CHINA JO-JO DRUGSTORES, INC.
Form 10-Q
February 19, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2013

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________________________________ to ____

Commission File Number: 001-34711

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

Nevada	98-0557852
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1st Floor, Yuzheng Plaza No. 76 Yuhuangshan Road Hangzhou, Zhejiang Province People’s Republic of China	
(Address of principal executive offices)	(Zip Code)

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

N/A
(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 þ No o

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 (Sec.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 þ No o

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	o	Accelerated Filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	þ

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

As of February 14, 2014, the registrant had 14,309,002 shares of common stock, par value $0.001 per share, outstanding.

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TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED DECEMBER 31, 2013

CAUTION REGARDING FORWARD-LOOKING INFORMATION

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

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

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

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CHINA JO-JO DRUGSTORES, INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	December 31, 2013	March 31, 2013
A S S E T S		
CURRENT ASSETS		
Cash	$3,106,659	$4,524,094
Trade accounts receivable, net	10,192,379	12,978,808
Inventories	18,231,126	8,586,999
Other receivables, net	423,715	157,849
Advances to suppliers, net	6,678,349	15,523,034
Restricted cash	3,229,744	2,162,837
Other current assets	2,272,678	1,221,499
Total current assets	44,134,650	45,155,120
PROPERTY AND EQUIPMENT, net	12,597,796	13,288,652
OTHER ASSETS		
Long term deposits	2,835,137	2,760,665
Other noncurrent assets	5,443,025	5,431,326
Intangible assets, net	2,477,648	1,202,258
Total other assets	10,755,810	9,394,249
Total assets	$67,488,256	$67,838,021
L I A B I L I T I E S A N D S T O C K H O L D E R S' E Q U I T Y		
CURRENT LIABILITIES		
Short-term loan payable	$163,700	$-
Accounts payable, trade	19,296,244	13,780,211
Notes payable	8,045,331	7,186,453
Other payables	3,211,101	1,327,454
Other payables - related parties	2,134,802	1,224,417
Customer deposits	4,040,587	4,828,293
Taxes payable	465,326	371,633
Accrued liabilities	222,203	956,342
Total current liabilities	37,579,294	29,674,803
Purchase option derivative liability	101,988	15,609
Total liabilities	37,681,282	29,690,412

COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock; $0.001 par value; 10,000,000 shares authorized; nil issued and outstanding as of December 31, 2013 and March 31, 2013	-	-
Common stock; $0.001 par value; 250,000,000 shares authorized; 13,959,002 shares issued and outstanding as of December 31, 2013 and March 31, 2013	13,959	13,609
Additional paid-in capital	17,077,556	16,609,747
Statutory reserves	1,309,109	1,309,109
Retained earnings	7,026,561	17,095,369
Accumulated other comprehensive income	4,342,311	3,121,654
Total stockholders' equity	29,769,496	38,149,488
Noncontrolling interests	37,478	(1,879)
Total equity	29,806,974	38,147,609
Total liabilities and stockholders' equity	$67,488,256	$67,838,021

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 OPERATIONS AND COMPREHENSIVE LOSS
(UNAUDITED)

	For the three months ended December 31,		For the nine months ended December 31,	
	2013	2012	2013	2012
REVENUES, NET	$17,833,072	$15,596,013	$50,025,012	$75,108,458
COST OF GOODS SOLD	17,653,988	12,605,711	43,296,356	63,551,182
GROSS PROFIT	179,084	2,990,302	6,728,656	11,557,276
SELLING EXPENSES	5,338,404	3,179,168	9,998,377	7,140,013
GENERAL AND ADMINISTRATIVE EXPENSES	3,700,466	3,300,064	6,833,265	7,456,956
TOTAL OPERATING EXPENSES	9,038,870	6,479,232	16,831,642	14,596,969
LOSS FROM OPERATIONS	(8,859,786)	(3,488,930)	(10,102,986)	(3,039,693)
OTHER INCOME (LOSS), NET	130,426	(25,380)	127,034	(75,178)
GOODWILL IMPAIRMENT LOSS	-	-	-	(1,473,606)
CHANGE IN FAIR VALUE OF DERIVATIVE LIABILITIES	(41,944)	(12,095)	(50,328)	13,652
LOSS BEFORE INCOME TAXES	(8,771,304)	(3,526,405)	(10,026,280)	(4,574,825)
PROVISION FOR INCOME TAXES	(35,887)	(39,613)	43,222	(93,886)
NET LOSS	(8,735,417)	(3,486,792)	(10,069,502)	(4,480,939)
ADD: NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTEREST	187	271	694	856
NET LOSS ATTRIBUTABLE TO CHINA JO-JO DRUGSTORES, INC.	(8,735,230)	(3,486,521)	(10,068,808)	(4,480,083)
OTHER COMPREHENSIVE INCOME				
Foreign currency translation adjustments	259,814	52,538	1,019,605	107,547
COMPREHENSIVE LOSS	$(8,475,416)	$(3,433,983)	$(9,049,203)	$(4,372,536)
WEIGHTED AVERAGE NUMBER OF SHARES:				
Basic	13,959,003	13,588,569	13,730,742	13,575,550
Diluted	13,959,003	13,588,569	13,730,742	13,575,550
LOSS PER SHARE:				
Basic	$(0.64)	$(0.26)	$(0.73)	$(0.33)
Diluted	$(0.64)	$(0.26)	$(0.73)	$(0.33)

