

CHINA SKY ONE MEDICAL, INC.
Form 10-Q
November 08, 2010

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

FORM 10-Q

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

For the nine months ended: September 30, 2010

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: 001-34080

CHINA SKY ONE MEDICAL, INC.
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

87-0430322
(I.R.S. Employer
Identification No.)

No. 2158, North Xiang An Road, Song Bei District,
Harbin, People's Republic of China
(Address of principal executive offices)

150028
(Zip Code)

86-451-8703-2617 (China)
(Registrant's telephone number, including area code)

Not Applicable
(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 No

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

Yes No

Edgar Filing: CHINA SKY ONE MEDICAL, INC. - Form 10-Q

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes No

As of November 1, 2010, the registrant had 16,790,851 shares of common stock issued and outstanding.

QUARTERLY REPORT ON FORM 10-Q
OF CHINA SKY ONE MEDICAL, INC. AND SUBSIDIARIES
FOR THE PERIOD ENDED SEPTEMBER 30, 2010

TABLE OF CONTENTS

			PAGE
PART I	-	FINANCIAL INFORMATION	
Item 1.		Financial Statements	2
		Condensed Consolidated Statements of Operations and Comprehensive Income for the Three and Nine Months Ended September 30, 2010 (unaudited) and 2009 (unaudited and restated)	2
		Condensed Consolidated Balance Sheets as of September 30, 2010 (unaudited) and December 31, 2009 (restated)	3
		Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2010 (unaudited) and 2009 (unaudited and restated)	4
		Notes to Condensed Consolidated Financial Statements (unaudited)	5
Item 2.		Management's Discussion and Analysis of Financial Condition and Results of Operations	34
Item 3.		Quantitative and Qualitative Disclosures About Market Risk	58
Item 4.		Controls and Procedures	58
PART II	-	OTHER INFORMATION	
Item 1.		Legal Proceedings	60
Item 1A.		Risk Factors	60
Item 2.		Unregistered Sales of Equity Securities and Use of Proceeds	61
Item 3.		Defaults Upon Senior Securities	61
Item 4.		Removed and Reserved	61
Item 5.		Other Information	61
Item 6.		Exhibits	61
Signatures			62

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, together with other statements and information we publicly disseminate, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and include this statement for purposes of complying with these safe harbor provisions.

Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “should”, “v”, “could”, “may”, “plan”, “possible”, “project” or similar expressions. You should not rely on forward-looking statements since they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control and which could materially affect actual results, performances or achievements.

Factors that may cause actual results to differ materially from current expectations include, but are not limited to the “Risk Factors” discussed in our Annual Report on Form 10-K for the year ended December 31, 2009, as amended. Accordingly, there is no assurance that our expectations will be realized. Except as otherwise required by the federal securities laws, we disclaim any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change our expectations with regard thereto, or any change in events, conditions or circumstances on which any such statement is based.

The terms “the Company,” “we,” “us” and “our” refer to China Sky One Medical, Inc., together with our consolidated subsidiaries.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Income
(Unaudited, \$ in thousands except share and per share data)

	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2009	
	2010	(restated)	2010	(restated)
Revenues	\$ 36,193	\$ 43,227	\$ 105,856	\$ 100,242
Cost of Goods Sold	9,796	10,897	28,287	24,690
Gross Profit	26,397	32,330	77,569	75,552
Operating Expenses				
Depreciation and amortization	879	447	2,547	1,348
Research and development	5,592	4,885	15,266	10,980
Selling	9,673	9,944	23,567	23,707
General and administrative	798	1,024	2,911	2,354
Total operating expenses	16,942	16,300	44,291	38,389
Income from Operations	9,455	16,030	33,278	37,163
Other Income				
Interest income	29	20	88	46
Change in fair value of derivative warrant liability	1,833	132	8,847	1,305
Total other income	1,862	152	8,935	1,351
Net Income Before Provision for Income Tax	11,317	16,182	42,213	38,514
Provision for Income Taxes	2,722	3,592	8,787	8,050
Net Income	\$ 8,595	\$ 12,590	\$ 33,426	\$ 30,464
Basic Earnings Per Share	\$ 0.51	\$ 0.76	\$ 1.99	\$ 1.84
Basic Weighted Average Shares Outstanding	16,790,851	16,655,697	16,786,240	16,535,924
Diluted Earnings Per Share	\$ 0.51	\$ 0.75	\$ 1.99	\$ 1.83
Diluted Weighted Average Shares Outstanding	16,790,851	16,741,745	16,825,294	16,606,576
Other Comprehensive Income				
Foreign currency translation adjustment	\$ 2,538	\$ 122	\$ 3,094	\$ 245
Net Income	8,595	12,590	33,426	30,464
Comprehensive Income	\$ 11,133	\$ 12,712	\$ 36,520	\$ 30,709

See accompanying summary of accounting policies and notes to the condensed consolidated financial statements.

