

UNITED 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 quarterly period ended June 30, 2009

OR

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

For the transition period from _____ to _____

Commission file number 001-33537

CHINA SHENGHUO PHARMACEUTICAL HOLDINGS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
*(State or Other
Jurisdiction of
Incorporation
or Organization)*

20-2903562
*(I.R. S. Employer
Identification
No.)*

No. 2, Jing You Road,
Kunming National Economy &
Technology Developing
District
People' s Republic of
China 650217
*(Address of Principal
Executive Offices)*

N/A
(Zip Code)

0086-871-728-2628

(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.

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

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

Yes No

There were 19,679,400 shares outstanding of the issuer's common stock, par value \$.0001 per share, as of August 14, 2009.

CHINA SHENGHUO PHARMACEUTICAL HOLDINGS, INC.
FORM 10-Q QUARTERLY REPORT

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CHINA SHENGHUO PHARMACEUTICAL HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2009	December 31, 2008
ASSETS:		
Current Assets:		
Cash and cash equivalents	\$ 717,134	\$ 1,612,054
Accounts and notes receivable, less allowance for doubtful accounts of \$5,969,399 and \$4,834,745, respectively	10,144,096	9,108,703
Sales representative advances, less allowance for doubtful accounts of \$3,289,200 and \$2,955,516, respectively	6,877,678	8,637,653
Advances to suppliers	554,828	446,168
Inventory, net of reserve for obsolescence of \$148,181 and \$147,978, respectively	3,360,899	4,287,462
Other current assets	29,971	41,177
Total Current Assets	21,684,606	24,133,217
Property, plant and equipment, net of accumulated depreciation of \$5,714,934 and \$5,341,933, respectively	7,534,993	7,581,664
Intangible assets, net of accumulated amortization of \$179,620 and \$71,456,	558,808	665,959

respectively		
Long-term sales representative advances, less allowance for doubtful accounts of \$667,725 and \$664,532, respectively	1,515,858	663,433
TOTAL ASSETS	\$ 31,294,265	\$ 33,044,273

**LIABILITIES AND
STOCKHOLDERS'
EQUITY:**

Current Liabilities:		
Accounts payable	\$ 1,702,841	\$ 1,293,460
Accrued expenses	8,733,930	2,721,082
Deposits	5,259,457	5,550,502
Payable to related parties	39,666	148,575
Short-term notes payable	11,324,701	9,850,211
Advances from customers	813,879	222,609
Taxes and related payables	1,296,596	1,236,574
Current portion of long-term debt	1,460,963	3,245,685
Total Current Liabilities	30,632,033	24,268,698
Long-Term Debt	—	1,131,193
Total Liabilities	30,632,033	25,399,891

Stockholders' Equity:

Common stock, \$0.0001 par value, 100,000,000 shares authorized, 19,679,400 and	1,968	1,968
---------------------------------------------------------------------------------------------	-------	-------

19,679,400 outstanding, respectively		
Additional paid-in capital	6,193,927	6,193,927
Statutory reserves	147,023	147,023
Retained deficit	(7,340,619)	(603,572)
Accumulated other comprehensive income, foreign currency translation	1,659,933	1,656,812
Noncontrolling Interest	—	248,224
Total Stockholders' Equity	662,232	7,644,382
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY \$	31,294,265 \$	33,044,273

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

CHINA SHENHUO PHARMACEUTICAL HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE LOSS
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Products \$	8,130,333	\$ 8,591,297	\$ 14,900,859	\$ 14,900,859
Products	2,394,530	2,988,119	4,696,055	5,676,234
Profit	5,735,803	5,603,178	10,204,804	9,224,625

es:				
ce	6,221,263	4,035,573	12,616,840	5
and				
strati				
ense	3,120,299	2,714,259	4,166,741	5
n and				
opment				
ce	6,640	70,213	13,921	
Operating				
s	9,348,202	6,820,045	16,797,502	11
ions	(3,612,399)	(1,216,867)	(6,592,698)	(2)
ome				
e):				
t	431	1,848	1,312	
from				
rch and				
opment				
ties	119,611	75,588	145,179	
t				
ce	(268,324)	(435,114)	(520,014)	
rating				
es	(15,137)	(65,337)	(19,191)	
Expense	(163,419)	(423,015)	(392,714)	
re				
Taxes	(3,775,818)	(1,639,882)	(6,985,412)	(2)
from				
ion				
come	—	2,163	—	
t in				
of	43	100,250	248,365	

aries								
	\$	(3,775,775)	\$	(1,537,469)	\$	(6,737,047)	\$	(2)
ncy ation ment		2,939		217,091		3,121		
sive	\$	(3,772,836)	\$	(1,320,378)	\$	(6,733,926)	\$	(1)
Share	\$	(0.19)	\$	(0.08)	\$	(0.34)	\$	
	\$	(0.19)	\$	(0.08)	\$	(0.34)	\$	
Average								
ding		19,679,400		19,679,400		19,679,400		19
		19,679,400		19,679,400		19,679,400		19

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

CHINA SHENGHUO PHARMACEUTICAL HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six months ended	
	2009	2008
	June 30,	
Cash Flows from		
Operating Activities:		
Net loss	\$ (6,737,047)	\$ (2,390,129)

Adjustments to		
reconcile net loss to		
net cash provided by		
operating activities:		
Depreciation and		
amortization	473,840	429,102
Noncontrolling		
interest in loss of		
subsidiaries	(248,365)	(165,334)
Change in current assets		
and liabilities:		
Allowance for		
doubtful accounts	1,460,256	1,962,910
Accounts and notes		
receivable	(2,212,347)	—
Sales representative		
advances	588,553	(134,786)
Advances to suppliers	(505,648)	30,685
Inventory	932,665	409,441
Other current assets	11,265	129,901
Accounts payable	805,273	642,217
Accrued expenses	6,001,346	(1,220,462)
Deposits	(298,736)	—
Advances from		
customers	652,055	2,362
Taxes and related		
payables	58,337	(251,997)
<hr/>		
Net Cash Provided by		
(Used in) Operating		
Activities	981,447	(556,090)
<hr/>		
Cash Flows from		
Investing Activities:		
Capital expenditures	(308,654)	(137,079)
Receivable from related		
parties	—	87,223
<hr/>		
Net Cash Used in		
Investing Activities	(308,654)	(49,856)
<hr/>		
Cash Flows from		

Financing Activities:		
Payable to related parties	(108,835)	(93,864)
Proceeds from short and long-term loans	3,653,246	5,655,605
Payments on short and long-term loans	(5,114,544)	(7,140,201)
Net Cash Used in Financing Activities	(1,570,133)	(1,578,460)
Effect of exchange rate changes on cash	2,420	128,340
Net Decrease in Cash and Cash Equivalents	(894,920)	(2,056,066)
Cash and Cash Equivalents at Beginning of Period	1,612,054	2,800,641
Cash and Cash Equivalents at End of Period	\$ 717,134	\$ 744,575

Supplemental Information

Cash paid for interest	\$ 582,854	\$ 691,196
Cash paid for income taxes	—	—

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

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of China Shenghuo Pharmaceutical Holdings, Inc., (the “Company” or the “Parent” or the “Group”) were prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting

principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. Management of the Company (“Management”) believes that the following disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company’s Form 10-K for the year ended December 31, 2008, as amended.

These unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of Management, are necessary to present fairly the consolidated financial position and results of operations of the Company for the periods presented. Operating results for the six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2009.

Translating Financial Statements - The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The functional currency of the operating subsidiaries in the People’s Republic of China (“PRC”) is the Chinese Yuan Renminbi (“CNY”); however, the condensed consolidated financial statements have been expressed in United States Dollars (“USD”). The accompanying condensed consolidated balance sheets have been translated into USD at the exchange rates prevailing at each balance sheet date. The condensed consolidated statements of operations have been translated using the weighted average exchange rates prevailing during the operating periods of each statement.

NOTE 2 - ORGANIZATION AND NATURE OF OPERATIONS

Nature of Business - The Company, through its subsidiaries, designs, develops, markets, exports and sells pharmaceutical, nutritional supplements and cosmetic products throughout the People’s Republic of China (PRC) and abroad. The Company also conducts research and development for third parties as well as for itself using the medicinal herb Panax notoginseng, also known as Sanqi, Sanchi, or Tienchi and sells pharmaceutical, nutritional supplements and cosmetic products that contain this herb, which is grown in two provinces in the PRC. Sales from the cosmetic products represent less than 10% of total Company sales and revenue. The Company does not maintain accounting records by line of business as the Company’s subsidiaries sell products from multiple lines of business and management evaluates each subsidiary as a separate entity.

Organization - The Company owns a 93.75% equity interest in Kunming Shenghuo Pharmaceuticals Co., Ltd. (“Shenghuo”). Shenghuo owns a 99% equity interest in Kunming Shenghuo Medicine Co., Ltd. (“Medicine”) and Kunming Pharmaceutical Importation and Exportation Co., Ltd. (“Import/Export”), a 98.18% interest in Kunming Shenghuo Cosmetics Co., Ltd. (“Cosmetic”). On April 30, 2009 the Company formed Shi Ling Shenghuo Co., Ltd. (“Shi Ling”) as a wholly owned subsidiary. Shi Ling was formed for the purpose of purchasing or leasing real property suitable for cultivating the medicinal

herb Panax notoginseng for use in the production of the Company' s medicinal products. All of these entities are formed in and operate within the PRC. No minority interest is presented at June 30, 2009 due to accumulated losses of the Company.

NOTE 3 - SELECTED SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Translating Financial Statements - The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the United States Securities and Exchange Commission. The functional currency of the operating subsidiaries in the PRC is the Chinese Yuan Renminbi ("CNY"); however, the consolidated financial statements have been expressed in United States Dollars ("USD"). The accompanying consolidated balance sheets have been translated into USD at the exchange rates prevailing at each balance sheet date. The consolidated statements of operations have been translated using the average exchange rates prevailing during the operating periods of each statement.