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

CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine months ended December 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (10,069,502)	$ (4,480,939)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,646,066	2,118,133
Stock compensation	477,284	135,107
Bad debt direct write-off	252,780	155,797
Allowance for accounts receivables	578,219	1,690,544
Allowance for advances to suppliers	(1,523,882)	319,481
Goodwill Impairment	-	1,482,327
Change in fair value of purchase option derivative liability	86,379	(13,652)
Inventory reserve and write-off	1,539,514	-
Change in operating assets:		
Accounts receivable, trade	2,278,341	(5,581,444)
Notes receivable	-	-
Inventories	(10,870,349)	(734,011)
Other receivables	(259,339)	(1,035,445)
Advances to suppliers	10,706,963	(5,404,917)
Other current assets	(1,009,632)	607,793
Long term deposit	-	422,457
Other noncurrent assets	133,648	331,544
Change in operating liabilities:		
Accounts payable, trade	5,099,673	6,891,514
Other payables and accrued liabilities	1,074,755	708,621
Customer deposits	(909,992)	755,387
Taxes payable	82,942	(141,984)
Net cash provided by (used in) operating activities	(686,132)	(1,773,687)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(457,609)	(252,128)
Purchase of land use right	(1,355,290)	-
Additions to leasehold improvements	(25,112)	(253,515)
Net cash used in investing activities	(1,838,011)	(505,643)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from short-term bank loan	162,280	-
Change in restricted cash	(999,814)	3,244
Change in notes payable	659,246	2,512,678
Change in other payables-related parties	909,954	(391,664)
Net cash provided by financing activities	731,666	2,124,258
EFFECT OF EXCHANGE RATE ON CASH	375,042	117,484

INCREASE (DECREASE) IN CASH		(1,417,435)		(37,588)
CASH, beginning of period		4,524,094		3,833,216
CASH, end of period	$	3,106,659	$	3,795,628
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for income taxes	$	9,529	$	72,024
Charge of property and equipment into disposal loss at store closing	$	-	$	76,368
Transfer from construction-in-progress to leasehold improvement	$	-	$	2,707,183
Good receipts against accounts receivables	$	1,434,043	$	-

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

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CHINA JO-JO DRUGSTORES, INC., AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – DESCRIPTION OF BUSINESS AND ORGANIZATION

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

On September 17, 2009, the Company completed a share exchange transaction with Renovation Investment (Hong Kong) Co., Ltd. (“Renovation”), whereby 7,900,000 shares of common stock were issued to the stockholders of Renovation in exchange for 100% of the capital stock of Renovation. The completion of the share exchange transaction resulted in a change of control. The share exchange transaction was accounted for as a reverse acquisition and recapitalization and, as a result, the consolidated financial statements of the Company (the legal acquirer) is, 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”), Zhejiang Shouantang Medical Technology Co., Ltd. (“Shouantang Technology”) and Hangzhou Jiutong Medical Technology Co., Ltd (“Jiutong Medical”), its wholly-owned subsidiaries.