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(\$ in thousands, except share data)

	September 30, 2010 (Unaudited)	December 31, 2009 (Restated)
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 71,971	\$ 52,756
Accounts receivable, net	23,036	21,146
Inventories	4,311	2,413
Prepaid and other current assets	25	74
Total current assets	99,343	76,389
Property and equipment, net	15,505	15,491
Intangible assets, net	23,551	25,114
Construction in progress	13,214	12,932
Land use rights, net	4,610	4,586
Construction and land deposits	13,437	5,851
Total Assets	\$ 169,660	\$ 140,363
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	\$ 5,233	\$ 4,186
Taxes payable	4,357	3,873
Derivative warrant liability	1,716	11,435
Total current liabilities	11,306	19,494
Commitments and Contingencies	-	-
Stockholders' Equity		
Preferred stock (\$0.001 par value, 5,000,000 shares authorized, none issued and outstanding)	-	-
Common stock (\$0.001 par value, 50,000,000 shares authorized, 16,790,851 and 16,714,267 issued and outstanding, respectively)	17	17
Additional paid-in capital	38,154	37,188
Retained earnings	111,210	77,785
Accumulated other comprehensive income	8,973	5,879
Total stockholders' equity	158,354	120,869
Total Liabilities and Stockholders' Equity	\$ 169,660	\$ 140,363

See accompanying summary of accounting policies and notes to the condensed consolidated financial statements.

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited, \$ in thousands)

	Nine Months Ended September 30,	
	2010	2009 (restated)
Cash flows from operating activities		
Net Income	\$ 33,426	\$ 30,464
Adjustments to reconcile net cash provided by (used in) operating activities:		
Depreciation and amortization	2,895	1,753
Change in fair value of derivative warrant liability	(8,847)	(1,305)
Net change in assets and liabilities		
Accounts receivable	(1,363)	(8,660)
Inventories	(1,816)	(2,634)
Prepaid and other current assets	(13)	(15)
Accounts payable and accrued expenses	880	3,938
Taxes payable	397	2,391
Net cash provided by operating activities	25,559	25,932
Cash flows from investing activities		
Land deposit	(7,335)	-
Purchase of fixed assets	(473)	(122)
Purchase of construction in progress	(14)	(9,927)
Net cash used in investing activities	(7,822)	(10,049)
Cash flows from financing activities		
Proceeds from warrants conversion	94	29
Net cash provided by financing activities	94	29
Effect of exchange rate changes on cash and cash equivalents	1,384	103
Net increase in cash and cash equivalents	19,215	16,015
Cash and cash equivalents at beginning of period	52,756	40,288
Cash and cash equivalents at end of period	\$ 71,971	\$ 56,303
Supplemental disclosure of cash flow information		
Interest paid	\$ -	\$ -
Taxes paid	\$ 8,541	\$ 6,570

See accompanying summary of accounting policies and notes to the condensed consolidated financial statements.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Description of Business

China Sky One Medical Inc. (“China Sky One” or the “Company”), a Nevada corporation, was formed on February 7, 1986, and formerly known as Comet Technologies, Inc. (“Comet”). On July 26, 2006, the Company changed the name of the reporting company from "Comet Technologies, Inc." to "China Sky One Medical, Inc."

China Sky One is a holding company whose principal operations are conducted through its wholly-owned subsidiaries. The Company has no revenues separate from its subsidiaries, and has expenses related to its status as a public reporting company and to its ownership interest in American California Pharmaceutical Group, Inc. (“ACPG”) and Harbin City Tian Di Ren Medical Co. (“TDR”).

ACPG, the Company’s non operating United States holding company subsidiary, was incorporated on December 16, 2003, in the State of California, under the name “QQ Group, Inc.” QQ Group, Inc. changed its name to “American California Pharmaceutical Group, Inc.” in anticipation of the Stock Exchange Agreement with China Sky One (then known as “Comet Technologies, Inc.”) and TDR, described herein. On December 8, 2005, ACPG completed a stock exchange transaction with TDR a People’s Republic of China (“China” or “PRC”) based operating company and TDR’s subsidiaries (the “TDR Acquisition”), each of which were fully operating companies in the PRC. Under the terms of the agreement, ACPG exchanged 100% of its issued and outstanding common stock for 100% of the capital stock of TDR and its subsidiaries, described below.