Principles of Consolidation - The accompanying consolidated financial statements present the operations of the Company and its majority owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Accounting Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Fair Value of Financial Instruments - The carrying amounts reported in the consolidated balance sheets for accounts and notes receivables, employee advances, advances to suppliers, accounts payable, accrued liabilities, and advances from customers approximate fair value because of the immediate or short-term maturity of these financial instruments. Management believes the interest rates on short-term notes payable and long-term debt reflect rates currently available in the PRC. Thus, the carrying value of these loans approximates fair value.

Cash and Cash Equivalents - The Company' s cash and cash equivalents are maintained in bank deposit accounts. The Company has not experienced any losses with respect to these deposits. Cash and cash equivalents include interest bearing and non-interest bearing bank deposits, money market accounts, and short-term certificates of deposit

with original maturities of three months or less. The Company did not enter into any hedge contracts during any of the periods presented.

Accounts and Notes Receivable and Allowance for Doubtful Accounts - Trade receivables are carried at original invoiced amounts less an allowance for doubtful accounts. An allowance for uncollectible accounts receivable is established by charges to operations for amounts required to maintain an adequate allowance, in Management's judgment, to cover anticipated losses from customer accounts and sales returns. Such accounts are charged to the allowance when collection appears doubtful. Any subsequent recoveries are credited to the allowance account. The Company believes that the allowance for doubtful accounts is consistent with industry standards in the PRC based on the products that are being sold.

Notes receivable were \$129,149 and \$750,877 as of June 30, 2009 and December 31, 2008, respectively. The notes represent bank drafts that have been arranged with third-party financial institutions by certain customers to settle their purchases from us. These bank drafts are non-interest bearing and are due within six months. Such sales and purchasing arrangements are consistent with industry practices in the PRC.

Sales Representative Advances - Sales representative advances are presented net of an estimated allowance for doubtful advances. As time passes from when advances are made to sales representatives for travel and related expenses, the Company will create an allowance for these older receivables as the likelihood of collection from each particular sales representative decreases as their respective advances age. Long-term sales representative advances are not expected to be realized in the current operating period.

Inventory - Inventories consist principally of pharmaceutical products and are stated at weighted average cost. When market value of the inventory products is lower than the weighted average cost, inventory is reduced to its net realizable value. The Company also holds inventory on consignment.

Property and Equipment - Property and equipment are stated at cost. Maintenance and depreciation are charged to expense as incurred and major improvements are capitalized. Gains or losses on sales or retirements are included in the statements of operations in the period of disposition, determined by reference to their carrying amounts. The Company reviews its property and equipment periodically for changes in circumstances that would indicate its recoverable carrying value is less than its net book value. If such circumstances occur, impairment is charged to such items.

Intangible Assets - Acquisition costs of land use rights are capitalized at their acquisition cost and amortized using the straight-line method over their estimated useful lives. For those intangible assets with legal protection over a specific period, their useful life is the protected period. Assets that do not have legal protection

periods are amortized over their estimated useful life. Research and development costs are expensed during the period incurred.

Impairment of Long-Lived Assets - The Company reviews its long-lived assets, including intangibles, for impairment at least annually or when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The Company evaluates, at each balance sheet date, whether events and circumstances have occurred that indicate possible impairment. The Company uses an estimate of future undiscounted net cash flows from the related asset or group of assets over their remaining life in measuring whether the assets are recoverable.

Deposits and Accrued Expenses - Accrued expenses consists of accrued commission expense, accrued payroll expense, and accrued welfare expense. Deposits consist of funds paid by the sales representatives to obtain the Company's products to sell. The Company retains these deposits during the time the sales representatives provide services to the Company. When the Company receives full payment from the customer or sales representatives terminate sales services, the deposits are returned to the sales representatives. The Company records deposits from sales representatives when payments are received.

Advances to Suppliers and Advances from Customers - The Company will often make advanced payments to suppliers for materials, or receive advance payments from customers in the normal course of business. Advances to suppliers were \$554,828 and \$446,168 as of June 30, 2009 and December 31, 2008, respectively. Advances to suppliers are recorded when payment is made by the Company and relieved against inventory when goods are received. The advance payments to suppliers may include provisions that set the purchase price and delivery date of raw materials. Advances from customers were \$813,879 and \$222,609 as of June 30, 2009 and December 31, 2008, respectively and are recognized in revenue when delivery has occurred.

Revenue Recognition - The Company recognizes revenue when it is realized and earned. The Company considers revenue realized or realizable and earned when (1) it has persuasive evidence of an arrangement, (2) delivery has occurred, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Delivery does not occur until products have been shipped to the client, risk of loss has transferred to the client and client acceptance has been obtained, client acceptance provisions have lapsed, or the Company has objective evidence that the criteria specified in client acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

The Company recognizes revenue for its consignment sales only after the customer has checked the quality of the goods and the Company has received a written confirmation from the customer that it has accepted the goods.

Cost of Revenues - The cost of revenues are the direct expenses incurred in producing the pharmaceuticals and cosmetics, which include materials, wages, handling charges, and a portion of overhead expenses associated with the manufacture and delivery of products.

Shipping and Handling Costs - Shipping and handling costs are included in selling expenses.

Research and Development - The Company charges research and development costs to operations in the period incurred. The Company recognizes revenue from research and development activities in accordance with the revenue recognition policy as stated above. Because in many cases the Company cannot be assured that the terms of specific contracts can be fulfilled, the Company recognizes revenue only after all terms of a contract are complete.

Advertising - Advertising expense was \$26,027 and \$1,395,146 for the six months ended June 30, 2009 and 2008, respectively.

Basic and Diluted Earnings per Share - The computation of basic and diluted earning per share is based on the weighted-average number of shares outstanding during the periods presented. Potentially dilutive securities for the three and six months ended June 30, 2009 and 2008 include 46,000 warrants which were antidilutive due to losses of the Company.

Retirement Benefit Plans - The Company makes monthly contributions to various employee retirement benefit plans organized by provincial governments in the PRC in accordance with rates prescribed by them. The provincial governments undertake to assume the retirement benefit obligations of all existing and future retired employees of the Company. Contributions to these plans are charged to expense as incurred.

Comprehensive Income - Other comprehensive income presented in the consolidated financial statements consists of cumulative foreign currency translation adjustments.

Credit Risk - The carrying amounts of accounts receivable and sales representative advances included in the balance sheets represent the Company' s major exposure to credit risk in relation to its financial assets. No other financial assets carry a significant exposure to credit risk. The Company performs ongoing credit evaluations of each customer' s financial condition. It maintains allowances for doubtful accounts and Management believes the Company' s current reserves are adequate.

The Company has its cash in bank deposits and money market funds primarily in the PRC. Historically, deposits in Chinese banks have been secure due to the state policy on protecting depositors' interests. China promulgated a new Bankruptcy Law in August 2006, which came into effect on June 1, 2007, which, together with more specific, complementary regulations to be issued in the future, shall provide the implementation for the bankruptcy of Chinese banks. In the event that bankruptcy laws are enacted for banks in the PRC, the Company's deposits may be at a higher risk of loss.

Business Condition and Liquidity - Although the Company has had a history prior to 2008 of positive income, working capital and retained earnings, the Company has incurred a net loss for the six months ended June 30, 2009 of \$6.7 million and had net cash provided by operating activities of \$1.0 million and used funds in financing activities of \$1.6 million. As a result, during the six months ended June 30, 2009, the cash and cash equivalents decreased \$0.9 million. In addition, the Company had an accumulated deficit of \$7.3 million as of June 30, 2009, primarily due to the losses in the six months ended June 30, 2009 and the loss of \$4.6 million for fiscal 2008. As discussed in Note 6, the Company has \$11.3 million in short term loans that mature in the next twelve months. Additionally, as discussed in Note 9, putative class action lawsuits have been asserted against the Company and the Company is undergoing an voluntary investigation by the Securities and Exchange Commission.

The Company has expended significant efforts to expand its revenues by assisting its sales representatives and increasing its marketing efforts during the six months ended June 30, 2009 and during fiscal 2008. The net loss for the six months ended June 30, 2009 was caused primarily by increased selling expenses, legal, auditing, sales representative assistance and marketing expenses. As of June 1, 2009, the Company has changed its policy with respect to its sales representatives and has reduced the percentage accrual for selling expenses which is based on a percentage of revenue. The Company believes that it will be able to stabilize selling, legal, auditing, marketing and sales representative

assistance expenses in the near future but the Company cannot give any assurance that this will be the case. In addition, the Company may be forced to give significant attention to the class action lawsuits noted above.

Recently Enacted Accounting Standards - In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* or SFAS No. 168. SFAS No. 168 will become the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related accounting literature. SFAS No. 168 reorganizes the thousands of GAAP pronouncements

into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant SEC guidance organized using the same topical structure in separate sections. SFAS No. 168 will be effective for financial statements issued for reporting periods ending after September 15, 2009. This will have an impact on the Company's financial disclosures since all future references to authoritative accounting literature will be references in accordance with SFAS No. 168.

NOTE 4 - INVENTORY

Inventory consisted of the following:

	June 30, 2009	December 31, 2008
Raw materials	\$ 545,246	\$ 1,061,465
Work-in-process	1,081,294	2,003,825
Finished goods	858,253	648,074
Product on consignment	1,024,286	722,076
Total Inventory	\$ 3,509,080	\$ 4,435,440
Less:		
Provision for obsolescence	(148,181)	(147,978)
Net Inventory	\$ 3,360,899	\$ 4,287,462

NOTE 5 - RELATED PARTY TRANSACTIONS

At June 30, 2009 and December 31, 2008 the amounts payable to officers were \$39,666 and \$148,575, respectively. These amounts are due on demand and do not accrue interest.