The Company is a retail and wholesale distributor of pharmaceutical and other healthcare products in the People’s Republic of China (“China” or the “PRC”). The Company’s retail business is comprised primarily of pharmacies, a majority of which are operated by Hangzhou Jiuzhou Grand Pharmacy Chain Co., Ltd. (“Jiuzhou Pharmacy”), a company that the Company controls through contractual arrangements. Shanghai Lydia Grand Pharmacy Co., Ltd. (“Shanghai Lydia”), a wholly-owned subsidiary of Jiuzhou Pharmacy, operates two store locations in Shanghai. On July 29, 2011, Shanghai Lydia obtained control of Shanghai Bieyanghong Zhongxing Grand Pharmacy Co. Ltd., which also operates one pharmacy in Shanghai, and which subsequently changed its name to Shanghai Lydia Zhongxing Grand Pharmacy Co., Ltd. (“Shanghai Zhongxing”). Shanghai Lydia has two additional subsidiaries, namely, Shanghai Lydia Trading Co., Ltd. (“Lydia Trading”), which operates one pharmacy in Shanghai, and Shanghai Lydia Zhenguang Grand Pharmacy Co., Ltd. (“Shanghai Zhenguang”), which operates another pharmacy in Shanghai. One drugstore previously operated by Hangzhou Quannuo Grand Pharmacy Co., Ltd. (“Hangzhou Quannuo”) closed in May 2012. Hangzhou Quannuo is the wholly-owned subsidiary of Zhejiang Quannuo Internet Technology Co., Ltd. (“Quannuo Technology”), which is wholly-owned by Shouantang Technology. At December 31, 2013, Hangzhou Quannuo had not been dissolved but had no operation.

The Company’s retail business also includes four 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. On December 18, 2013, Jiuzhou Service established, and currently holds 51% of, Hangzhou Shouantang Health Management Co., Ltd. (“Shouantang Health”).

The Company’s wholesale business is primarily conducted through Zhejiang Jiuxin Medicine Co., Ltd. (“Jiuxin Medicine”), which is licensed to distribute prescription and non-prescription pharmaceutical products throughout China. Jiuzhou Pharmacy acquired Jiuxin Medicine on August 25, 2011.

The Company’s herb farming business is conducted by Hangzhou Qianhong Agriculture Development Co., Ltd. (“Qianhong Agriculture”), a wholly-owned subsidiary of Jiuxin Management, which operates a cultivation project of herbal plants used for traditional Chinese medicine (“TCM”).

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

Entity Name	Background
Renovation HK	· Incorporated in Hong Kong SAR on September 2, 2008
Jiuxin Management	· Established in the PRC on October 14, 2008 · Deemed a wholly foreign owned enterprise (“WFOE”) under PRC law · Registered capital of $4.5 million fully paid
Shouantang Technology	· Established in the PRC on July 16, 2010 by Renovation with registered capital of $20 million · Registered capital requirement reduced by the SAIC to $11 million in July 2012, which is fully paid · Deemed a WFOE under PRC law · Invests and finances the working capital of Quannuo Technology
Qianhong Agriculture	· Established in the PRC on August 10, 2010 by Jiuxin Management · Registered capital of RMB 10 million fully paid · Carries out herb farming business

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Quannuo Technology	· Established in the PRC on July 7, 2009 · Registered capital of RMB 10 million fully paid · Acquired by Shouantang Technology in November 2010 · Operates the Company's online pharmacy website and provide software and technical support	100%
Hangzhou Quannuo	· Established in the PRC on July 8, 2010 by Quannuo Technology · Registered capital of RMB 800,000 fully paid · Currently has no operation	100%
Jiuzhou Pharmacy (1)	· Established in the PRC on September 9, 2003 · Registered capital of RMB 5 million fully paid · Operates the "Jiuzhou Grand Pharmacy" stores in Hangzhou	VIE by arranger
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 arranger
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 arranger
Shanghai Lydia	· Established in the PRC on January 31, 2011 by Jiuzhou Pharmacy · Registered capital of RMB 1 million fully paid · Operates the "Lydia Grand Pharmacy" and "Chaling Grand Pharmacy" stores in Shanghai	VIE by arranger wholly- subsidia Jiuzhou (2)
Jiuxin Medicine	· Established in PRC on December 31, 2003 · Acquired by Jiuzhou Pharmacy in August 2011 · Registered capital of RMB 10 million fully paid · Carries out pharmaceutical distribution services	VIE by arranger wholly- subsidia Jiuzhou (2)
Shanghai Zhongxing	· Established in PRC on June 19, 2006 · Registered capital of RMB 1 million fully paid · 99% acquired by Shanghai Lydia in July 2011 · Operates one "Zhongxing Grand Pharmacy" store in Shanghai	VIE by arranger controlle Jiuzhou through Lydia (2
Lydia Trading	· Established in the PRC on June 20, 2012 · Registered capital of RMB 1 million fully paid · Operations at its "Weifang Grand Pharmacy" store in Shanghai currently halted	VIE by arranger controlle Jiuzhou through Lydia (2

