

CHINA JO-JO DRUGSTORES, INC.
Form 10-K
July 02, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

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

For the fiscal year ended March 31, 2012
or

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

For the transition period _____ to _____
from _____

Commission File Number: 001-34711

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

Nevada
(State or other jurisdiction of incorporation or organization)

98-0557852
(I.R.S. employer identification number)

Room 507-513, 5th Floor A Building, Meidu
Plaza
Gongshu District, Hangzhou, Zhejiang
Province
People's Republic of China
(Address of principal executive offices and zip code)

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common stock, \$0.001 par value

Name of each exchange on which registered
NASDAQ Capital Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every, Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer	<input type="radio"/>	Accelerated Filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

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

As of June 22, 2012, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$7,944,871, based on a closing price of \$1.08 per share of common stock as reported on the NASDAQ Stock Market on such date.

As of June 22, 2012, the registrant had 13,571,553 shares of common stock outstanding.

TABLE OF CONTENTS
TO ANNUAL REPORT ON FORM 10-K
FOR YEAR ENDED MARCH 31, 2012

	Page
PART I	
Item 1. Business	4
Item 1A. Risk Factors	18
Item 1B. Unresolved Staff Comments	35
Item 2. Properties	35
Item 3. Legal Proceedings	36
Item 4. Reserved	36
PART II	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	36
Item 6. Selected Financial Data	37
Item 7. Management's Discussion and Analysis of Financial Conditions and Results of Operations	37
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	44
Item 8. Financial Statements	44
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	44
Item 9A. Controls and Procedures	44
Item 9B. Other Information	45
PART III	
Item 10. Directors, Executive Officers and Corporate Governance	45
Item 11. Executive Compensation	49
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	51
Item 13. Certain Relationships and Related Transactions	53
Item 14. Principal Accounting Fees and Services	53
PART IV	
Item 15. Exhibits, and Financial Statement Schedules	54
Signatures	57

CAUTION REGARDING FORWARD-LOOKING INFORMATION

This report contains forward-looking statements. All forward-looking statements are inherently uncertain as they are based on current expectations and assumptions concerning future events or future performance of the registrant. Readers are cautioned not to place undue reliance on these forward-looking statements, which are only predictions and speak only as of the date hereof. Forward-looking statements usually contain the words “estimate,” “anticipate,” “believe,” “expect,” or similar expressions, and are subject to numerous known and unknown risks and uncertainties. In evaluating such statements, prospective investors should carefully review various risks and uncertainties identified in this report, including the matters set forth under the captions “Risk Factors” and in the registrant’s other SEC filings. These risks and uncertainties could cause the registrant’s actual results to differ materially from those indicated in the forward-looking statements. The registrant undertakes no obligation to update or publicly announce revisions to any forward-looking statements to reflect future events or developments.

Although forward-looking statements in this report reflect the good faith judgment of our management, such statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and actual results and outcomes may differ materially from the results and outcomes discussed in or anticipated by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those specifically addressed under the heading “Risks Relating to Our Business” below, as well as those discussed elsewhere in this report. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We file reports with the Securities and Exchange Commission (“SEC”). You can read and copy any materials we file with the SEC at the SEC’s Public Reference Room located at 100 F. Street, NE, Washington, D.C. 20549, on official business days during the hours of 10 a.m. to 3 p.m. You can obtain additional information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including the registrant.

We undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this report. Readers are urged to carefully review and consider the various disclosures made throughout the entirety of this report, which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.

PART I

ITEM 1. BUSINESS

General

China Jo-Jo Drugstores, Inc. (the “Company”) is a retailer and distributor of pharmaceutical and other healthcare products typically found in a retail pharmacy in the People’s Republic of China (“PRC” or “China”). Prior to acquiring Zhejiang Jiuxin Medicine Co., Ltd. (“Jiuxin Medicine”) in August 2011 as described in “Our Corporate History and Structure – HJ Group” below, we were primarily a retail pharmacy operator. We currently have 64 store locations under four brands: 56 “Jiuzhou Grand Pharmacy” stores, four “Jiuying Grand Pharmacy” stores and one “Quannuo Grand Pharmacy” store mostly in Hangzhou, the capital of Zhejiang Province, and two “Lydia Grand Pharmacy” store and one “Lydia Zhongxing Grand Pharmacy” store in Shanghai. Our stores provide customers with a wide variety of pharmaceutical products, including prescription and over-the-counter (“OTC”) drugs, nutritional supplements, traditional Chinese medicine (“TCM”), personal care products, family care products, medical devices, as well as convenience products including consumable, seasonal and promotional items. We briefly offered baijiu, or Chinese white liquor, at some of our pharmacies, from December 2010 to February 2011. Each store typically carries approximately 2,500 to 7,500 different products. In addition to these products, we have licensed doctors of both western medicine and TCM onsite for consultation, examination and treatment of common ailments at scheduled hours. Two of our stores have adjacent medical clinics offering urgent care (to provide treatment for minor ailments such as sprains, minor lacerations and dizziness which can be treated on an outpatient basis), TCM (including acupuncture, therapeutic massage and cupping) and minor outpatient surgical treatments (such as suturing). Our store locations vary in size; however, our 64 stores presently average approximately 250 square meters. We attempt to tailor our product offerings, physician access and operating hours based on the community where each individual store is located.