During 2007, the Company entered into a loan agreement with a bank which is secured by shares of the Company owned by the Company's principal shareholder. See Note 6.

NOTE 6 - NOTES PAYABLE

The Company's notes payable consist of short-term debt that is payable to banks, governmental financial bureaus, municipalities and a company. The following schedule summarizes the Company's debt obligations and respective balances at June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
Short-term note payable to a municipality, interest at 1.8%, due on demand, unsecured	\$ 73,048	\$ 72,948
Short-term note payable to a finance bureau, interest at 4.5%, due on demand, unsecured	75,285	75,182
Short-term note payable to a bank, interest at 5.31%, matures April 2010, secured by property	3,652,408	—
Short-term note payable to a bank, interest at	—	3,647,399

7.47%,
 matured
 April 2009,
 secured by
 property

Short-term note payable to a bank, interest at 6.57%, matures April 2010, secured by property	1,460,963	—
--------------------------------------------------------------------------------------------------------------------------	-----------	---

Short-term note payable to a government development zone interest at 2.43%, due on demand, secured by property	219,144	218,844
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Short-term note payable to a bank, interest at 7.72%, matures August 2009, secured by shareholder	5,843,853	5,835,838
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Total short-term notes	\$ 11,324,701	\$ 9,850,211
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payable	June 30, 2009	December 31, 2008
Long-term note payable to a bank, interest at 8.316%, matures April 2010, secured by property	1,460,963	1,458,959
Long-term note payable to a bank, interest at 6.57%, matures March 2010, due on demand, unsecured	—	2,917,919
Total long-term debt	1,460,963	4,376,878
Less current maturities of long-term debt	1,460,963	3,245,685
Long-term notes payable, net of \$	\$ —	\$ 1,131,193

current
portion

Past due notes payable	\$	294,430	\$	294,026
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In April 2009, a note payable with an interest rate of 7.47% and a balance of \$3,647,399 as of December 31, 2008 was refinanced. The new note payable is due in one year and has an interest rate of 5.31%.

On August 17, 2007, the Company received a loan for \$6,651,094 from Shuang Long Branch of Agricultural Bank of China with a term of two years. The loan bears interest at a rate of 7.72% which is due quarterly. The loan was for working capital and is guaranteed by Lan’s International Medicine Investment Co Ltd. (“LIMI”). Gui Hua Lan, our Chief Executive Officer; Feng Lan, our President; and Zheng Yi Wang, our Executive Director of Exports, are directors and have voting and investment control over the shares owned by LIMI, which beneficially owns or controls approximately 78% of our outstanding shares. In addition, Gui Hua Lan, Feng Lan and Zheng Yi Wang owns 62.42%, 5.15% and 1.45%, respectively, of LIMI’s issued and outstanding shares. LIMI is not receiving any compensation for the guarantee of the Company’s loan.

NOTE 7 - STOCKHOLDERS’ EQUITY

Statutory Reserves - According to the Articles of Association, the Company is required to transfer a certain portion of its net profits to Statutory Reserves, as determined under PRC accounting regulations, from net income to both the surplus reserve fund and the public welfare fund. Accordingly, the Company has recorded an aggregate of \$147,023 in the Statutory Reserves account in the equity section of the accompanying balance sheet as of June 30, 2009 and December 31, 2008, respectively.

The following summarizes the outstanding warrants as of June 30, 2009:

Exercise Price	Warrants Outstanding	Weighted-Average	
		Remaining Contractual Life (Years)	Number Exercisable
\$3.50	6,000	3.2	6,000

\$4.20	40,000	3.0	40,000
	<u>46,000</u>		<u>46,000</u>

NOTE 8 - INCOME AND OTHER TAXES

The Company accounts for its income taxes in accordance with SFAS No. 109, which requires recognition of deferred tax assets and liabilities and their respective tax bases and any tax credit carry forwards available. Deferred tax assets 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 on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company has established a valuation allowance for all deferred income tax assets due to the uncertainty of their realization. Income taxes payable are included in taxes and related payables on the accompanying balance sheets. Income taxes are not required to be paid to the PRC until after the end of the Company's fiscal year.

The principle of group consolidation for tax purposes does not exist in China. Each legal entity files its own individual tax return in the PRC. This means that the Company pays tax on all profits realized by each subsidiary, and that losses can only be carried forward and utilized in the same legal entity.

On March 16, 2007, the National People's Congress of China passed the new Enterprise Income Tax Law, ("EIT Law"), and on December 6, 2007, the State Council of China issued the Implementation Regulations for the EIT Law which took effect on January 1, 2008. The EIT Law and Implementation Regulations Rules impose a unified EIT of 25% on all domestic-invested enterprises and Foreign Invested Entities, or FIEs, unless they qualify under certain limited exceptions.

As a result of the above change in the income tax laws, the Parent has a 18% rate for 2009 with a tax holiday of 50% of the tax rates in effect during fiscal 2009 through 2011 as determined by the PRC government and the regional tax authorities. The phase-in income tax rate is 18% for 2009, 20% for 2010, 22% for 2011, 24% for 2012, and 25% for 2013 and after. Medicine, Import/Export, Cosmetics, Beisheng and Pingbian Shenghuo are taxed at the new 25% rate effective January 1, 2008.

The Company is not subject to any income taxes in the United States, but was subject to corporate income tax in the PRC at a combined rate of 25% for 2008. However, because the Parent is located in a special region, it has a 15% corporate income tax rate and has been granted a "tax holiday" during which it paid no income taxes through December 31, 2008.

The Company had no undistributed earnings of the Company' s foreign subsidiaries since acquisition at June 30, 2009. The investment in subsidiaries of approximately \$8.73 million is considered to be indefinitely reinvested and, accordingly, no U.S. federal and state income taxes have been provided thereon. The Company has U.S. net operating loss carryforwards of approximately \$2.86 million that, if unused begin to expire in 2026. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credits may be available to reduce a portion of the U.S. tax liability.

The Company is also subject to Value Added Tax ("VAT") and other miscellaneous taxes including city construction tax, turnover tax and consumption tax. All enterprises that sell commodities, engage in repair and maintenance or import and export business in the PRC are subject to VAT tax. The standard rate for VAT tax is 17%. Once declared, VAT taxes are due on a monthly basis.

The Company has an aggregate of \$12.1 million of net operating loss carryforwards available to its subsidiaries in the PRC that, if unused by the offset of future income of the individual subsidiary, begin to expire in 2011.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

SEC Investigation - The United States Securities and Exchange Commission ("SEC") has been conducting an informal inquiry regarding the events that resulted in the Company' s restatement of its financial statements for the fiscal year 2007 and the first quarter of 2008. The Company is represented by counsel and has been cooperating with the SEC' s inquiry on a voluntary basis.

Class Action Lawsuits - In 2008, putative class action lawsuits were asserted against the Company and certain other parties in the United States District Court for the Southern District of New York (the "Court"). On February 12, 2009, an amended complaint was served on the Company by new lead counsel for the class, consolidating the putative class actions and bearing the caption Beni Varghese, Individually and on Behalf of All Other Similarly Situated v. China Shenghuo Pharmaceutical Holdings, Inc., et al., Index No. 1:08 CIV. 7422. The defendants include the Company, the Company' s controlling shareholders, Lan' s International Medicine Investment Co., Limited, the Company' s chief executive officer, Gui Hua Lan, the Company' s former chief financial officer, Qiong Hua Gao, and the Company' s independent registered public accounting firm, Hansen, Barnett & Maxwell, P.C. During the second quarter of 2009, the Company and the accounting firm filed

motions to dismiss the complaint and the plaintiffs filed a memorandum in opposition to those motions. During the third quarter of 2009, the Company plans to file a reply brief in further support of its motion.

The amended consolidated complaint alleges that the Company failed to take adequate steps to ensure its financial reporting comported with U.S. Generally Accepted Accounting Principles ("GAAP") and, as a result, the Company was required to restate what are alleged to be materially false and misleading financials for accounting periods during the alleged class period from August 2007 through August 20, 2008. The amended consolidated complaint further alleges, among other things, that certain of the Company' s SEC filings and other public statements contained false and misleading statements which resulted in damages to the plaintiffs and the members of the purported class when they purchased the Company' s securities. On the basis of those allegations, plaintiffs in each of the actions seek an unspecified amount of damages under Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

The Company believes the allegations in the amended consolidated complaint are without merit, and intends to vigorously defend the class action lawsuits. The Company does not believe the outcome of this suit will have a material adverse effect on the Company. However, the Company is unable at this time to predict the outcome of this litigation or whether the Company will incur any liability associated with the litigation, or to estimate the effect such outcome would have on the financial condition, results of operations, or cash flows of the Company.

Other litigation has arisen in the normal course of the Company' s business, none of which is deemed to be material.

Economic environment - Since all of the Company' s operations are conducted in the PRC, the Company is subject to special considerations and significant risks not typically associated with companies operating in the United States of America. These risks include, among others, the political, economic and legal environments and foreign currency exchange rate fluctuations. The Company' s operational results may be adversely affected by changes in the political and social conditions in the PRC, and by changes in governmental policies with respect to medical reforms and other laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things. In addition, all of the Company' s revenue is denominated in the PRC' s currency CNY, which must be converted into other currencies before remittance out of the PRC. Both the conversion of CNY into foreign currencies and the remittance of foreign currencies abroad require approval of the PRC government.

Due to changes in current worldwide economic conditions, the Company' s ability to raise capital or borrow funds may be limited and may also adversely affect the Company' s operations.

Dependence on a single raw material - The primary ingredient in all of the Company's products is Sanchi, an herb grown in two provinces of the PRC. The Company relies on its in-house purchasing department to acquire sufficient Sanchi at reasonable prices and may on occasion make advance payments to suppliers that include provisions for setting the purchase price and delivery date. However, the Company is not reliant on a single source or supplier in order to obtain the Sanchi.