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Shanghai Zhenguang	· Established in the PRC on October 31, 2012 · Registered capital of RMB 500,000 fully paid · Operations at its "Zhenguang Grand Pharmacy" store in Shanghai, currently halted	VIE by contractu arrangem as a controlle entity of Jiuzhou Pharmac through Shangha Lydia (2
Jiutong Medical	· Established in the PRC on December 20, 2011 by Renovation with registered capital of $5 million · $2.6 million of registered capital paid, with the remaining $2.4 million due by December 20, 2013 · Currently has no operation	100%
Shouantang Health	· Established in the PRC on December 18, 2013 by Jiuzhou Service · Registered capital of RMB 500,000 fully paid · 51% held by Jiuzhou Service · Currently has no operation	VIE by contractu arrangem as a controlle entity of Jiuzhou Service (

(1) Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service have been under the common control of their three cofounders (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, Shanghai Zhongxing, Lydia Trading, Shanghai Zhenguang and Jiuxin Medicine are also deemed under the common control of the Owners as subsidiaries of Jiuzhou Pharmacy, as is Shouantang Health as a subsidiary of Jiuzhou Service.

(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 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 all three companies (as well as the two subsidiaries 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 and Jiuzhou Service (Shanghai Lydia, Jiuxin Medicine, Shanghai Zhongxing, Lydia Trading, Shanghai Zhenguang and Shouantang Health), are consolidated into the financial statements of the Company.

Note 2 – LIQUIDITY

As reflected in the Company's condensed consolidated financial statements, the Company reported net loss for the three and nine months ended December 31, 2013. In assessing its liquidity, management monitors and analyzes the Company's cash on-hand, its ability to renew bank facilities, and its operating and capital expenditure commitments. Its principal liquidity needs are to meet its working capital requirements, operating expenses and capital expenditure obligations.

The Company's principal sources of liquidity consist of existing cash on hand, bank facilities from local banks as well as personal loans from its principal shareholders if necessary. The Company has a loan agreement to borrow up to $5.3 million from a local bank. Any borrowing therefrom is secured by the Company's assets pursuant to a collateral agreement, as well as the personal guarantees of some of its principal shareholders. As of December 31, 2013, approximately $3.9 million remained available for future borrowing from such bank. In addition, a principal shareholder has agreed to provide necessary financial support to meet the Company's financial obligations in the event that it requires additional liquidity. Additionally, the Company will continue to seek potential equity financing opportunities.

On the operating side, losses attributable to the pharmacy business during the three months ended December 31, 2013 are due to promotion activities and membership rewards incurred in connection with the ten-year anniversary of the pharmacy chain. This is a non-recurring event and should not affect long term profitability and cash flow of the Company's retail business. As described in the "Management Discussion and Analysis" section of the quarterly report which these notes to the financial statements are a part of, a new management and sales team has been transitioning into the Company's wholesale business in the quarter ended December 31, 2013, whose members have been involved with wholesale pharmaceutical distribution for over twenty years. As the prior team transitioned out, certain customers and suppliers chose to discontinue further business with the Company. In response, the Company settled certain prepayment accounts with the withdrawing suppliers through either their products or cash, and received approximately $6.9 million in products of merchandisable condition delivered during the quarter. However, because some of the products were specifically for customers that discontinued business with the Company, the new team decided not to continue expending significant efforts to sell them in the future, and began selling them at discount as an effort to reduce inventory from the Company's warehouse. While the total discounted sales amount was approximately $0.7 million, the cost of the products sold was approximately $2.1 million, which resulted in $1.4 million in net loss from such sales and negative gross margin in this quarter. The Company believes that such sales, while affecting its short-term profitability, may minimize further loss and free up storage space that the new team may require. In addition, such sales free the new team from dealing with prior accounts of the discontinued suppliers, which in turn allows the Company to better track the performance of the new team. The new team is actively seeking out potential customers such as local hospitals. As profit margins for sales to hospitals tend to be higher than to other wholesale customers, sales of existing inventory to hospitals can potentially generate positive cash flow in the future. Additionally, the new team will establish an OTC department aimed at supplying other drugstores which, if successful, can accelerate inventory disposal. The new team is also tasked with exploring rural markets outside Zhejiang Province, which can potentially become a new revenue source in the future. The Company plans to fund current operations by continuing to focus on profitability for its wholesale operations and focus on strengthening and expanding its core business model of integrated pharmacy and clinic, which has proven to be a key profit driver. As online sales have tripled this quarter as compared to the same period a year ago, the Company plans to further expand its online business so that it may contribute additional positive operating cash flow in the future. The Company also plans to control its general and administrative expenses by identifying and eliminating unnecessary administrative costs such as overcapacity in administrative personnel and related office expenses.

Management believes that the foregoing measures collectively will provide sufficient liquidity for the Company to meet its future liquidity and capital obligations in the next twelve months.