All of our retail pharmacy business (including the medical clinics) is carried out by companies in China that either we control through contractual arrangement or are our wholly-owned subsidiaries:

- Hangzhou Jiuzhou Grand Pharmacy Chain Co., Ltd. (“Jiuzhou Pharmacy”), which we control contractually, operates our “Jiuzhou Grand Pharmacy” stores;
- Zhejiang Jiuying Grand Pharmacy Co., Ltd. (“Jiuying Pharmacy”), 49% of which we own and the remaining 51% we control contractually, operates our “Jiuying Grand Pharmacy” stores and will operate such additional “Jiuying Grand Pharmacy” locations that we may open throughout Zhejiang Province;
- Shanghai Lydia Grand Pharmacy Co., Ltd. (“Shanghai Lydia”), which is wholly-owned by Jiuzhou Pharmacy, operates our “Lydia Grand Pharmacy” store and will operate such additional “Lydia Grand Pharmacy” locations that we may open in Shanghai;
- Shanghai Lydia Zhongxing Grand Pharmacy Co., Ltd. (“Shanghai Zhongxing”), which is 99% owned by Shanghai Lydia, operates our “Lydia Zhongxing Grand Pharmacy” store in Shanghai;
- Hangzhou Quannuo Grand Pharmacy Co., Ltd. (“Hangzhou Quannuo”), which operates the “Quannuo Grand Pharmacy” store, is a wholly-owned subsidiary;
- Hangzhou Jiuzhou Clinic of Integrated Traditional and Western Medicine (General Partnership) (“Jiuzhou Clinic”), which we control contractually, operates one of our two medical clinics; and
- Hangzhou Jiuzhou Medical & Public Health Service Co., Ltd. (“Jiuzhou Service”), which we also control contractually, operates our other medical clinic.

In April 2010, we were granted an Internet Pharmaceutical Transaction Service Qualification Certificate by the State Food and Drug Administration of Zhejiang Province, which allows us to engage in online retail pharmaceutical sales

throughout China. Since May 2010, we have also been operating an online drugstore (www.dada360.com) that currently sells non-prescription OTC drugs and nutritional supplements. In July 2010, we established Zhejiang Shouantang Pharmaceutical Technology Co., Ltd. (“Shouantang Technology”) as a wholly-owned subsidiary to carry out such business, and acquired Zhejiang Quannuo Internet Technology Co., Ltd. (“Quannuo Technology”) in November 2010 to operate the website and provide software and technical support. We have established payment methods with banks and online intermediaries such as Alipay for our online drugstore. As a part of our acquisition of Quannuo Technology, we also acquired its wholly-owned subsidiary, Hangzhou Quannuo, which operates the “Quannuo Grand Pharmacy” store.

For the fiscal year ended March 31, 2012, our retail business, which includes our pharmacies, medical clinics and online drugstore, accounted for approximately 70.0% of our total revenue.

In addition to our retail business, we operate a wholesale business distributing TCM herbs that we are cultivating and third-party pharmaceutical products (similar to those we carry in our own pharmacies) primarily to trading companies throughout China. We currently operate the wholesale business through four companies:

- Jiuxin Medicine, a wholesale drug distributor licensed to distribute prescription and non-prescription pharmaceutical products throughout China, that was acquired by Jiuzhou Pharmacy in August 2011;
- Hangzhou Qianhong Agriculture Development Co., Ltd. (“Qianhong Agriculture”), a wholly-owned subsidiary that operates our cultivation project of TCM herbs;
- Hangzhou Jiutong Medical Technology Co., Ltd. (“Jiutong Medical”), a wholly-owned subsidiary through which we plan to process TCM herbs, mainly those cultivated by Qianhong Agriculture; and
- Tonglu Lydia Agriculture Development Co., Ltd. (“Tonglu Lydia”), a wholly-owned subsidiary that we intend to operate a cultivation project similar to that of Qianhong Agriculture.