NOTE 10 - GEOGRAPHIC INFORMATION

The Company derives its sales from China and from other various countries. Operations in China make up the majority of the Company's sales, with a very small portion from other various countries. No revenues from external customers attributed to any individual foreign country are material. The following table summarizes sales by geographic location for the three and six months ended June 30, 2009 and 2008, respectively:

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Sales from China	\$ 8,125,153	\$ 8,389,308	14,827,243	13,673,527
Sales from other countries	5,180	201,989	73,616	404,238
Total Sales	\$ 8,130,333	\$ 8,591,297	14,900,859	14,077,765

NOTE 11 - CONCENTRATIONS

For the six months ended June 30, 2009 the Company had concentrations of purchases from one vendor accounting for 59.7% of total purchases.

NOTE 12 - SUBSEQUENT EVENTS

The Yunnan Shuang Long Branch of Agricultural Bank of China ("Agricultural Bank") has conducted a review of the Company' s operations and unencumbered assets, including the improvements being made to the Company owned real estate on which it is constructing Shenghuo Plaza. Based on its assessment, the Agricultural Bank has approved a loan facility of up to RMB 110 million (approximately \$16 million). The first approved draw down of this facility will be to repay the RMB 39.6 million (approximately \$5.8 million) advanced by a government financial bureau to pay the Agricultural Bank facility that matured in August 2009. It is also anticipated that RMB 20 million of this facility (approximately \$2.9 million) will be advanced to fund further construction costs of Shenghuo Plaza. The balance of the facility is intended to fund working capital needs. Each borrowing will require the commitment of specific collateral to be determined at that time. As currently contemplated, the interest rate on all advances will be at the Agricultural Bank' s base rate.

ITEM 2. MANAGEMENT' S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The information contained in this quarterly report, including in the documents incorporated by reference into this quarterly report, includes some statements that are not purely historical and that are "forward-looking statements." Such forward-looking statements include, but are not limited to, statements regarding our company' s and our management' s expectations, hopes, beliefs, intentions or strategies regarding the future, including our financial condition, and results of operations. In addition, any statements that refer to projections, forecasts or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. The words "anticipates," "believes," "continue," "could," "estimates," "expects," "intends," "may," "might," "plans," "possible," "potential," "predicts," "projects," "seeks," "should," "will," "would" and similar expressions, or the negatives of such terms, may identify forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking.

The forward-looking statements contained in this quarterly report are based on current expectations and beliefs concerning future developments and the potential effects on the Company. There can be no assurance that future developments actually affecting us will be those anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements, including the following:

- our reliance on one product for over 87% of our revenues;
- our reliance on limited suppliers for Sanchi, a scarce plant that is the primary ingredient in almost all of our products;
- replacement of our primary product by other medicines or the removal of our primary product from China's Insurance Catalog;
- our ability to raise additional capital needed for working capital, future operations and research and development;
- our ability to collect on advances to sales representatives;
- our reliance on our three largest customers for a significant percentage of our sales;
- our ability to effectively grow management;
- our dependence on key personnel;
- our ability to establish and maintain a strong brand;
- the ability of our products to effectively compete with those of our competitors;
- continued receipt and maintenance of regulatory approvals, certificates, permits and licenses required to conduct business in China;
- our ability to collect on trade receivables;
- our ability to develop and market new products, including those with high profit margins;
- subjection of additional products to price controls by the Chinese government;
- our ability to obtain all necessary government certifications and/or licenses to conduct our business;
- protection of our intellectual property rights;
- loss of certain tax concessions;
- our lack of insurance to cover losses due to fire, casualty or theft;

- changes in the laws of the PRC that affect our operations;
- changes in the foreign currency exchange rate between U.S. dollars and Renminbi;
- cost of complying with current and future governmental regulations and the impact of any changes in the regulations on our operations;

- the effect on our operations of costs associated with the Restatement, including litigation costs;
- a downturn in the economy of the PRC or inflation in the PRC;
- our ability to establish and maintain adequate management, legal and financial controls, including effective internal controls over financial reporting;
- volatility of the market for our common stock;
- the possibility of substantial sales of our common stock;
- influence of our principal stockholder;
- cooperation of the minority shareholder of our principal operating subsidiary; and
- other factors listed from time to time in our filings with the Securities and Exchange Commission, including without limitation, our Annual Report on Form 10-K for the year ended December 31, 2008 and subsequent reports on Form 8-K.

The risks included above are not exhaustive. Other sections of this quarterly report may include additional factors that could adversely impact our business and operating results. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and we cannot predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward looking statements.

You should not rely upon forward-looking statements as predictions of future events. We cannot assure you that the events and circumstances reflected in the forward-looking statements will be achieved or occur. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other

person assume responsibility for the accuracy and completeness of the forward-looking statements. Except as required by law, we undertake no obligation to update publicly any forward-looking statements for any reason after the date of this report to conform these statements to actual results or to changes in our expectations.

You should read this quarterly report, and the documents that we reference in this quarterly report and have filed as exhibits to this quarterly report with the Securities and Exchange Commission, completely and with the understanding that our actual future results, levels of activity, performance and achievements may materially differ from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

Overview

We are primarily engaged in the research, development, manufacture, and marketing of pharmaceutical, nutritional supplement and cosmetic products. Almost all of our products are derived from the medicinal herb *Panax notoginseng*, also known as Sanqi, Sanchi or Tienchi. *Panax notoginseng* is the root of a greyish-brown or greyish-yellow plant that only grows in a few geographic locations, including Yunnan Province in southwest China where we are located. Yunnan Province accounts for 90% of the global production of *Panax notoginseng*. The main root of *Panax notoginseng* is cylindrically shaped and is most commonly one-to-six centimeters long and one-to-four centimeters in diameter. *Panax notoginseng* saponins (PNS), the active ingredients in *Panax notoginseng*, are extracted from the plant using high-tech equipment and in accord with Good Manufacturing Practice (GMP) standards. Our main product, Xuesaitong Soft Capsules, accounted for more than 73% of our sales for the six months ended June 30, 2009.

We earn revenues mainly from the production and sale of our products and external processing. We hope to increase profits as a result of making new products and increasing sales, since the sale of products is our main source for generating cash. Our business involves a significant degree of risk as a result of the opportunities and challenges we face in selling our products. We have traditionally focused on research and development of products serving cardiovascular and cerebrovascular disease, peptic ulcer disease and health products markets, but we intend to devote additional resources to research and development and to continue to evaluate and develop additional product candidates to expand our pipeline where we perceive an unmet need and commercial potential, as well as to improve existing products to enhance their efficacy.

With intense price competition among many similar or identical products in the industry, we believe that building brand equity is the primary means to generate and sustain profitable growth in the future. Our brand strategy is centered on “Lixuwang” - the brand under which most of our products are sold. We believe that our relationships within the Chinese pharmaceutical industry are key to building brand equity, and we believe we can benefit from developing and maintaining relationships with professionals within the industry, especially physicians and hospitals.

Xuesaitong Soft Capsules, which have been listed in the National Insurance Catalogue and is subject to wholesale and retail price controls by the Chinese government, are primarily sold in China, but the product is also sold in various developing countries, including Malaysia, Indonesia and Kyrgyzstan. Sales of the product in China are regulated by the State Food and Drug Administration (“SFDA”) as a prescription drug and therefore must be sold to consumers through hospital pharmacies and cannot be advertised, thus limiting the ability of the company to market the brand. We sell to hospital pharmacies in cities through regional distributors in the area. No single distributor accounts for over 10% of our sales as of June 30, 2009.

As of June 30, 2009, our medicine marketing team maintains sales offices or agents in approximately 31 provinces throughout China. The sales network covers approximately 210 cities and is staffed by approximately 600 sales representatives. We intend to grow our internal marketing and sales function and increase our relationships with other national distributors to expand the distribution and presence of our non-prescription brands and cosmetics.

We hope to further expand sales beyond China into other countries where our products could be affordable treatment options. We intend to focus on the expansion of our cosmetics product line and devote additional marketing and sales resources to that end with the aim that our cosmetics products will account for a larger percentage of our revenue in the future.

Our business is capital intensive, and these research and development, marketing, sales network expansion and cosmetic product expansion initiatives will require us to expend significant cash resources, which could adversely affect our profitability and liquidity. We do face certain challenges and risks, including our relatively high debt ratio, which is one of our main risks. We also regularly incur significant expenses in our efforts to maintain the continued listing status of the Company on an exchange. We have encountered a shortage of working capital and are exploring possible ways to address our short and long term cash needs.

We believe that among the most important economic or industry-wide factors relevant to our growth in the short term are the reform of the medical system in China and the adjustment of medicine prices, which will affect the sale of our main product, Xuesaitong Soft Capsules, in hospitals. In order to increase long-term growth, we previously applied for the designation of Xuesaitong Soft Capsules as a medicine with “good quality worthy of high price,” which designation we received in February 2007. Currently, the Chinese government supports the medical system in urban and rural communities, which we believe will lead to a sustained increase in the sales of non-prescription medicines in the future.

According to data from the Southern Medicine Economy Research Institute, the pharmaceutical industry in China grew about 27% on a year-over-year basis in 2008. This growth was driven by a number of favorable factors including improving standards of living from an increase in disposable income, an aging population, the improving access and higher participation in the State Basic Medical Insurance System, and the increase in government spending on public health care.

On January 21, 2009, the Chinese government announced a healthcare reform plan pursuant to which the government would spend upward of RMB 850 billion over the next three years to make medical services and products more affordable and accessible to the entire population. We believe the successful implementation of the policies outlined in the plan will have a significant impact on the domestic pharmaceutical sector. There are five key tasks the healthcare reforms are aiming to address: 1) expanding medical insurance coverage and increasing participation rates, 2) initiating a national basic drug system, 3) establishing an extensive public health system, 4) increasing the efficiency and improving the quality of basic medical services, especially in the rural areas, and 5) reforming state-owned hospitals.