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Note 3 – 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 ("US GAAP") 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, 2013 filed with the SEC on July 1, 2013. Operating results for the three and nine months ended December 31, 2013 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 the contractual arrangements, that Jiuzhou Pharmacy (including its subsidiaries and controlled entities), Jiuzhou Clinic and Jiuzhou Service (including its subsidiary) 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, thereby enabling the Company, through Jiuxin Management, to receive a majority of their respective expected residual returns.

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

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. Although the Company has not experienced losses from these situations and believes that it is in compliance with existing laws and regulations including its 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 that 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 or landlords.

The Owners own the VIEs as well as controlling interests in the Company, and two of them are also members of the Company's management. 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 Owners could cancel these agreements or permit them to expire at the end of their terms, as a result of which the Company would not retain control of the VIEs.

Use of estimates

The preparation of unaudited condensed consolidated financial statements in conformity with US GAAP 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 unaudited condensed 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, 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.

Intangibles

Intangible assets, whether acquired individually or as part of a group of assets, 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.

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

	Estimated Useful Life
Licenses and permits	Indefinite
Land use right	50 years
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 intangible impairment during the three and nine months ended December 31, 2013.

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 minimal.

The Company's revenue is net of value added tax ("VAT") collected on behalf of PRC tax authorities in respect to the sales 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.

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.

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Accounts receivable

Accounts receivable represents the following: (1) amounts due from banks relating to retail sales that are paid or settled by the customers' debit or credit cards, (2) amounts due from government social security bureaus and commercial health insurance programs relating to retail sales of drugs, prescription medicine, and medical services that are paid or settled by the customers' medical insurance cards, and (3) 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 necessary. In its wholesale business, the Company uses the aging method to estimate the allowance for anticipated uncollectible receivable balances. Under the aging method, bad debt percentages are determined by management, based on historical experience and the 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.

In its retail business, accounts receivable mainly consist of reimbursements due from government insurance bureaus and commercial health insurance programs and are usually collected within two or three months. The Company directly writes off delinquent account balances, which is determined to be uncollectable after confirming with the appropriate bureau or program each month. Additionally, the Company also makes estimated reserves on related outstanding accounts receivable based on historical trend.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first in first out (FIFO) method. Market is the lower of replacement cost or net realizable value. The Company carries out physical inventory counts on a monthly basis at each store and warehouse location. Herbs that the Company farms are recorded at its purchase price, which includes direct cost such as seed selection, fertilizer, labor costs and contract fee that are spent in growing herbs on the leased farmland, and indirect cost which includes amortization of farmland development cost. All the costs are accumulated until the time of harvest and then allocated to harvested herbs upon sales. The Company periodically reviews its inventory and 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	3-10 years
Motor vehicles	5 years
Office equipment & furniture	3-5 years
Buildings	10 years

Maintenance, repairs and minor renewals are charged to expense as incurred. Major 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 assets' 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. There was no impairment of these assets as of December 31, 2013.

Notes payable

During the normal course of business, the Company regularly issues bank acceptance bills as a payment method to settle outstanding accounts payables with various material suppliers. The Company records such bank acceptance bills as notes payable. Such 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.

Stock based compensation

The Company follows the provisions of ASC 718, “Compensation — Stock Compensation,” which establishes the accounting for non-employee and employee stock-based awards. Under the provisions of ASC 718, the fair value of the stock issued is used to measure the fair value of services received as the Company believes such approach is a more reliable method of measuring the fair value of the services. For non-employee stock-based awards, fair value is measured based on the value of the Company’s common stock on the date that the commitment for performance by the counterparty has been reached or the counterparty’s performance is complete. The fair value of the equity instrument is calculated and then recognized as compensation expense over the requisite performance period. For employee stock-based awards, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense with graded vesting on a straight–line basis over the requisite service period for the entire award.

Advertising and promotion costs

Advertising and promotion costs are expensed as incurred and amounted to $3,542,412 and $560,474 for three months ended December 31, 2013 and 2012, respectively, and $3,598,945 and $635,613 for the nine months ended December 31, 2013 and 2012, respectively. Such costs consist primarily of print and television advertisements, and promotion expense related to the Company’s commemoration of its pharmacy’s ten-year anniversary.

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”), the currency of the PRC.

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

The balance sheet amounts, with the exception of equity, at December 31, 2013 and March 31, 2013 were translated at 1 RMB to $0.1637 USD and at 1 RMB to $0.1594 USD, respectively. The average translation rates applied to income and cash flow statement amounts for the nine months ended December 31, 2013 and 2012 were at 1 RMB to $0.1623 USD and at 1 RMB to $0.1586 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 PRC. Balances at financial institutions in Hong Kong may, from time to time, exceed Hong Kong Deposit Protection Board’s insured limits. Balances at financial institutions and state-owned banks within the PRC are not covered by insurance. As of December 31, 2013 and March 31, 2013, the Company had deposits totaling $3,993,802 and $6,475,772 that were not covered by insurance, respectively. To date, the Company has not experienced any losses in such accounts.