Although our wholesale operations are fairly new to us (Jiuxin Medicine began its wholesale distribution in August 2011, and distribution of TCM herbs that we are cultivating began in the fourth quarter of fiscal 2012), our wholesale business accounted for approximately 30.0% of our total revenue for the fiscal year ended March 31, 2012, primarily from Jiuxin Medicine.

Throughout this report, we will sometimes refer to Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, as well as the subsidiaries of Jiuzhou Pharmacy, collectively as “HJ Group.”

Our Corporate History and Structure

We were incorporated in Nevada on December 19, 2006, under the name “Kerrisdale Mining Corporation,” with a principal business objective to acquire and develop mineral properties. Although we had acquired certain mining claims, we were not operational.

On July 14, 2008, we amended our Articles of Incorporation to change our authorized capital stock from 75,000,000 shares of common stock, par value \$0.001 per share, to 500,000,000 shares of common stock, par value \$0.001 per share, and 10,000,000 shares of preferred stock, par value \$0.001. The preferred stock is “blank check,” with the right to set its designations, preferences, limitations, privileges, qualifications, dividend, conversion, voting, and other special or relative rights, conferred on our board of directors.

On September 17, 2009, we acquired control of Renovation Investment (Hong Kong) Co., Ltd. (“Renovation”) pursuant to a share exchange agreement. We control Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service through contractual arrangements between each of these companies and Renovation’s wholly-owned subsidiary, Zhejiang Jiuxin Investment Management Co., Ltd. (“Jiuxin Management”).

On September 24, 2009, we amended our Articles of Incorporation to change our name from “Kerrisdale Mining Corporation” to “China Jo-Jo Drugstores, Inc.”

On April 9, 2010, we effected a 1-for-2 reverse stock split of our issued and outstanding shares of common stock and a proportional reduction of our authorized shares of common stock, by filing a Certificate of Change Pursuant to Nevada Revised Statutes 78.209 with the Nevada Secretary of State on April 6, 2010. All share information in this report takes into account this reverse stock split.

On April 28, 2010, we completed a registered public offering of 3.5 million shares of common stock at a price of \$5.00 per share, resulting in gross proceeds to us, prior to deducting underwriting discounts, commissions and offering expenses, of approximately \$17.5 million.

Renovation

Renovation is a limited liability company incorporated in Hong Kong on September 2, 2008. Renovation was formed by the owners of HJ Group as a special purpose vehicle for purposes of raising capital, in accordance with requirements of the PRC State Administration of Foreign Exchange (“SAFE”). Specifically, SAFE issued the Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in Financing and Inbound Investment via Overseas Special Purpose Vehicles (“Circular No. 75,”) on October 21, 2005. To further clarify the implementation of Circular 75, on May 31, 2007, SAFE issued an official notice known as Hi Zhong Fa [2007] No. 106 (“Circular 106”). The Circular 75 and the supplementing Circular 106 require the owners of any Chinese company to obtain SAFE’s approval before establishing any offshore holding company structure for foreign financing as well as subsequent acquisition matters in China. Accordingly, the owners of HJ Group who are our three cofounders, namely Lei Liu, Li Qi and Chong’an Jin, submitted their applications to SAFE on July 25, 2008. On August 16, 2008, SAFE approved the application, permitting these Chinese nationals to establish Renovation as an offshore, special purpose vehicle which may have foreign ownership and participate in foreign capital raising activities. After SAFE’s approval, Mr. Liu, Ms. Qi and Dr. Jin became holders of 100% of Renovation’s issued and outstanding capital stock on September 2, 2008. See “Relevant PRC Regulations – SAFE Registration” below.

Jiuxin Management

Jiuxin Management was organized in the PRC on October 14, 2008. Because all of its issued and outstanding capital stock is held by Renovation, a Hong Kong company, Jiuxin Management is deemed a “wholly foreign owned enterprise” (“WFOE”) under PRC laws.