Traditional Chinese Medicine (“TCM”), including prescription and over-the-counter pharmaceuticals, has been widely used in China for many years and is an important part of the overall Chinese culture. The recently announced healthcare reform plan contains measures and policies that we believe will help support and promote the growth and development of the domestic TCM market. TCM drug manufacturers are likely to benefit from this reform as we believe the government will add more TCM-related drugs to the national medicine catalog. In addition, we expect the government will focus on disease prevention as it rolls out the nationwide medical insurance coverage. The TCM market is a vibrant and growing industry despite the challenging economic environment and it will remain a part of mainstream medicine in China.

We hope to stabilize the sales channel into hospitals and widen the reach of sales in urban and rural communities at the same time. Large increases in medicine sales at an average lower price will ensure the growth of general medicinal sales over the next few years.

Our 12 Ways™ Chinese Traditional Medicine Beauty Salon Series (“12 Ways”) cosmetic products are sold to a number of cities and provinces outside our local region. We have opened a number of retail specialty counters to offer our cosmetic products at pharmacies throughout Eastern China, eventually expanding our retail presence across China. As of June 30, 2009, we have opened approximately 605 retail specialty counters in more than 30 cities throughout China. In addition, we opened a 12 Ways Chinese Herbal Beauty Salon in Kunming that will feature approximately ten traditional Chinese medicine practitioners and beauticians that provide a variety of services, including acupuncture, body massage, foot massage and other services. All products used in the salon will be supplied by us. Management hopes that the opening of this salon and the opening of retail counters will allow us to increase our brand recognition and strengthen marketing. Our

ability to effectively open and operate new retail locations depends on several factors, including, among others, our ability to identify suitable counter locations, the

availability of which is outside our control; our ability to prepare counters for opening within budget; our ability to hire, train and retain personnel; our ability to secure required governmental permits and approvals; our ability to contain payroll costs; and our ability to generate sufficient operating cash flows or secure adequate capital on commercially reasonable terms to fund short term cash needs and our expansion plans.

There is potential for growth in production and sales due to the growth of new products and expansion of new channels into urban and rural communities. However, it will be uncertain which of our new products will pass the applicable tests and get clinical approval without difficulty because of the uncertainty of test results and clinical approvals. Over the last three years, the price of the main raw material we use - sanchi - has risen. We expect this trend to continue and will likely increase our cost of product sold. In addition, our expected increased expenses for research and development, marketing and sales may have a short-term adverse affect on future profit levels and available cash resources.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America, or U.S. GAAP. We believe the following are the critical accounting policies that impact the financial statements, some of which are based on management' s best estimates available at the time of preparation. Actual experience may differ from these estimates.

Basis of Presentation and Translating Financial Statements - The condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the United States Securities and Exchange Commission. The functional currency of the operating subsidiaries in the People' s Republic of China ("PRC") is the Chinese Yuan Renminbi ("CNY"); however, the consolidated financial statements have been expressed in United States Dollars ("USD"). The accompanying consolidated balance sheets have been translated into USD at the exchange rates prevailing at each balance sheet date. The consolidated statements of operations have been translated using the weighted average exchange rates prevailing during the operating periods of each statement.

Principles of Consolidation - The accompanying consolidated financial statements present the operations of the Company and its majority owned subsidiaries. All

significant intercompany accounts and transactions have been eliminated in consolidation.

Accounting Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Fair Value of Financial Instruments - The carrying amounts reported in the consolidated balance sheets for accounts and notes receivables, employee advances, advances to suppliers, accounts payable, accrued liabilities, and advances from customers approximate fair value because of the immediate or short-term maturity of these financial instruments. We believe the interest rates on short-term notes payable and long-term debt reflect rates currently available in the PRC. Thus, the carrying value of these loans approximates fair value.

Cash and Cash Equivalents - Our cash and cash equivalents are maintained in bank deposit accounts. We have not experienced any losses with respect to these deposits. Cash and cash equivalents include interest bearing and non-interest bearing bank deposits, money market accounts and short-term certificates of deposit with original maturities of three months or less. We do not have any restricted cash as of June 30, 2009. We did not enter into any hedge contracts during any of the periods presented.

Accounts and Notes Receivable and Allowance for Doubtful Accounts - Trade receivables are carried at original invoiced amounts less an allowance for doubtful accounts. An allowance for uncollectible accounts receivable is established by charges to operations for amounts required to maintain an adequate allowance, in our judgment, to cover anticipated losses from customer accounts and sales returns. Such accounts are charged to the allowance when collection appears doubtful. Any subsequent recoveries are credited to the allowance account. We believe that the allowance for doubtful accounts is consistent with industry standards in the PRC based on the products that are being sold.

Notes receivable were \$129,149 and \$750,877 as of June 30, 2009 and December 31, 2008, respectively. The notes represent bank drafts that have been arranged with third-party financial institutions by certain customers to settle their purchases from us. These bank drafts are non-interest bearing and are due within six months. Such sales and purchasing arrangements are consistent with industry practices in the PRC.

Sales Representative Advances - Sales representative advances are presented net of an estimated allowance for doubtful advances. As time passes from when advances are made to sales representatives for travel and related expenses, we will create an allowance for these older receivables as the likelihood of collection from each particular sales

representative decreases as their respective advances age. Long-term sales representative advances are not expected to be realized in the current operating period.

Inventory - Inventories consist principally of pharmaceutical products and are stated at weighted average cost. When market value of the inventory products is lower than the weighted average cost, inventory is reduced to its net realizable value. We also hold inventory on consignment.

Property and Equipment - Property and equipment are stated at cost. Maintenance and depreciation are charged to expense as incurred and major improvements are capitalized. Gains or losses on sales or retirements are included in the statements of operations in the period of disposition, determined by reference to their carrying amounts. We review our property and equipment periodically for changes in circumstances that would indicate its recoverable carrying value is less than its net book value. If such circumstances occur, impairment is charged to such items.

Intangible Assets - Acquisition costs of land use rights are capitalized at their acquisition cost and amortized using the straight-line method over their estimated useful lives. For those intangible assets with legal protection over a specific period, their useful life is the protected period. Assets that do not have legal protection periods are amortized over their estimated useful life. Research and development costs are expensed during the period incurred.

Impairment of Long-Lived Assets - We review our long-lived assets, including intangibles, for impairment at least annually or when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We evaluate, at each balance sheet date, whether events and circumstances have occurred that indicate possible impairment. We use an estimate of future undiscounted net cash flows from the related asset or group of assets over their remaining life in measuring whether the assets are recoverable.

Deposits and Accrued Expenses - Accrued expenses consists of accrued commission expense, accrued payroll expense, and accrued welfare expense. Deposits consist of funds paid by the sales representatives to obtain our products to sell. We retain these deposits during the time the sales representatives provide services to us. When we receive full payment from the customer or sales representatives terminate sales services, the deposits are returned to the sales representatives. We record deposits from sales representatives when payments are received.

Advances to Suppliers and Advances from Customers - We will often make advanced payments to suppliers for materials, or receive advance payments from customers in the normal

course of business. Advances to suppliers were \$554,828 and \$446,168 as of June 30, 2009 and December 31, 2008, respectively. Advances to suppliers are recorded when payment is made by us and relieved against inventory when goods are received. The advance payments to suppliers may include provisions that set the purchase price and delivery date of raw materials. Advances from customers were \$813,879 and \$222,609 as of June 30, 2009 and December 31, 2008, respectively and are recognized in revenue when delivery has occurred.

Revenue Recognition - We recognize revenue when it is realized and earned. We consider revenue realized or realizable and earned when (1) it has persuasive evidence of an arrangement, (2) delivery has occurred, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Delivery does not occur until products have been shipped to the client, risk of loss has transferred to the client and client acceptance has been obtained, client acceptance provisions have lapsed, or we have objective evidence that the criteria specified in client acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

We recognize revenue for its consignment sales only after the customer has checked the quality of the goods and we have received a written confirmation from the customer that it has accepted the goods.

Cost of Revenues - The cost of revenues are the direct expenses incurred in producing the pharmaceuticals and cosmetics, which include materials, wages, handling charges, and a portion of overhead expenses associated with the manufacture and delivery of products.

Shipping and Handling Costs - Shipping and handling costs are included in selling expenses.

Research and Development - We charge research and development costs to operations in the period incurred. We recognize revenue from research and development activities in accordance with the revenue recognition policy as stated above. Because in many cases we cannot be assured that the terms of specific contracts can be fulfilled, we recognize revenue only after all terms of a contract are complete.

Advertising - Advertising expense was \$26,027 and \$1,395,146 for the six months ended June 30, 2009 and 2008, respectively.

Basic and Diluted Earnings per Share - The computation of basic and diluted earnings per share is based on the weighted-average number of shares outstanding during the periods presented. Potentially dilutive securities for the three and six months ended June 30, 2009 and 2008 include 46,000 warrants which were antidilutive due to losses we sustained.

Retirement Benefit Plans - We make monthly contributions to various employee retirement benefit plans organized by provincial governments in the PRC in accordance with rates prescribed by them. The provincial governments undertake to assume the retirement benefit obligations of all of our existing and future retired employees. Contributions to these plans are charged to expense as incurred.

Comprehensive Income - Other comprehensive income presented in the consolidated financial statements consists of cumulative foreign currency translation adjustments.

Credit Risk - The carrying amounts of accounts receivable and sales representative advances included in the balance sheets represent our major exposure to credit risk in relation to our financial assets. No other financial assets carry a significant exposure to credit risk. We perform ongoing credit evaluations of each customer's financial condition. We maintain allowances for doubtful accounts and we believe our current reserves are adequate.