Thereafter, on May 11, 2006, ACPG entered into a Stock Exchange Agreement (the “Exchange Agreement”) with the shareholders of China Sky One. The terms of the Exchange Agreement were consummated and the acquisition was completed on May 30, 2006. As a result of the transaction, the Company issued a total of 10,193,377 shares of its common voting stock to the stockholders of ACPG, in exchange for 100% of the capital stock of ACPG resulting in ACPG becoming the Company’s wholly-owned subsidiary. The transaction is treated as a reverse merger for accounting purposes.

TDR, formerly known as “Harbin City Tian Di Ren Medical Co.,” was originally formed in 1994 and its principal executive office is located in Harbin City of Heilongjiang Province, in the PRC. TDR was reorganized and incorporated as a limited liability company on December 29, 2000, under the “Corporation Laws and Regulations” of the PRC. At the time of the TDR Acquisition by ACPG in December of 2005, TDR had two wholly-owned subsidiaries, Harbin First Bio-Engineering Company Limited (“First”) and Kangxi Medical Care Product Factory, until July, 2006, when the two were merged, with First as the surviving subsidiary of TDR. The principal activities of TDR and First are the research, manufacture and sale of over-the-counter non-prescription health care products. TDR commenced its business in the sale of branded nutritional supplements and over-the-counter pharmaceutical products in the Heilongjiang Province. TDR has subsequently evolved into an integrated manufacturer, marketer, and distributor of external use natural Chinese medicine products sold primarily to and through independent agents and China’s large pharmaceutical chains.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

As of October 16, 2006, the Company organized Harbin Tian Qing Biotech Application Company as a wholly-owned PRC subsidiary of TDR (“Tian Qing”), to conduct research and development in the areas of tissue and stem cell banks. As of September 30, 2010, Tian Qing had insignificant operations.

On April 3, 2008, TDR completed an acquisition pursuant to an Equity Transfer Agreement dated February 22, 2008, between TDR and Heilongjiang Tianlong Pharmaceutical, Inc., a corporation with a multitude of medicines approved by the PRC’s State Food and Drug Administration (“SFDA”) and new medicine applications, organized under the laws of the PRC (“Tianlong”), which is in the business of manufacturing external-use pharmaceuticals. Pursuant to the Equity Transfer Agreement, TDR acquired 100% of the issued and outstanding capital stock of Tianlong from Tianlong’s sole stockholder, in consideration for an aggregate purchase price of approximately \$8,300,000, consisting of (i) \$8,000,000 in cash, and (ii) 23,850 shares of China Sky One (at \$12 per share). The acquisition received regulatory approval and closed on April 3, 2008.

The following table summarizes the approximate estimated fair values of the assets acquired in the Tianlong acquisition.

	(\$ in thousands)	
Property and equipment	\$	6,315
Intangible assets – SFDA licenses for drug batch numbers		1,787
Other		170
Net assets acquired	\$	8,272

On April 18, 2008, China Sky One through its subsidiary TDR consummated a share acquisition pursuant to an Equity Transfer Agreement with the shareholders of Heilongjiang Haina Pharmaceutical Inc., a recently formed corporation organized under the laws of the PRC (“Haina”) licensed as a wholesaler of TCD, bio-medicines, bio-products, medicinal devices, antibiotics and chemical medicines. Haina does not have an established sales network and was acquired for its primary asset, a Good Supply Practice (GSP) license (License No. A-HLJ03-010) issued by the Heilongjiang office of the State Food and Drug Administration (“SFDA”). The SFDA recently started issuing such licenses to resellers of medicines that maintain certain quality controls. The GSP license was issued as of December 21, 2006 and will expire on January 29, 2012 and will enable the Company to expand its sales of medicinal products without having to go through a lengthy license application process.

The following table summarizes the approximate estimated fair values of the assets acquired in the Haina acquisition.

	(\$ in thousands)	
Cash	\$	84
Intangible assets – Goodwill		353
Net assets acquired	\$	437

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Pursuant to the Equity Transfer Agreement, TDR acquired 100% of the issued and outstanding capital stock of Haina from its three stockholders in consideration for payment of 3,000,000 RMB (approximately \$437,000). TDR has been overseeing the operations of Haina since January of 2008 as part of its due diligence prior to closing of this acquisition.

On June 9, 2008, TDR entered into a Merger and Acquisition Agreement (the “Acquisition Agreement”) with Peng Lai Jin Chuang Company, a corporation organized under the laws of the People’s Republic of China (“Peng Lai”), which was organized to develop, manufacture and distribute pharmaceutical, medicinal and diagnostic products in the PRC. Pursuant to the Acquisition Agreement, TDR acquired all of the assets of Peng Lai in consideration for an aggregate of approximately (i) U.S.\$2.5 million in cash, and (ii) 381,606 shares of the Company’s common stock with a fair value of approximately \$4.6 million (at \$12 per share). The acquisition of Peng Lai closed on September 5, 2008.