For the three months ended December 31, 2013, three vendors accounted for 33% of the Company's total purchases and no vendor accounted for more than 10% of total advances to suppliers. For the three months ended December 31, 2012, one vendor accounted for approximately 10 % of the Company's total purchases, and another vendor accounted for 18 % of total advances to suppliers.

For the nine months ended December 31, 2013, one vendor accounted for 13% of the Company's total purchases and another vendor accounted for more than 10% of total advances to suppliers. For the nine months ended December 31, 2012, one vendor accounted for approximately 13% of the Company's total purchases and another vendor accounted for more than 18% of total advances to suppliers.

For the three months ended December 31, 2013, no customer accounted for more than 10% of the Company's total sales and no customer accounted for more than 10% of total accounts receivable. For the three months ended December 31, 2012, no customer accounted for 10% or more of the Company's total sales, and two customers collectively accounted for approximately 28% of total accounts receivable.

For the nine months ended December 31, 2013, no customer accounted for more than 10% of the Company's total sales, and no customer accounted for more than 10% of total accounts receivable. For the nine months ended December 31, 2012, one customer accounted for approximately 13% of the Company's total sales and two customers collectively accounted for approximately 28% of total accounts receivable.

Noncontrolling interest

As of December 31, 2013, Shanghai Bieyanghong Grand Pharmacy Co., Ltd. owned 1% of the equity interests of Shanghai Zhongxing, and so was not under the Company's control.

As of December 31, 2013, Wang Yi, an individual, owned 49% of the equity interests of Shouantang Health, and so was not under the Company’s control.

NOTE 4 – TRADE ACCOUNTS RECEIVABLE

Trade accounts receivable consisted of the following:

	December 31, 2013	March 31, 2013
Accounts receivable (1)	$15,939,542	$18,007,051
Less: allowance for doubtful accounts	(5,747,163)	(5,028,243)
Trade accounts receivable, net	$10,192,379	$12,978,808

For the three months ended December 31, 2013 and 2012, $100,847 and $225,832 in accounts receivable were directly written off, respectively, none of which were written off against previous allowance for doubtful accounts.

For the nine months ended December 31, 2013 and 2012, $448,243 and $536,293 in accounts receivable were directly written off, respectively, $364,608 and $0 of which were written off against previous allowance for doubtful accounts, respectively.

(1) In the three months ended December 31, 2013, the Company took delivery of approximately $1.4 million of inventory against certain prepayment accounts of wholesale suppliers that chose to discontinue business with the Company following the transitioning of its new wholesale team.

Note 5 – Inventory

Inventory consisted of the following:

	December 31, 2013	March 31, 2013
Finished goods	$ 17,053,406	$ 7,224,976
Work-in-process	1,723,556	1,362,023
Total inventory	$ 18,776,962	$ 8,586,999
Less: reserve for inventory (1)	(545,836)	-
Inventory, net	$ 18,231,126	$ 8,586,999

(1) Reserve was made for products received during the three months ended December 31, 2013, that were specifically for certain customers that discontinued their business with the Company. Because the new wholesale team decided not to continue expending significant efforts to sell these products in the future, the Company recorded a loss of $998,000 for such products in this quarter for its wholesale segment.

(2)

During the nine months ended December 31, 2013, inventory in the retail segment increased by $3,860,487 in preparation for sales during upcoming national holidays. Inventory in the wholesale segment increased by $5,422,107 as result of the net effect of goods received from certain vendors and disposal of certain products. Inventory in the farming segment increased by $361,533 due to further amortization of land improvement into gingko trees.

Note 6 – OTHER CURRENT ASSETS

Other current assets consisted of the following:

	December 31, 2013	March 31, 2013
Prepaid rental expenses	$1,938,047	$647,489
Lease rights transfer fees (1)	48,720	247,789
Prepaids and other current assets	285,911	326,221
Total	$2,272,678	$1,221,499

(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 7 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	December 31, 2013	March 31, 2013
Building	$1,149,240	$1,119,053
Leasehold improvements	14,471,287	13,956,605
Office equipment and furniture	5,609,370	5,264,996
Motor vehicles	582,836	424,958
Total	21,812,733	20,765,612
Less: Accumulated depreciation	(9,214,937)	(7,476,960)
Property and equipment, net	$12,597,796	$13,288,652

Total depreciation expense for property and equipment was $461,196 and $822,958 for the three months ended December 31, 2013 and 2012, respectively, and $1,522,951 and $2,002,094 for the nine months ended December 31, 2013 and 2012, respectively.

