and 2011, botanical anti-depression and nerve-regulation products accounted for 71% and 70%, respectively, of total sales. For nine months ended July 31, 2012 and 2011, botanical anti-depression and nerve-regulation products accounted for 68% and 68%, respectively, of total sales.

(3) Foreign currency

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

(4) Dividends

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

(5) Price control

The retail prices of certain pharmaceuticals sold in the PRC, primarily those included in the national and provincial Medical Insurance Catalogs are subject to price controls in the form of fixed prices or price ceilings. As such, the retail prices for certain of the Company’s pharmaceutical products can be adjusted downward or upward from time to time. Price controls did not have a material impact on the Company’s operation during the three and nine months ended July 31, 2012 and 2011.

(6) Cost of goods sold

Cost of goods sold is subject to price fluctuations due to various factors beyond the Company’s control, including, among other pertinent factors, inflation and changes in governmental regulations and programs. The Company expects cost of goods sold will continue to fluctuate and be affected by inflation in the future. The Company’s raw materials are purchased from various independent suppliers. The Company does have long term relationships with major suppliers to ensure quality material, good service with competitive prices. The Company maintains an updated qualified supplier list to secure the Company’s material needs in case of changing situation from any one of our major suppliers. There are three and four individual suppliers of over 10% of total purchasing accounted for 59% and 68% of total purchasing during the three months ended July 31, 2012 and 2011, respectively. These three and four individual suppliers are accounted for 87% and 100% of trade payable as of July 31, 2012 and October 31, 2011, respectively. There are three and two individual suppliers of over 10% of total purchasing accounted for 43% and 36% of total purchasing during nine months ended July 31, 2012 and 2011, respectively. These three and two individual suppliers are accounted for 87% and 75% of trade payable as of July 31, 2012 and October 31, 2011.

NOTE 5 - TRADE RECEIVABLES, NET

The trade receivables amount included in the condensed consolidated balance sheets as of July 31, 2012 and October 31, 2011 were as follows:

	July 31, 2012 US$	October 31, 2011 US$
Trade receivables	18,832,775	23,704,241
Less: Sales rebates	(1,225,303)	(1,681,721)
Less: Allowance for doubtful accounts	(477,928)	(474,195)
Trade receivables, net	17,129,544	21,548,325

NOTE 6 - OTHER RECEIVABLES, NET

The other receivables amount included in the condensed consolidated balance sheets as of July 31, 2012 and October 31, 2011 were as follows:

	July 31, 2012 US$	October 31, 2011 US$
Advanced Siberian Ginseng payment	-	6,631,157
Other receivables	568,545	577,554
Less: Allowance for doubtful accounts	(388,334)	(385,301)
Other receivables, net	180,211	6,823,410

The Company advanced Siberian Ginseng payment to two of our employees in our Dongfanghong branch, Mr. Zhao, Fengwu and Mr. Deng, Fujie before October 31, 2011 for the purchasing of Siberian Ginseng raw material in the Siberian Ginseng harvest season. There was no such advance at July 31, 2012.

NOTE 7 - INVENTORY, NET

The inventory amounts included in the condensed consolidated balance sheets for as of July 31, 2012 and October 31, 2011 comprised of:

	July 31, 2012 US$	October 31, 2011 US$
Raw materials	1,443,678	946,600
Packaging materials	3,782,804	1,896,169
Work-in-progress	8,740,389	3,205,862
Finished goods	1,404,006	1,436,767
Less: Inventory provision	(69,218)	(68,678)
Inventory, net	15,301,659	7,416,720

NOTE 8 - PROPERTY AND EQUIPMENT, NET

On April 10, 2010, CBP China entered into a Purchase Agreement with Hongxiangmingyuan of Heilongjiang Yongtai Company, to acquire two office floors for a total consideration of $6,064,878. Pursuant to the Purchase Agreement, a payment of $4,245,415 was made in April 2010 and recorded as deposits on the condensed consolidated balance sheet. Pursuant to the Purchase Agreement, final payment of $1,819,463was paid in May 2012. The title of one office floor was transferred in May 2012, the Company reclassified $2,829,699 from deposits to property and equipment and started depreciation over the estimated useful life of the asset. The other office floor is still in the process of title transfer.

Property and equipment and related accumulated depreciation as of July 31, 2012 and October 31, 2011 were as follows:

	July 31, 2012 US$	October 31, 2011 US$
Machinery and equipment	3,739,492	3,710,282
Office Building	2,829,699	-
Office equipment and furnishings	66,874	66,352
Motor vehicles	57,206	56,759
Total:	6,693,271	3,833,393
Less: Accumulated depreciation	(2,438,296)	(2,054,409)
Net book value	4,254,975	1,778,984

The depreciation expense incurred and recognized on our condensed consolidated statements of income and comprehensive income during the three and nine months ended July 31, 2012 and 2011 were as follow:

	For the three months ended July 31,	
	2012 US$	2011 US$
Depreciation expenses in general and administrative	75,251	5,365
Depreciation expenses in cost of goods sold	94,418	92,283
Total depreciation expenses	169,669	97,648

	For the nine months ended July 31,	
	2012 US$	2011 US$
Depreciation expenses in general and administrative	84,185	12,899
Depreciation expenses in cost of goods sold	282,988	273,480
Total depreciation expenses	367,173	286,379

No assets were pledged for borrowings as of July 31, 2012 and October 31, 2011.