Jiutong Medical

Jiutong Medical was established on December 20, 2011. Like Jiuxin Management, Jiutong Medical is deemed a WFOE because it is wholly owned by Renovation. We intend for Jiutong Medical to process TCM herbs, mainly cultivated by Qianhong Agriculture. However, Jiutong Medical has not yet commenced operation as of the date of this report.

HJ Group

Jiuzhou Pharmacy is a PRC limited liability company established on September 9, 2003 by our three cofounders: Lei Liu (55%), Chong’an Jin (23%) and Li Qi (22%). Jiuzhou Pharmacy operates a chain of pharmacies primarily in Hangzhou that is presently comprised of 56 “Jiuzhou Grand Pharmacy” stores.

Jiuzhou Pharmacy currently has three subsidiaries:

- Shanghai Lydia was established on January 17, 2011 in order to operate drugstores in Shanghai.
- Jiuxin Medicine was established on December 31, 2003. On April 15, 2011, Jiuzhou Pharmacy entered into an equity ownership transfer agreement with the owners of Jiuxin Medicine. In April 2011, the business license of Jiuxin Medicine was transferred to Jiuzhou Pharmacy, although no consideration was paid. On August 25, 2011, the acquisition of Jiuxin Medicine was completed for total consideration of RMB 30 million.
- Shanghai Zhongxing was established on June 19, 2006, originally under the name Shanghai Bieyanghong Zhongxing Grand Pharmacy Co. Ltd. (“Bieyanghong Zhongxing”). On July 29, 2011, Shanghai Lydia acquired 99% of Bieyanghong Zhongxing for total consideration of RMB 495,000. Bieyanghong Zhongxing subsequently changed its name to Shanghai Zhongxing.

Jiuzhou Pharmacy had another subsidiary, namely Hangzhou Kuaileren Grand Pharmacy Co., Ltd. (“Kuaileren”), which was formally dissolved on April 9, 2011. Kuaileren was established on May 9, 2006, with registered capital of RMB 100,000. Kuaileren’s then sole owner transferred all of his ownership interest to our three cofounders for no consideration on June 30, 2009, who in turn transferred the ownership interest to Jiuzhou Pharmacy for no consideration on August 28, 2009. Prior to its dissolution, Kuaileren operated a “Kuaileren Grand Pharmacy” store, which now operates as a “Jiuzhou Grand Pharmacy” store.

Jiuzhou Clinic is a PRC general partnership established on October 10, 2003 by our three cofounders: Lei Liu (39%), Li Qi (30%) and Chong’an Jin (31%). Jiuzhou Clinic is a medical practice currently operating adjacent to Jiuzhou Pharmacy’s Dagan store, providing primary, urgent, minor surgical and traditional medical care services. Additionally, Jiuzhou Clinic’s physicians consult with, and examine, patients at other Jiuzhou Pharmacy stores.

Jiuzhou Service is a PRC limited liability company established on November 2, 2005 by our three cofounders: Lei Liu (39%), Li Qi (30%) and Chong’an Jin (31%). Jiuzhou Service is licensed as a healthcare management company and currently manages the medical clinic operating adjacent to Jiuzhou Pharmacy’s Wenhua store that provides services similar to those provided by Jiuzhou Clinic.

Shouantang Technology

Shouantang Technology is a PRC limited liability company established on July 16, 2010. Shouantang Technology, like Jiuxin Management, is wholly owned by Renovation, and as such, it is deemed a WFOE under PRC laws. Shouantang Technology is an investment company that finances its operating subsidiary Quannuo Technology. Other than activities relating to investing and financing the working capital of Quannuo Technology, Shouantang has no separate operations of its own.

In November 2010, Shouantang Technology acquired 100% of Quannuo Technology and its wholly-owned subsidiary, Hangzhou Quannuo, pursuant to an equity ownership transfer agreement. Quannuo Technology is a PRC limited liability company established on July 7, 2009. Quannuo Technology operates and maintains the website for our online drugstore and provides software and technical support. Hangzhou Quannuo is a PRC limited liability company established on July 8, 2010. Hangzhou Quannuo operates our “Quannuo Grand Pharmacy” store.

On June 24, 2011, Shouantang Technology established Tonglu Lydia as a wholly-owned subsidiary, to undertake herbal cultivation similar to that by Qianhong Agriculture. As of the date of this report, however, Tonglu Lydia has had no operation as it has not been able to locate and lease suitable land for cultivation.