Note 8 – 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 bears no interest. As of December 31, 2013 and March 31, 2013, advances to suppliers consisted of the following:

	December 31, 2013	March 31, 2013
Advance to suppliers	$8,834,342	$19,119,231
Less: allowance for doubtful accounts	(2,155,993)	(3,596,197)
Advance to suppliers, net	$6,678,349	$15,523,034

For the three months ended December 31, 2013 and 2012, no advances to suppliers were written off against previous allowance for doubtful accounts. For the nine months ended December 31, 2013 and 2012, $452,246 and $0 of advances to suppliers were written off against previous allowance for doubtful accounts, respectively. During the three months ended December 31, 2013, the Company collected goods of approximately $6.9 million against advances to vendors as a result of settling accounts with certain vendors that discontinued their business with the Company following the transition of a new sales and management team for the Company's wholesale segment.

Note 9 – LONG TERM DEPOSITS

As of December 31, 2013 and March 31, 2013, long term deposits amounted to $2,835,137 and $2,760,665, respectively, and consist of money 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 10 – OTHER NONCURRENT ASSETS

Other noncurrent assets consisted of the following:

	December 31, 2013	March 31, 2013
Prepayment for lease of land use right – noncurrent (1)	$ 5,443,025	$ 5,419,600
Lease rights transfer fees-noncurrent (2)	-	11,726
Total	$ 5,443,025	$ 5,431,326

(1) Payments made to a 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 11 – INTANGIBLE ASSETS

Net intangible assets consisted of the following at:

	December 31, 2013	March 31, 2013
Land use rights (1)	1,367,149	-
Licenses and permits	1,135,071	1,104,801
Software	478,178	466,071
Total other intangible assets	2,980,398	1,570,872
Less: accumulated amortization	(502,750)	(368,614)
Intangible assets, net	$2,477,648	$1,202,258

Amortization expense of intangibles amounted to $44,284 and $38,823 for the three months ended December 31, 2013 and 2012, respectively, and $123,115 and $116,039 for the nine months ended December 31, 2013 and 2012, respectively.

(1) During the quarter ended December 31, 2013, the Company purchased the land use right of a farm land in Lin'An, Hangzhou, intended for herb planting and processing in the future.

Note 12 – SHORT-TERM LOAN PAYABLE

As of December 31, 2013, short-term loan consisted of a loan of $163,700 (RMB 1,000,000) from Industrial and Commercial Bank of China, due on May 9, 2014 with annual interest of 6.6%. This loan is guaranteed by Hangzhou SME Guaranty Co., Ltd., which is not related to or affiliated with the Company.

Note 13 – TAXES

Income tax

The Company is subject to income taxes on an entity basis on income arising in or derived from the tax jurisdiction in which each entity is domiciled.

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

The following table reconciles the U.S. statutory tax rates with the Company's effective tax rate for the three and nine months ended December 31, 2013 and 2012:

	For the three months ended December 31,		For the nine months ended December 31,	
	2013	2012	2013	2012
U.S. Statutory rates	34.0 %	34.0%	34.0%	34.0%
Foreign income not recognized in the U.S.	(34.0)	(34.0)	(34.0)	(34.0)
China income taxes	25.0	25.0	25.0	25.0
Exemption rendered by local tax authorities (1)	-	(25.0)	-	(25.0)
Change in valuation allowance (2)	(25.0)	-	(25.0)	-
Others (3)	0.4	1.1	(0.4)	2.1
Effective tax rate	0.4%	1.1%	(0.4)%	2.1%

(1) Qianhong Agriculture enjoyed income tax waiver as an agriculture company since inception in 2010.

(2) Certain subsidiaries incurred operating loss in the three and nine months ended December 31, 2013.

(3) Represent expenses incurred by the Company that were not deductible for PRC income tax.

Jo-Jo Drugstores is incorporated in the U.S. and incurred a net operating loss for income tax purposes for three and nine months ended December 31, 2013 and 2012. As of December 31, 2013, the estimated net operating loss carryforwards for U.S. income tax purposes amounted to $1,948,000 which may be available to reduce future years' taxable income. These carryforwards will expire, if not utilized by 2031. Management believes that the realization of the benefits arising from this loss appears to be uncertain due to the Company's limited operating history and continuing losses for U.S. income tax purposes. Accordingly, the Company has provided a 100% valuation allowance at December 31, 2013. The net change in the valuation allowance for the nine months ended December 31, 2013 and 2012 was an increase of approximately $195,000 and $50,000, respectively. Management reviews this valuation allowance periodically and makes adjustments as necessary.