NOTE 9 - INTANGIBLE ASSETS, NET

Intangible assets and related accumulated amortization as of July 31, 2012 and October 31, 2011 were as follows:

	July 31, 2012 US$	October 31, 2011 US$
YiChun undergrowth resources	15,808,527	15,685,044
Product patents	2,529,364	2,509,607
Total	18,337,891	18,194,651
Less: Accumulated amortization	(1,598,377)	(1,047,951)
Intangible assets, net	16,739,514	17,146,700

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The amortization expense of intangible assets incurred and recognized on our condensed consolidated statements of income and comprehensive income during the three and nine months ended July 31, 2012 and 2011 were as follow:

	For the three months ended July 31,	
	2012	2011
	US$	US$
Amortization Expense:	180,631	167,776

	For the nine months ended July 31,	
	2012	2011
	US$	US$
Amortization Expense:	541,380	368,782

The following table shows the estimated amortization expenses expected to be incurred in the next five years:

Year	Amortization Expense
2012 remaining	$ 180,631
2013	722,524
2014	722,524
2015	722,524
2016	722,524
2017 and thereafter	13,668,787
Total	$ 16,739,514

NOTE 10 - CONSTRUCTION-IN-PROGRESS

The total capital expenses in Construction-in-progress as of July 31, 2012 and October 31, 2011 were as follows:

	July 31, 2012	October 31, 2011
	US$	US$
Ah City Pharmaceutical Plant phase two	1,952,353	1,937,103

Plant and production lines currently under development at the Ah City Pharmaceutical Plant Phase Two are accounted for as construction-in-progress. Construction-in-progress is recorded at historical cost, including development expenditures, professional fees and the interest expenses capitalized during the course of construction for the purpose of financing the project. Upon readiness for use of the project, the cost of construction-in-progress is transferred to property and equipment, at which time depreciation will commence. The Company had no capitalized interest and to date has funded this construction through operations without the use of outside debt financing. The Ah City Phase Two is expected to be completed in the end of 2013 and these amounts will be reclassified to property and equipment when it is ready to use.

NOTE 11 - RELATED PARTY TRANSACTIONS

On October 12, 2009, we entered into a purchase agreement with Renhuang Stock, which Mr. Shaoming Li, our chairman, chief executive officer and president, is also chairman and a 50% shareholder of Harbin Renhuang Pharmaceutical Stock Co. Ltd (“Renhuang Stock”), to acquire the land use right, property and plant located at our Ah City Natural and Biopharmaceutical plant for a total consideration of $25,293,644. Pursuant to the purchase agreement, a payment of $15,808,527 was made to Renhuang Stock in October 2009 and a payment of $7,904,264 was made to Renhuang Stock in January 2011, with a final payment of $1,580,853 due by the date of receiving all the related government transfer documents, at which time title for the assets will be transferred. Accordingly the transaction is considered incomplete as of July 31, 2012. The Company recorded the payments under the Deposits for properties on condensed consolidated balance sheet.

Before the transaction is completed, the Company is deemed to lease property and plant from Renhuang Stock. Rental expenses related to this lease, incurred and expensed to condensed consolidated statements of income and comprehensive income, which were forgiven rental expenses and recognized to account for the rental exemption pursuant to the purchase agreement, and the deposits for the property were reduced accordingly. Under the purchase terms, the Company does not pay rent to Renhuang Stock for the use of the property and plant before the title is transferred. The detailed forgiven rental expense incurred and recognized to date is explained at Note. 12.

NOTE 12 - DEPOSITS FOR PROPERTIES

Deposits for properties as of July 31, 2012 and October 31, 2011 were listed as following:

	July 31, 2012			October 31, 2011		
Name of Asset	Prepaid Amount	Rent expenses deducted	Net deposits	Prepaid Amount	Rent expenses deducted	Net deposits
Ah City Pharmaceutical Plant	$23,712,791	$(1,811,457)	$21,901,334	$23,527,566	$(1,209,375)	$22,318,191
Office Floor	3,032,439	(236,530)	2,795,909	4,212,253	(268,209)	3,944,044
Product Patents	9,121,520	-	9,121,520	11,559,878	-	11,559,878
Total	$35,866,750	$(2,047,987)	$33,818,763	$39,299,697	$(1,477,584)	$37,822,113

Forgiven rental expenses incurred and recognized to the condensed consolidated financial statements of income and comprehensive income during the three and nine months ended July 31, 2012 and 2011, respectively, were listed as following:

	For the three months ended July 31,	
	2012	2011
	US$	US$
Ah City Pharmaceutical Plant		