Qianhong Agriculture

Qianhong Agriculture is a PRC limited liability company established on August 10, 2010. Qianhong Agriculture operates our cultivation project of TCM herbs. The project is being carried out on approximately 53 acres of leased land in Lin'an, in northwestern Zhejiang Province approximately 30 miles from Hangzhou. We entered a 30-year lease in February 2010, and currently, more than ten plant varieties, including fructus rubi (used in TCM to promote blood circulation), white atractylodes rhizome (used in TCM to treat physical and mental fatigue), atractylodes macrocephala (used in TCM to control sweating) and ginkgo seeds (used in TCM to treat asthma), have been planted on approximately 48 acres. We have been harvesting the herbs since December 2011, and began distributing them in bulk to third-party vendors in the fourth quarter of fiscal 2012.

Jiuying Pharmacy

Jiuying Pharmacy is a PRC limited liability company established on February 27, 2012. We own 49% of its outstanding equity interests through Jiuxin Management (10%) and Shouantang Technology (39%), the maximum amount of equity interests that we as a non-PRC national can hold in a retail pharmacy business under applicable PRC laws. See “Relevant PRC Regulations – Restrictions on Foreign Ownership of Wholesale or Retail Pharmaceutical Business in China” below.

The remaining 51% are held by our three cofounders: Lei Liu (19.89%), Li Qi (15.3%) and Chong’an Jin (15.81%). On May 15, 2012, Jiuxin Management acquired control of the cofounders’ 51% through a series of contractual arrangements with Jiuying Pharmacy and the three cofounders. Other than the date in which they were entered into, such contractual arrangements are identical to the contractual arrangements that Jiuxin Management entered into with HJ Group and our three cofounders. See “Contractual Arrangements with HJ Group and our Three Cofounders” below. Thus, as with HJ Group, we control 100% of Jiuying Pharmacy’s business operations.

Jiuying Pharmacy currently operates four “Jiuying Grand Pharmacy” stores in Hangzhou. It is our intention to eventually shift a majority of the stores under Jiuzhou Pharmacy to Jiuying Pharmacy, although the timing of such has not yet been established.

Contractual Arrangements with HJ Group and our Three Cofounders

Our relationships with HJ Group and our three cofounders are governed by a series of contractual arrangements that they have entered into with Jiuxin Management.

PRC regulations on foreign investment currently permit foreign companies to establish or invest in WFOEs or joint ventures that engage in wholesale or retail sales of pharmaceuticals in China. For retail sales, however, these regulations restrict the number and size of retail pharmacy stores that a foreign investor may establish. If a foreign investor owns more than 30 stores that sell a variety of branded pharmaceutical products sourced from different suppliers, such foreign investor’s ownership interests in the stores are limited to 49.0%. The contractual arrangements with Jiuzhou Pharmacy enable us to bypass such restrictions, since neither we nor our subsidiaries own equity interests in Jiuzhou Pharmacy, while at the same time we retain control of the drugstore chain by virtue of the contractual arrangements.

Similarly, PRC regulations place certain restrictions on foreign ownership of medical practice. Foreign investors can acquire ownership interests through a Sino-foreign joint venture only and cannot do so through a WFOE. Since we do not have actual equity interest in Jiuzhou Clinic or Jiuzhou Service, but control these entities through contractual arrangements, the PRC regulations restricting foreign ownership of medical practice are not applicable to us or our structure.

Under PRC laws, Jiuxin Management, Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic are each an independent business entity not exposed to the liabilities incurred by any of the other three entities. The contractual arrangements constitute valid and binding obligations of the parties of such agreements. Each of the contractual arrangements and the rights and obligations of the parties thereto are enforceable and valid in accordance with the laws of the PRC. These contractual arrangements, as amended and in effect, include the following:

Consulting Services Agreement. Pursuant to the exclusive consulting services agreement, Jiuxin Management has the exclusive right to provide to Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic with general business operation services, including advice and strategic planning, as well as consulting services related to their current and future operations (the “Services”). Additionally, Jiuxin Management owns the intellectual property rights developed or discovered through research and development, in the course of providing the Services, or derived from the provision

of the Services. Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic each pays a quarterly consulting service fees in RMB to Jiuxin Management that is equal to its profits for such quarter. This agreement is in effect unless and until terminated by written notice of a party to the agreement in the event that: (a) a party becomes bankrupt, insolvent, is the subject of proceedings or arrangements for liquidation or dissolution, ceases to carry on business, or becomes unable to pay its debts as they become due; (b) Jiuxin Management terminates its operations; or (c) circumstances arise which would materially and adversely affect the performance or the objectives of the agreement. Jiuxin Management may also terminate the agreement with Jiuzhou Pharmacy, Jiuzhou Medical or Jiuzhou Clinic if one of them breaches the terms of the agreement, or without cause.

