

CHINA JO-JO DRUGSTORES, INC.

Form 10-K

July 01, 2013

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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,  
2013

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: 001-34711

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

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Gongshu District, Hangzhou, Zhejiang Province  
People's Republic of China

(Address of principal executive offices)

(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

Securities registered pursuant to section 12(g) of the Act:

(Title of class)

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 Website, if any, every, Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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 ☐  
Non-accelerated filer ☐

Accelerated Filer ☐  
Smaller reporting company ☒

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

As of September 28, 2012, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$4.03 million, based on a closing price of \$0.68 per share of common stock as reported on the NASDAQ Stock Market on such date.

As of June 20, 2013, the registrant had 13,609,002 shares of common stock outstanding.



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FOR YEAR ENDED MARCH 31, 2013

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### Forward Looking Statements

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](http://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.

#### 1.

##### Overview

We are 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 (see "Our Corporate History and Structure – HJ Group" below), we were primarily a retail pharmacy operator. We currently have 51 store locations under two store brands:

46 "Jiuzhou Grand Pharmacy" stores in Hangzhou; and

Five "Lydia Grand Pharmacy" stores in Shanghai, including one "Lydia Zhongxing Grand Pharmacy," one "Lydia Weifang Grand Pharmacy," one "Lydia Chaling Grand Pharmacy" and one "Lydia Zhenguang Grand Pharmacy."

Our "Quannuo Grand Pharmacy" store in Hangzhou ceased operation in the last quarter of fiscal 2013, and we expect to unwind the store and dissolve the subsidiary operating it in the near future.

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 and family care products, and medical devices, as well as convenience products including consumable, seasonal and promotional items. Additionally, we have licensed doctors of both western medicine and TCM onsite for consultation, examination and treatment of common ailments at scheduled hours. Two 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). Store locations vary in size, but presently average approximately 217 square meters. We attempt to tailor each store's product offerings, physician access and operating hours to suit the community where it is located.

We operate our pharmacies (including the medical clinics) through the following companies in China that we control through contractual arrangement:

Hangzhou Jiuzhou Grand Pharmacy Chain Co., Ltd. ("Jiuzhou Pharmacy"), which we control contractually, operates our "Jiuzhou Grand Pharmacy" stores;

Shanghai Lydia Grand Pharmacy Co., Ltd. ("Shanghai Lydia"), wholly-owned by Jiuzhou Pharmacy, operates our "Lydia Grand Pharmacy" and "Lydia Chaling Grand Pharmacy" stores in Shanghai;

Shanghai Lydia Zhongxing Grand Pharmacy Co., Ltd. ("Shanghai Zhongxing"), 99% owned by Shanghai Lydia, operates our "Lydia Zhongxing Grand Pharmacy" store in Shanghai;

Shanghai Lydia Trading Co., Ltd. ("Lydia Trading"), wholly-owned by Shanghai Lydia, operates our "Lydia Weifang Grand Pharmacy" store in Shanghai;

Shanghai Lydia Zhenguang Grand Pharmacy Co., Ltd. ("Shanghai Zhenguang"), wholly-owned by Shanghai Lydia, operates our "Lydia Zhenguang Grand Pharmacy" store in Shanghai;

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.



We also retail OTC drugs and nutritional supplements through a website (www.dada360.com) that we operate through Zhejiang Shouantang Pharmaceutical Technology Co., Ltd. (“Shouantang Technology”), a wholly-owned subsidiary, and its subsidiary, Zhejiang Quannuo Internet Technology Co., Ltd. (“Quannuo Technology”). For the fiscal year ended March 31, 2013, retail revenue, including pharmacies, medical clinics and online sales, accounted for approximately 45.5% of our total revenue.

Since August 2011, we operate a wholesale business through Zhejiang Jiuxin Medicine Co., Ltd. (“Jiuxin Medicine”), distributing third-party pharmaceutical products (similar to those that our pharmacies carry) primarily to trading companies throughout China. Jiuxin Medicine is wholly owned by Jiuzhou Pharmacy. For the fiscal year March 31, 2013, wholesale revenue accounted for approximately 51.7% of our total revenue.