We have our cash in bank deposits and money market funds primarily in the PRC. Historically, deposits in Chinese banks have been secure due to the state policy on protecting depositors' interests. China promulgated a new Bankruptcy Law in August 2006, which came into effect on June 1, 2007, which, together with more specific, complementary regulations to be issued in the future, shall provide the implementation for the bankruptcy of Chinese banks. In the event that bankruptcy laws are enacted for banks in the PRC, our deposits may be at a higher risk of loss.

Business Condition and Liquidity - Although the Company has had a history prior to 2008 of positive income, working capital and retained earnings, the Company has incurred a net loss for the six months ended June 30, 2009 of \$6.7 million and had net cash provided by operating activities of \$1.0 million and used funds in financing activities of \$1.6 million. As a result, during the six months ended June 30, 2009, the cash and cash equivalents decreased \$0.9 million. In addition, the Company had an accumulated deficit of \$7.3 million as of June 30, 2009, primarily due to the losses in the six months ended June 30, 2009 and the loss of \$4.6 million for fiscal 2008. As discussed in Note 6, the Company has \$11.3 million in short term loans that mature in the next twelve months. Additionally, as discussed in Note 9, putative class action lawsuits have been asserted against the Company and the Company is undergoing a voluntary investigation by the Securities and Exchange Commission.

The Company has expended significant efforts to expand its revenues by assisting its sales representatives and increasing its marketing efforts during the six months ended June 30, 2009 and during fiscal 2008. The net loss for the six months ended June 30, 2009 was caused primarily by increased selling expenses, legal, auditing, sales

representative assistance and marketing expenses. As of June 1, 2009, the Company has changed its policy with respect to its sales representatives and has reduced the percentage accrual for selling expenses which is based on a percentage of revenue. The Company believes that it will be able to stabilize selling, legal, auditing, marketing and sales representative assistance expenses in the near future but the Company cannot give any assurance that this will be the case. In addition, the Company may be forced to give significant attention to the class action lawsuits noted above.

Recently Enacted Accounting Standards - In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* or SFAS No. 168. SFAS No. 168 will become the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related accounting literature. SFAS No. 168 reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant SEC guidance organized using the same topical structure in separate sections. SFAS No. 168 will be effective for financial statements issued for reporting periods ending after September 15, 2009. This will have an impact on the Company's financial disclosures since all future references to authoritative accounting literature will be references in accordance with SFAS No. 168.

Results of Operations

Three Months Ended June 30, 2009 and 2008

The following table sets forth our statements of operations for the three months ended June 30, 2009 and 2008 in U.S. dollars (unaudited):

	For the three months ended June,			
	2009	2008	Change (\$)	Variance (%)
	<i>(in thousand, except share and per share amounts)</i>			
Products \$	8,130	\$ 8,591	(461)	
Products	2,395	2,988	(593)	

fit	5,735	5,603	132
expenses	6,221	4,036	2,185
and ative	3,120	2,714	406
and nt	7	70	(63)
rating	9,348	6,820	2,528
s	(3,613)	(1,217)	(2,396)
ome):			
income	—	2	(2)
om and nt s	120	76	44
expense	(268)	(435)	167
ting	(15)	(65)	50
Income	(163)	(422)	259
re xes	(3,776)	(1,639)	(2,137)

from n for)			
xes	—	2	(2)

in			
ies	—	100	(100)

	(3,776)	(1,537)	(2,239)
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urrency on ts	3	217	(214)
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sive			
\$	(3,773)\$	(1,320)\$	(2,453)

(Loss)			
\$	(0.19)\$	(0.08)\$	(0.11)

\$	(0.19)\$	(0.08)\$	(0.11)
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Average			
ng			

	19,679,400	19,679,400	—
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	19,679,400	19,679,400	—
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Sale of products: Sale of products for the three months ended June 30, 2009 was approximately \$8.13 million, a decrease of approximately \$0.46 million, or 5.37 %, from

\$8.59 million for the three months ended June 30, 2008. The decrease in sale of products was primarily due to the decrease of \$0.4 million in the sales of other brands' non-prescription pharmaceuticals, and approximately \$0.03 million decrease in the sales of cosmetic products and export of our products, respectively.

Cost of products sold: Our cost of products sold for the three months ended June 30, 2009 was approximately \$2.39 million, a decrease of \$0.6 million, or 19.85%, from approximately \$2.99 million for the three months ended June 30, 2008. The decrease in cost of products sold was due primarily to the decrease in the cost of products sold of non-prescription pharmaceuticals because of the decrease in the sales volume of such products for the three months ended June 30, 2009 as compared to the sales volume of goods sold for the three months ended June 30, 2008.

Gross profit: Our gross profit for the three months ended June 30, 2009 was approximately \$5.74 million as compared with approximately \$5.6 million for the three months ended June 30, 2008, an increase of \$0.14 million, or 2.36%. Gross profit as a percentage of revenues was approximately 70.55% for the three months ended June 30, 2009, an increase of 5.33 % from 65.22% for the three months ended June 30, 2008. The increase in gross margin percentage was primarily due to the above-mentioned reduction of the sales of non-prescription pharmaceuticals of other brands.

Selling expense: Selling expenses were approximately \$6.22 million for the three months ended June 30, 2009, an increase of \$2.18 million, or 54.14%, from \$4.04 million for the three months ended June 30, 2008. The primary reason for the increase in selling expenses was the change in our marketing policy. Our main product has been sold to patients through hospitals, which customer relationships were cultivated by sales representatives. However, we believe it is in our best-long term interest to grow our operations through the over-the-counter ("OTC") market, which will produce higher profit margins, and we have decided to begin developing the OTC market in 2009. Although we are focusing our operations on the OTC market, we have adopted a policy to absorb a significantly higher percentage of costs incurred by our sales representatives than in the past in order to foster their cooperation in developing the OTC market. The costs to be borne by us are being accrued in selling expenses.

Previously, the Company advanced selling expenses to the sales representatives to develop the market. Starting in 2009, due to the new policy, the Company accrues a fixed amount of selling expenses to the sales representatives for each sale. The Company reimburses the sales representatives their selling and marketing expenses when they submit the appropriate documentation to be reimbursed and their sales are collected. The accrued sales expenses are due within six months.

General and administrative expense: General and administrative expenses were approximately \$3.12 million for the three months ended June 30, 2009, an increase of \$0.41 million, or 15.00%, from approximately \$2.71 million for the three months ended

June 30, 2008. The increase was primarily due to the increase of expense related to our status as a public company with its securities traded on a U.S. national exchange.

Research and development expense: Research and development expense for the three months ended June 30, 2009 was \$6,640 as compared to \$70,213 for the period ended June 30, 2008. The decrease was primarily due to our focus on a few innovative pharmaceuticals instead of on a number of generic drugs.

Net other expense: Net other expense, which includes interest income, income from research and development activities, interest expense and non-operating expenses, was \$163,419 for the three months ended June 30, 2009 and \$423,015 for the three months ended June 30, 2008. The decrease in net other expense was primarily due to (i) an increase in the income generated from newly-developed products and (ii) a decrease in the interest expense on long-term loans.

Net loss: Net loss increased to \$3.78 million for the three months ended June 30, 2009 as compared to net loss of \$1.54 million for the three months ended June 30, 2008. The increase in net loss was primarily due to (i) an increase in the expenses related to our status as a public company; (ii) an increase in selling expense and (iii) an increase in the allowance for bad debts.

Six Months Ended June 30, 2009 and 2008

The following table sets forth our statements of operations for the six months ended June 30, 2009 and 2008 in U.S. dollars (unaudited):

	For the six months ended June,			
	2009	2008	Change (\$)	Variance (%)
<i>(in thousand, except share and per share amounts)</i>				
Sale of Products	\$ 14,901	\$ 14,078	823	5.85%
Cost of Products Sold	4,696	5,088	(392)	(8.0%)

Gross Profit	10,205	8,990	1,215	14.0%
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Operating Expenses:

Selling expenses	12,617	5,677	6,940	122.0%
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General and administrative expenses	4,167	5,182	(1,015)	(20.0%)
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Research and development expenses	14	189	(175)	(93.0%)
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Total Operating Expenses	16,798	11,048	5,750	52.0%
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Loss from Operations	(6,593)	(2,058)	(4,535)	(220.0%)
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Other Income (Expenses):

Interest income	1	5	(4)	(80.0%)
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Income from research and development activities	145	339	(194)	(57.0%)
Interest expense	(520)	(691)	171	25.0%
Non-operating expenses	(19)	(138)	119	(86.0%)
Net Other Income (Expense)	(393)	(485)	92	(19.0%)
Loss Before Income Taxes	(6,986)	(2,543)	(4,443)	(175.0%)
Benefit from (provision for) income taxes	—	—	—	—%
Minority interest in income of subsidiaries	249	154	94	61.0%
Net Loss	(6,737)	(2,389)	(4,349)	(182.0)

				%
Foreign currency translati on adjustmen ts	3	690	(687)	(99.0%)
Comprehen sive Loss	\$ (6,734)	\$ (1,700)	(5,033)	(296.0%)
Loss Per Share				
Basic	\$ (0.34)	\$ (0.12)	0.22	183.0%
Diluted	\$ (0.34)	\$ (0.12)	0.22	183.0%
Weighted- Average Shares Outstandi ng				
Basic	19,679,400	19,679,400	—	—%
Diluted	19,679,400	19,679,400	—	—%

Sale of products: Sale of products for the six months ended June 30, 2009 was approximately \$14.90 million, an increase of approximately \$0.82 million, or 5.85%, from approximately \$14.08 million for the six months ended June 30, 2008. The increase in

sales is due to the increase in sales of our primary product, Xuesaitong Soft Capsules, by \$0.93 million and an increase in our sales of cosmetic products by \$0.02 million. The increase in sales was partially offset by the decrease of \$0.07 million in our sales of other companies' non-prescription medicine and the decrease in exports of \$0.06 million attributable to the general condition of the global economy. The foreign exchange rate fluctuation also impacted the sales revenue by \$0.07 million.