Operating Agreement. Pursuant to the operating agreement, Jiuxin Management agrees to guarantee the contractual performance by Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic of their agreements with any third party. In return, our three cofounders (the "Owners") must appoint designees of Jiuxin Management to the boards of directors and senior management of Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic. In addition, Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic each agrees to pledge its accounts receivable and all of its assets to Jiuxin Management. Moreover, Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic agree that without the prior consent of Jiuxin Management, they will not engage in any transactions that could materially affect their respective assets, liabilities, rights or operations, including, without limitation, incurrence or assumption of any indebtedness, sale or purchase of any assets or rights, incurrence of any encumbrance on any of their assets or intellectual property rights in favor of a third party or transfer of any agreements relating to their business operation to any third party. Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic further agree to abide by corporate policies set by Jiuxin Management with respect to their daily operations, financial management and employment issues. The term of this agreement is from August 1, 2009 until the maximum period of time permitted by law. On the other hand, Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic cannot terminate this agreement.

Equity Pledge Agreement. Pursuant to the equity pledge agreement, the Owners have pledged all of their equity interests in Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic to Jiuxin Management in order to guarantee the performance by Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic of their respective obligations under the consulting services agreement. If Jiuzhou Pharmacy, Jiuzhou Medical, Jiuzhou Clinic or the Owners breaches their respective contractual obligations, Jiuxin Management, as pledgee, will be entitled to certain rights, including the right to sell the pledged equity interests. The Owners have also agreed that upon occurrence of any event of default, Jiuxin Management shall be granted an exclusive, irrevocable power of attorney to take actions in the place and stead of the Owners to carry out the security provisions of this agreement and take any action and execute any instrument that Jiuxin Management may deem necessary or advisable to accomplish the purposes of this agreement. The Owners agree not to dispose of the pledged equity interests or take any actions that would prejudice Jiuxin Management's interests. This agreement will expire two (2) years after the obligations of Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic under the consulting services agreements have been fulfilled.

Option Agreement. Pursuant to the option agreement, the Owners irrevocably grant Jiuxin Management or its designee an exclusive option to purchase, to the extent permitted under PRC law, all or part of their equity interests in Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic for the cost of the initial contributions to the registered capital or the minimum amount of consideration permitted by applicable PRC law. Jiuxin Management or its designee has sole discretion to decide when to exercise the option, whether in part or in full. The term of this agreement is from August 1, 2009 until the maximum period of time permitted by law.

Proxy Agreement. Pursuant to the proxy agreement, the Owners irrevocably grant a Jiuxin Management designee with the right to exercise their voting and other ownership rights in Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic, including the rights to attend any meeting of the Owners (or participate by written consent in lieu of such meeting) in accordance with applicable laws and each company's incorporating documents, as well as the rights to sell or transfer all or any of the Owners' equity interests in Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic, and to appoint and vote for their directors. The proxy agreement may be terminated by mutual consent of the parties or upon 30-day written notice from Jiuxin Management.

Other than pursuant to the forgoing contractual arrangements, Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic cannot transfer any funds generated from their respective operations. The contractual arrangements were originally entered into on August 1, 2009, and amended on October 27, 2009.

Our Corporate Structure

The following diagram illustrates our corporate structure as of the date of this report:

The table below summarizes the status of the registered capital of our PRC subsidiaries and controlled companies as of the date of this report:

Entity Name	Entity Type	Registered Capital	Registered Capital Paid	Due Date for Unpaid Registered Capital
Jiuxin Management	Subsidiary	\$4.5 million	\$4.5 million	N/A
Jiutong Medical	Subsidiary	\$5 million	\$2 million	December 20, 2013
Jiuzhou Pharmacy	VIE	RMB 5 million	RMB 5 million	N/A
Shanghai Lydia	VIE	RMB 1 million	RMB 1 million	N/A
Shanghai Zhongxing	VIE	RMB 1 million	RMB 1 million	N/A
Jiuzhou Clinic	VIE	N/A	N/A	N/A
Jiuzhou Service	VIE	RMB 500,000	RMB 500,000	N/A
Jiuxin Medicine	VIE	RMB 10 million	RMB 10 million	N/A
Qianhong Agriculture	Subsidiary			