Taxes payable at December 31, 2013 and March 31, 2013 consisted of the following:

	December 31, 2013	March 31, 2013
VAT	$430,049	$334,833
Income tax	7,834	7,628
Others	27,443	29,172
Total taxes payable	$465,326	$371,633

Note 14 – POSTRETIREMENT BENEFITS

Regulations in the PRC require the Company to contribute to a defined contribution retirement plan for all permanent employees. The contribution for each employee is based on a percentage of the employee's current compensation as required by the local government. The Company contributed $236,397 and $154,895 in employment benefits and pension for the three months ended December 31, 2013 and 2012, respectively, and $558,344 and $400,840 for the nine months ended December 31, 2013 and 2012, respectively.

Note 15 – RELATED PARTY TRANSACTIONS AND ARRANGEMENTS

Amounts payable to related parties are summarized as follows:

	December 31, 2013	March 31, 2013
Due to cofounders (1):	$ 576,818	$ 576,818
Due to director (2):	1,557,983	647,599
Total	$ 2,134,801	$ 1,224,417

(1) As of December 31, 2013 and March 31, 2013, amount due to cofounders represents contributions from the Owners to Jiuxin Management to meet its approved PRC registered capital requirement.

(2) Due to foreign exchange restrictions, Mr. Lei Liu personally lent U.S. dollars to the Company to facilitate its payments of expenses in the United States. In addition, Mr. Lei Liu lent about $600,000 to purchase a land use right.

As of December 31, 2013 and March 31, 2013, notes payable totaling $8,045,331 and $7,186,453 were secured by the personal properties of certain of the Company's shareholders, respectively.

The Company leases from Mr. Lei Liu a retail space which expires in August 2014, and leased its corporate office which expired as of December 31, 2013. The Company relocated its corporate office in January 2014 pursuant to a lease agreement entered into with a third party. Rent expense amounted to $48,990 and $47,712 for the three months ended December 31, 2013 and 2012, respectively, and $146,052 and $142,740 for the nine months ended December 31, 2013 and 2012, respectively. Rent was accrued but not paid to Mr. Liu for the three and nine months ended December 31, 2013 and 2012.

Note 16 – PURCHASE OPTION DERIVATIVE LIABILITY

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

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

On April 22, 2010, the issue date of MWC's option, the Company classified the fair value of this option as a liability resulting in a decrease of additional paid-in capital of $402,451 and the establishment of a $402,451 in liability to recognize the option's fair value. The Company recognized a loss of $10,768 from the change in fair value of the option liability for the three months ended December 31, 2013, and a gain of $861 for the nine months ended December 31, 2013.The Company recognized a loss of $12,095 and a gain of $13,652 from the change in fair value of the option liability for the three and nine months ended December 31, 2012, respectively.

This option does not trade in an active securities market, and as such, the Company estimates its fair value using the Black-Scholes Option Pricing Model (the "Black-Scholes Model") on the date that the option was originally issued and as of December 31, 2013 using the following assumptions:

	Underwriter Purchase Option December 31, 2013 (1)	
Stock price	$ 0.96	
Exercise price	$ 6.25	
Annual dividend yield	0	%
Expected term (years)	1.30	
Risk-free interest rate	0.38	%
Expected volatility	128.02	%

(1) As of December 31, 2013, the option was not exercised.

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

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

The fair value of the 105,000 shares underlying the option outstanding as of December 31, 2013 was determined using the Black-Scholes Model, with certain inputs significant to the valuation methodology as level 2 inputs, and the Company recorded the change in fair value in earnings. As a result, the option liability is carried on the consolidated balance sheets at fair value.

Note 17 – WARRANTS

On September 26, 2013, as annual compensation for its financial advisory service, the Company issued warrant to a financial consulting firm to purchase up to 150,000 shares of common stock at $1.20 per share. The warrant is exercisable from September 26, 2013 to September 25, 2016.

Because the warrant is denominated in U.S. dollars and the Company's functional currency is the RMB, it does not meet the requirements of the accounting standard to be indexed only to the Company's stock. Accordingly, it is accounted for at fair value as derivative liabilities and marked to market each period.

The warrant does not trade in an active securities market, and as such, the Company estimates its fair value using the Black-Scholes Model on the date that the warrants were originally issued and as of December 31, 2013 using the following assumptions:

	Common Stock Warrants December 31, 2013 (1)	
Stock price	$	0.96
Exercise price	$	1.20
Annual dividend yield		