Cost of products sold: Our cost of products sold for the six months ended June 30, 2009 was approximately \$4.69 million, a decrease of \$0.39 million, or 8%, from approximately \$5.08 million for the six months ended June 30, 2008. The decrease in cost of products sold was due primarily to the decrease in the cost of products sold of non-prescription pharmaceuticals because of the decrease in the sales volume of such products for the three months ended June 30, 2009 as compared to the sales volume of goods sold for the three months ended June 30, 2008.

Gross profit: Our gross profit for the six months ended June 30, 2009 was approximately \$10.20 million as compared with approximately \$8.99 million for the six months ended June 30, 2008. Gross profit as a percentage of revenues was approximately 68% for the six months ended June 30, 2009, up from 64% for the six months ended June 30, 2008. The increase in gross margin percentage is attributable primarily to the Company's 2009 decision to reduce promotion of other brands' non-prescription medicines that had generated poor profit margins for the period ended June 30, 2008.

Selling expense: Selling expenses were approximately \$12.61 million for the six months ended June 30, 2009, an increase of approximately \$6.94 million, or 122%, from approximately \$5.67 million for the six months ended June 30, 2008. The primary reason for the increase in selling expenses was the change in our marketing policy. Our main product has been sold to patients through hospitals, which customer relationships were cultivated by sales representatives. However, we believe it is in our best-long term interest to grow our operations through the over-the-counter ("OTC") market, which will produce higher profit margins, and we have decided to begin developing the OTC market in 2009. Although we are focusing our operations on the OTC market, we have adopted a policy to absorb a significantly higher percentage of costs incurred by our sales representatives than in the past in order to foster their cooperation in developing the OTC market. The costs to be borne by us are being accrued in selling expenses.

Previously, the Company advanced selling expenses to the sales representatives to develop the market. Starting in 2009, due to the new policy, the Company accrues a fixed amount of selling expenses to the sales representatives for each sale. The Company reimburses the sales representatives their selling and marketing expenses when they submit the appropriate documentation to be reimbursed and their sales are collected. The accrued sales expenses are due within six months.

General and administrative expense: General and administrative expenses were approximately \$4.16 million for the six months ended June 30, 2009, a decrease of

approximately \$1.02 million, or 20%, from approximately \$5.18 million for the six months ended June 30, 2008. The decrease was primarily due to the reduction in advertising expenses.

Research and development expense: Research and development expense for the six months ended June 30, 2009 was \$14,000 as compared to \$190,000 for the six months ended June 30, 2008. The decrease was primarily due to our focus on a few innovative pharmaceuticals instead of on a number of generic drugs.

Net other expense: Net other expense, which includes interest income, income from research and development activities, interest expense and non-operating expenses, was \$393,000 for the six months ended June 30, 2009 as compared to \$486,000 for the six months ended June 30, 2008, a decrease of \$93,000, or 19%. The decrease in net other expense was primarily due to (i) an increase in the income generated from newly-developed products and (ii) a decrease in the interest expense on long-term loans.

Benefits from (provision for) income taxes: Provision for income taxes was \$0 for the six months ended June 30, 2009 as compared to a provision for income tax of approximately \$13 for the six months ended June 30, 2008. In China, each of our subsidiary entities files its own individual tax return in the PRC. The Company pays tax on all profits realized by each subsidiary, and any losses generated by a subsidiary can only be carried forward and utilized by the same legal entity. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical because of the complexities associated with its hypothetical calculation.

Net loss: We incurred a net loss of \$6.73 million for the six months ended June 30, 2009 as compared to a net loss of \$2.39 million for the six months ended June 30, 2008, an increase in net loss of approximately \$4.34 million. The increase in net loss was primarily due to (i) an increase in the expenses related to our status as a public company; (ii) an increase in selling expense and (iii) an increase in the allowance for bad debts.

Liquidity and Capital Resources

General - As of June 30, 2009, we had cash and cash equivalents of \$717,134. We have historically financed our business operations through bank loans, in addition to equity offerings. As of June 30, 2009, we had borrowed from banks and other institutions and had amounts of approximately \$11.32 million in short-term notes payable. All loans are secured by land, buildings and machinery as collateral except the loan from the Agricultural Bank of China mentioned below which is secured by a pledge by Lan's International Medicine Investment Co Ltd. ("LIMI") of its shareholding in the Company.

Our notes payable consist of short term debt that is payable to banks, governmental financial bureaus, municipalities and a company. The following schedule summarizes our debt obligations and respective balances:

	June 30, 2009	December 31, 2008
Short-term note payable to a municipality, interest at 1.8%, due on demand, unsecured	\$ 73,048	\$ 72,948
Short-term note payable to a finance bureau, interest at 4.5%, due on demand, unsecured	75,285	75,182
Short-term note payable to a bank, interest at 5.31%, matures April 2010, secured by property	3,652,408	—
Short-term note payable to a bank, interest at 7.47%, matured April 2009, secured by property	—	3,647,399

Short-term note payable to a bank, interest at 6.57%, matures April 2010, secured by property	1,460,963	—
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Short-term note payable to a government development zone interest at 2.43%, due on demand, secured by property	219,144	218,844
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Short-term note payable to a bank, interest at 7.72%, matures August 2009, secured by shareholder	5,843,853	5,835,838
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Total short-term notes payable \$	11,324,701 \$	9,850,211
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June 30,
2009

December 31,
2008

Long-term note payable to a bank, interest at 8.316%,	1,460,963	1,458,959
-------------------------------------------------------	-----------	-----------

matures April 2010, secured by property		
Long-term note payable to a bank, interest at 6.57%, matures March 2010, due on demand, unsecured	—	2,917,919
<hr/>		
Total long-term debt	1,460,963	4,376,878
Less current maturities of long-term debt	1,460,963	3,245,685
<hr/>		
Long-term notes payable, net of current portion	\$ —	\$ 1,131,193
<hr/>		
Past due notes payable	\$ 294,430	\$ 294,026
<hr/>		

On August 17, 2007, we received a loan for \$6,651,094 from Shuang Long Branch of Agricultural Bank of China with a term of two years. The loan bears interest at a rate of 7.722%, which is due quarterly. The loan was for working capital and is guaranteed by Lan's International Medicine Investment Co Ltd. ("LIMI"). Gui Hua Lan, our Chief Executive Officer; Feng Lan, our President; and Zheng Yi Wang, our Executive Director of Exports, are directors and have voting and investment control over the shares owned by LIMI, which beneficially owns or controls approximately 77.3% of our outstanding shares. In addition, Gui Hua Lan, Feng Lan and Zheng Yi Wang owns 62.42%, 5.15% and 1.45%,

respectively, of LIM I' s issued and outstanding shares. LIM I is not receiving any compensation for the guarantee of our loan.

In August, 2009, the Yunnan Shuang Long Branch of Agricultural Bank of China ("Agricultural Bank") has conducted a review of the Company' s operations and unencumbered assets, including the improvements being made to the Company owned real estate on which it is constructing Shenghuo Plaza. Based on its assessment, the Agricultural Bank has approved a loan facility of up to RMB 110 million (approximately \$16 million). The first approved draw down of this facility will be to repay the RMB 39.6 million (approximately \$5.8 million) advanced by a government financial bureau to pay the Agricultural Bank facility that matured in August 2009. It is also anticipated that RMB 20 million of this facility (approximately \$2.9 million) will be advanced to fund further construction costs of Shenghuo Plaza. The balance of the facility is intended to fund working capital needs. Each borrowing will require the commitment of specific collateral to be determined at that time. As currently contemplated, the interest rate on all advances will be at the Agricultural Bank' s base rate.

The following table provides summary information about net cash flow for the six months ended June 30, 2009 and 2008:

Cash Flow
Six months ended June 30,

	2009	2008
	(unaudited, in thousands)	
Net cash provided by (used in) operating activities	\$ 981	\$ (556)
Net cash used in investing activities	(308)	(50)
Net cash used in financing activities	(1,570)	(1,578)
Cash and Cash Equivalents at End of Period	\$ 717	\$ 744

Operating Activities: Net cash provided from operating activities for the six months ended June 30, 2009 was \$981,447, as compared to net cash used in operating activities of \$556,090 for the six months ended June 30, 2008. These results reflect the impacts of (i) net loss; (ii) cash used in accounts and notes receivable, advances to suppliers and deposits; and (iii) cash generated in accrued expenses, allowance for doubtful accounts, sales representative advances, inventory, accounts payable, deposits, and taxes and related payables.

Investing Activities: Net cash used by investing activities was \$308,654 for the six months ended June 30, 2009, as compared to net cash used in the amount of \$49,856 for the six months ended June 30, 2008. The increase in net cash used by investing activities was primarily due to increases in capital expenditures, specifically, the construction of Shenghuo Plaza, our wellness center and training facility for professionals who use our cosmetic products.

Financing Activities: Net cash used by financing activities was approximately \$1.57 million for the six months ended June 30, 2009 compared to net cash used in the amount of \$1.58 million for the six months ended June 30, 2008. The decrease in cash used was primarily due to the decrease in proceeds from short- and long-term loans.

Working Capital

As of June 30, 2009, our accounts receivable and notes receivable (less allowance for doubtful accounts of approximately \$5.96 million) were approximately \$10.14 million, an increase of approximately \$1.03 million, or 11% from accounts receivable of approximately \$9.11 million (net of allowance for doubtful accounts of \$4.83 million) as of December 31, 2008. The collection period typically runs from nine months to one year, considering the relatively long collection period in our industry.

Our company normally requires one to two months to deliver products once an order is placed with our workshop. Inventory decreased for the six months ended June 30, 2009 by \$0.93 million, a decrease of 22% over inventory as of December 31, 2008. The decrease in inventory was

primarily due to the increased sales volume stimulated by the newly implemented sales policy pursuant to which sales representatives are reimbursed for their selling expenses rather than receiving advances.