We also have an herb farming business cultivating and wholesaling herbs used for TCM. This business is conducted through Hangzhou Qianhong Agriculture Development Co., Ltd. (“Qianhong Agriculture”), a wholly-owned subsidiary. Herb farming revenue accounted for approximately 2.8% of our total revenue for the fiscal year ended March 31, 2013.

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.

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 our 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 to raise capital overseas, in accordance with requirements of China's State Administration of Foreign Exchange (the "SAFE"). Specifically, the 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, the 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 the 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 submitted their applications to the SAFE on July 25, 2008. On August 16, 2008, the SAFE approved their applications, 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 the SAFE's approval, the owners of HJ Group became holders of 100% of Renovation's issued and outstanding capital stock on September 2, 2008. See "Relevant PRC Regulations – the 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 applicable PRC laws.

On February 27, 2012, Jiuxin Management, Shouantang Technology and our three cofounders organized Zhejiang Jiuying Grand Pharmacy Co., Ltd. (“Jiuying Pharmacy”), with 49% of its equity interests held by Jiuxin Management and Shouantang Technology, and the remaining 51% by the cofounders. In May 2012, the cofounders gave control of their 51% to Jiuxin Management through contractual arrangements, thereby giving us 100% control of Jiuying Pharmacy’s business operations. Jiuying Pharmacy ceased operations as of December 31, 2012, and was dissolved on January 7, 2013.

### Jiutong Medical

Jiutong Medical was organized in the PRC on December 20, 2011. Like Jiuxin Management, Jiutong Medical is deemed a WFOE because it is wholly owned by Renovation. Jiutong Medical currently has no operation and we may dissolve it in the near future.

### Shouantang Technology

Shouantang Technology was organized in the PRC on July 16, 2010, and like Jiuxin Management, is deemed a WFOE because it is wholly owned by Renovation.

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 was organized in the PRC on July 7, 2009, and Hangzhou Quannuo on July 8, 2010. Hangzhou Quannuo currently has no operation and we plan to dissolve it in the near future.

On August 1, 2012, Shouantang Technology dissolved Tonglu Lydia Agriculture Development Co., Ltd. (“Tonglu Lydia”), a wholly-owned subsidiary organized on June 24, 2011. Prior to its dissolution, Tonglu Lydia did not have any operations.

### Qianhong Agriculture

Qianhong Agriculture was organized in the PRC on August 10, 2010.

### HJ Group

Jiuzhou Pharmacy is a PRC limited liability company established on September 9, 2003 by our three cofounders: Mr. Lei Liu (55%), Mr. Chong’an Jin (23%) and Ms. Li Qi (22%). Jiuzhou Pharmacy currently has five subsidiaries:

Shanghai Lydia was organized in the PRC on January 17, 2011.

Jiuxin Medicine was organized in the PRC on December 31, 2003. In April 2011, Jiuzhou Pharmacy entered into an equity ownership transfer agreement with the owners of Jiuxin Medicine, and its business license was transferred to Jiuzhou Pharmacy, although no consideration was paid. On August 25, 2011, the acquisition of Jiuxin Medicine was completed for RMB 30 million.

Shanghai Zhongxing was organized in the PRC 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.

Shanghai Lydia Trading Co., Ltd. (“Lydia Trading”) was organized in the PRC on June 20, 2012, as a wholly-owned subsidiary of Shanghai Lydia.

Shanghai Lydia Zhenguang Grand Pharmacy Co., Ltd. (“Shanghai Zhenguang”) was organized in the PRC on October 31, 2012, as a wholly-owned subsidiary of Shanghai Lydia.

Another subsidiary, Hangzhou Kuaileren Grand Pharmacy Co., Ltd. (“Kuaileren”), was dissolved on April 9, 2011. Prior to its dissolution, Kuaileren operated a “Kuaileren Grand Pharmacy” store, which is now a “Jiuzhou Grand Pharmacy” store.

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

Jiuzhou Service is a PRC limited liability company established on November 2, 2005 by our three cofounders: Mr. Liu (39%), Mr. Jin (31%) and Ms. Qi (30%). Jiuzhou Service is licensed as a healthcare management company and currently manages the medical clinic operating adjacent to the “Jiuzhou Grand Pharmacy” store in Wenhua, providing services similar to those at the Daguan clinic.