The following table summarizes the approximate estimated fair values of the assets acquired in the Peng Lai acquisition.

	(\$ in thousands)	
Property and equipment	\$	4,177
Intangible assets - SFDA licenses for drug batch numbers		2,917
Net assets acquired	\$	7,094

All of the Company’s significant operations and long lived assets are located in the PRC.

2. Restatement

On May 11, 2010, the Company filed with the Securities and Exchange Commission (“SEC”) a Current Report on Form 8-K, as amended on May 24, 2010, to report management’s determination that the Company’s financial statements for the year ended December 31, 2009, included in its Annual Report on Form 10-K filed with the SEC on March 16, 2010, as amended on March 17, 2010 (the “2009 Form 10-K”), should no longer be relied upon due to an error in such financial statements with respect to the accounting for the 750,000 common stock purchase warrants the Company issued in connection with its January 31, 2008 private placement (the “Warrants”). The Company received comments from the staff of the SEC, which led to the Company’s conclusion that the historical financial statements for the year ended December 31, 2009 in the 2009 Form 10-K required restatement to properly record the Warrants as a derivative liability.

On June 24, 2010, the Company filed with the SEC an additional Current Report on Form 8-K to report management’s determination that the Company’s financial statements: (i) for the fiscal quarter ended March 31, 2009, included in its Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2010, filed with the SEC on May 17, 2010 (the “March 2010 Form 10-Q”); (ii) for the fiscal quarter ended June 30, 2009, included in its Quarterly Report on Form 10-Q filed with the SEC on August 14, 2009 (the “June 2009 Form 10-Q”); and (iii) for the fiscal quarter ended September 30, 2009, included in its Quarterly Report on Form 10-Q filed with the SEC on November 16, 2009 (the “September 2009 Form 10-Q” and, collectively with the March 2010 Form 10-Q and June 2009 Form 10-Q, the “Form 10-Qs”), should no longer be relied upon due to errors in such financial statements with respect to the accounting for the Warrants. The Company received comments from the staff of the SEC, which led to the Company’s conclusion that the historical financial statements in the Form 10-Qs required restatement to properly record the Warrants as a derivative liability.

China Sky One Medical, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

The Company has performed a complete assessment of the Warrants and has concluded that the Warrants are within the scope of Accounting Standards Codification 815-40, “Derivatives and Hedging – Contracts in Entity’s Own Equity” (“ASC 815-40”), formerly Emerging Issues Task Force Issue No. 07-05, “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock” (“EITF 07-05”), due to the inclusion in the Warrants of a provision requiring a weighted average adjustment to the exercise price of the Warrants in the event the Company issues common stock, or securities convertible into or exercisable for common stock, at a price per share lower than such exercise price. Accordingly, ASC 815-40, formerly EITF 07-05, which was effective as of January 1, 2009, should have been applied resulting in a reclassification of the warrants as a liability, measured at fair value, with changes in fair value recognized as part of other income or expense for each reporting period thereafter.

On July 23, 2010, the Company filed amendments to the 2009 Form 10-K and March 2010 Form 10-Q with the SEC, reflecting the restatement. On August 9, 2010, the Company filed June 2010 Form 10-Q, reflecting the restatement. The corrections to the quarterly information in the amended March 31, 2010 Form 10-Q and the June 2010 Form 10-Q had no impact on the Company’s previously reported income from operations or cash flows for the periods being restated.

This quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2010 incorporates corrections made in response to the accounting errors described above by restating the Company’s financial statements presented herein for the three and nine months ended September 30, 2009. The corrections to the quarterly information in this Form 10-Q had no impact on the Company’s previously reported income from operations or cash flows for the periods being restated.

The following tables (\$ in thousands, except per share information) show the effects of the restatement on the Company’s consolidated statements of operations and comprehensive income and consolidated statements of cash flows for the three and nine month period ended September 30, 2009:

China Sky One Medical, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Income
(Unaudited, \$ in thousands except per share data)

	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2009	
	As Previously Recorded	As Restated	As Previously Recorded	As Restated
Change in fair value of derivative warrant liability	\$ -	\$ 132	\$ -	\$ 1,305
Total other income	\$ 20	\$ 152	\$ 46	\$ 1,351
Net Income Before Provision for Income Tax	\$ 16,051	\$ 16,182	\$ 37,209	\$ 38,514
Net Income	\$ 12,459			