Our payment cycle is considerably shorter than our receivable cycle, since we typically pay our suppliers all or a portion of the purchase price in advance and for some suppliers we must maintain a deposit for future orders. We require our customers to pay a certain percentage of the sales price as deposit before we ship products to them. The percentage varies from customer to customer. During the course of business, we reduce the deposit requirement for some customers with good credit.

To the extent that we cannot satisfy our cash needs, whether from operations or from a financing source, our business would be impaired in that it may be difficult for us to obtain products which could, in turn, impair our ability to generate sales. We have implemented new policies aimed at improving collection of accounts receivable in the

future, including more detailed reporting from and increased control over provincial sales offices and representatives, incentives for sales representatives more closely tied to timely collection and more stringent enforcement of payment terms with distributors.

In addition, in the course of our business, we must make significant deposits to our suppliers when we place an order. As of June 30, 2009, our advance payments to our suppliers totaled approximately \$0.55 million. We are confident that our available funds and cash generated from operations will provide us with sufficient capital for a sustainable operation; however, we may require additional capital for acquisitions, for expanding business to related fields, or for the operation of the combined companies. We cannot assure that such funding will be available.

Before 2009, we made significant cash advances to our sales representatives to assist and encourage them to expand the marketing and sales of our products into new markets and to develop new customers. We believed that the sales representatives would be better able to expand into new markets and to secure new customers if they were advanced funds for their travel, meals and other incidental expenses that arose in connection with their sales activities. Prior to September 2006, we did not ask sales representatives to pay off advances immediately because the Chinese economy has grown quickly and because competition in the pharmaceutical industry is intense. Instead, we encouraged sales representatives to expand their markets and gain more customers. However, beginning in September of 2006, we began to more vigorously pursue collection of all sales representative advances. Nonetheless, there are some sales representative advances that have aged so significantly that, based on prior experience, we do not expect to collect on every outstanding advance and have estimated the uncollectible balance based on the age of the advances. Pursuant to the policies adopted at the beginning of 2009, instead of advancing sales representatives money to sustain or develop markets, we reimburse sales representatives their selling and marketing expenses when they present expense vouchers. Management considers this a better way to manage the potential for bad debts on the advances to sales representatives. We pay the accrued selling expenses only when the Company collects an account receivable for which a sales representative has presented his expense receipts. Because we offer a grace period of one-to-six months to our clients for remitting payments due, the accrued sales expenses may remain outstanding for however long it takes to collect the corresponding accounts receivable.

Beginning June 1, 2009, we implemented a new policy aimed at reducing sales representatives' selling expenses. We expect to see the effect of the new policy on operating results in the second half of 2009.

Current and long-term employee advances (net of allowances for doubtful accounts) were approximately \$8.39 million at June 30, 2009 and \$9.3 million as of December 31, 2008, a decrease of approximately \$0.9 million or 10%. The decrease was due to our change to a system of reimbursing sales representatives based upon presentment of expense vouchers rather than advancing funds for such expenses.

The table below sets forth the outstanding gross and net amount of outstanding balances of current and long-term employee advances as of December 31, 2008 and June 30, 2009.

	As of December 31, 2008	As of June 30, 2009
Gross amount of employee accounts	\$12,921,134	\$12,350,461
Allowance for doubtful accounts	3,620,048	3,956,925
Net amount	\$ 9,301,086	\$ 8,393,536

Off-Balance Sheet Arrangements

None.

Foreign Currency Risk

Since all of our operations are conducted in the PRC, we are subject to special considerations and significant risks not typically associated with companies operating in the United States of America. These risks include, among others, the political, economic and legal environments and foreign currency exchange rate fluctuations. Our operational results may be adversely affected by changes in the political and social conditions in the PRC, and by changes in governmental policies with respect to medical reforms and other laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things. Exchange rate fluctuations may adversely affect the value, in U.S. dollar terms, of our net assets and income derived from its operations in the PRC. In addition, all of our revenue is denominated in the Chinese Yuan Renminbi ("CNY"), which must be converted into other currencies before remittance out of the PRC. Both the conversion of CNY into foreign currencies and the remittance of foreign currencies abroad require approval of the PRC government. The effect of the fluctuations of exchange rates is not considered to be material to our business operations.

Interest Rate Risk

We do not have significant interest rate risk, as our debt obligations are primarily fixed interest rates.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Smaller reporting companies are not required to provide the information required by this Item.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

As of June 30, 2009, our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO) performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act. Based on that evaluation, management concluded that our disclosure controls and procedures were effective as of June 30, 2009.

Changes in Internal Controls over Financial Reporting

Our management, including the CEO and CFO, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act. Our management is also required to evaluate and report on the effectiveness of our internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404") and to file an annual report pursuant to section 13(a) of the Securities Exchange Act where we reported that we determined the existence of a material weakness in internal control. The CEO and CFO have evaluated several changes to our internal control over financial reporting as of June 30, 2009 that will or are reasonably likely to materially affect our internal control over financial reporting.

In making this evaluation, they used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. The information below shows the changes to the internal control over financial reporting that were evaluated and the status of our other material weakness remediation to date:

- Material adjustments related to the prior year audits were not recorded in the company's accounting records that were necessary to reconcile the retained earnings to the prior year balances, which is a material weakness.

Due to the complexities of applying the audit adjustments to sub-ledgers, to date, only material audit adjustments to general ledgers were tracked, but the detailed adjustments to sub-ledgers still needs to be tracked.

Remediation:

In addition to keeping Chinese GAAP books as a statutory requirement in China, our financial department is working with our auditors to identify the detailed supporting information of prior year adjustments to sub-ledgers for all audit adjustments. We are endeavoring to keep clear records of all adjustments made to our accounts from year-to-year and to reconcile our accounts with audited reports.

Remediation is in process at this date.

- Multiple material adjustments were made as a result of audit procedures performed, which is a material weakness.

Remediation:

Our financial department has improved our book keeping procedures and closing procedures to improve financial reporting quality and reduce material adjustments.

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Remediation is completed at this date.

In addition, we have allocated significant financial and human resources to strengthen our internal control structure.

We believe that the foregoing steps have helped us remediate the material weakness and significant deficiencies identified above and we will continue to monitor the effectiveness of these steps and make any changes that our management deems appropriate.

A material weakness (within the meaning of PCAOB Auditing Standard No. 5) is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Mingying Co., Ltd. Lawsuit – On July 20, 2009, the Company appeared before a court sitting in the Tianhe District of Guangzhou, Guangdong Province, People’s Republic of China, to defend itself in an action brought by Mingying Co., Ltd. for allegedly failing to satisfy payment obligations for advertising services. Mingying Co., Ltd. is seeking a judgment in the amount of RMB 465,000 (approximately \$68,000). The court has informed Mingying Co., Ltd. that it has failed to meet its burden of proof in support of its claims, however the action is still proceeding. The Company believes the allegations in the amended consolidated complaint are without merit, and intends to vigorously defend the lawsuit. The Company does not believe the outcome of this suit will have a material adverse effect on the Company.

SEC Investigation – The United States Securities and Exchange Commission (“SEC”) has been conducting an informal inquiry regarding the events that resulted in the Company’s restatement of its financial statements for the fiscal year 2007 and the first quarter of 2008. The Company is represented by counsel and has been cooperating with the SEC’s inquiry on a voluntary basis.

Class Action Lawsuit – In 2008, putative class action lawsuits were asserted against the Company and certain other parties in the United States District Court for the Southern District of New York (the “Court”). On February 12, 2009, an amended complaint was served on the Company by new lead counsel for the class, consolidating the putative class actions and bearing the caption Beni Varghese, Individually and on Behalf of All Other Similarly Situated v. China Shenghuo Pharmaceutical Holdings, Inc., et al., Index No. 1:08 CIV. 7422. The defendants include the Company, the Company’s controlling shareholders, Lan’s International Medicine Investment Co., Limited, the Company’s chief executive officer, Gui Hua Lan, the Company’s former chief financial officer, Qiong Hua Gao, and the Company’s independent registered public accounting firm, Hansen, Barnett & Maxwell, P.C. During the second quarter of 2009, the Company and the accounting firm filed motions to dismiss the complaint and the plaintiffs filed a memorandum in opposition to those motions. During the third quarter of 2009, the Company plans to file a reply brief in further support of its motion.

The amended consolidated complaint alleges that the Company failed to take adequate steps to ensure its financial reporting comported with U.S. Generally Accepted Accounting Principles (“GAAP”) and, as a result, the Company was required to restate what are alleged to be materially false and misleading financials for accounting periods during the alleged class period from August 2007 through August 20, 2008. The amended consolidated complaint further alleges, among other things, that certain of the Company’s SEC filings and other public statements contained false and misleading statements which resulted in damages to the plaintiffs and the members of the purported class when they purchased the Company’s securities. On the basis of those allegations,

plaintiffs in each of the actions seek an unspecified amount of damages under Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

The Company believes the allegations in the amended consolidated complaint are without merit, and intends to vigorously defend the class action lawsuits. The Company does not believe the outcome of this suit will have a material adverse effect on the Company. However, the Company is unable at this time to predict the outcome of this litigation or whether the Company will incur any liability associated with the litigation, or to estimate the effect such outcome would have on the financial condition, results of operations, or cash flows of the Company.

ITEM 1A. RISK FACTORS

Except as reflected in this Form 10-Q, there have been no material changes from the risk factors previously disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit

Number **Description of Exhibit**

31.1	Certification of the Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a).
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31.2 Certification of the Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a).

32.1 Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.*

* This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHINA SHENGHUO PHARMACEUTICAL HOLDINGS, INC.
(Registrant)

August 14, 2009

By: /s/ Gui Hua Lan

Gui Hua Lan
Chief Executive Officer and Chairman of
the Board

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EXHIBIT INDEX

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