We control HJ Group through contractual arrangements. See “Contractual Arrangements with HJ Group and our Three Cofounders” below.

#### 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 pharmacies that a foreign investor may own. If a chain operates more than 30 stores and sell branded pharmaceutical products from different suppliers, a foreign investor may own only up to 49% of such chain. 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 its drugstore chain by virtue of the contractual arrangements.

Similarly, PRC regulations place certain restrictions on foreign ownership of medical practice. Foreign investors can only acquire ownership interests through a Sino-foreign joint venture and not through a WFOE. Since we do not have actual equity interest in Jiuzhou Clinic or Jiuzhou Service, but control these entities through contractual arrangements, such regulations do not apply 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 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 must each pay 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, without the prior consent of Jiuxin Management, they cannot 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. They must also 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. 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 these companies' performance of their respective obligations under the consulting services agreement. If these companies or the Owners breach 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 these companies, 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 Current Corporate Structure

The following diagram illustrates our current corporate structure:

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 |
|--------------------------------|-------------|--------------------|-------------------------|--|
| Hangzhou Quannuo               | Subsidiary  | RMB 800,000        | RMB 800,000             | N/A                                    |
| Jiutong Medical                | Subsidiary  | \$5 million        | \$2 million             | December 20, 2013                      |
| Jiuzhou Clinic                 | VIE         | N/A                | N/A                     | N/A                                    |
| Jiuzhou Pharmacy               | VIE         | RMB 5 million      | RMB 5 million           | N/A                                    |
| Jiuzhou Service                | VIE         | RMB 500,000        | RMB 500,000             | N/A                                    |
| Jiuxin Management              | Subsidiary  | \$4.5 million      | \$4.5 million           | N/A                                    |
| Jiuxin Medicine                | VIE         | RMB 10 million     | RMB 10 million          | N/A                                    |
| Lydia Trading                  | VIE         | RMB 1 million      | RMB 1 million           | N/A                                    |
| Qianhong Agriculture           | Subsidiary  | RMB 10 million     | RMB 10 million          | N/A                                    |
| Quannuo Technology             | Subsidiary  | RMB 10 million     | RMB 10 million          | N/A                                    |
| Shanghai Lydia                 | VIE         | RMB 1 million      | RMB 1 million           | N/A                                    |
| Shanghai Zhenguang             | VIE         | RMB 500,000        | RMB 500,000             | N/A                                    |
| Shanghai Zhongxing             | VIE         | RMB 1 million      | RMB 1 million           | N/A                                    |
| S h o u a n t a n g Technology | Subsidiary  | \$11 million       | \$11 million            | N/A                                    |

## Our Business

### Pharmacies

We currently have 46 pharmacies throughout Hangzhou, the provincial capital of Zhejiang, and five in Shanghai. Pharmacy sales accounted for approximately 92.5% of our retail revenue, and 42.1% of our total revenue, for the fiscal year ended March 31, 2013. We offer primarily third-party products at our pharmacies, including:

Approximately 1,529 prescription drugs (322 of which require a physician's prescription and the rest requires customer personal information registration only), sales of which accounted for approximately 40.5% of our retail revenue for the fiscal year ended March 31, 2013;

Approximately 1,330 OTC drugs, sales of which accounted for approximately 34.5% of our retail revenue for the fiscal year ended March 31, 2013;

Approximately 533 nutritional supplements, including a variety of healthcare supplements, vitamin, mineral and dietary products, sales of which accounted for approximately 10.5% of our retail revenue for the fiscal year ended March 31, 2013;

TCM, including drinkable herbal remedies and pre-packaged herbal mixtures for making soup, sales of which accounted for approximately 9.0% of our retail revenue for the fiscal year ended March 31, 2013; Sundry products (i.e., personal care products such as skin care, hair care and beauty products, convenience products such as soft drinks, packaged snacks, and other consumable, cleaning agents, stationeries, and seasonal and promotional items tailored to local consumer demand for convenience and quality), sales of which accounted for approximately 2.7% of our retail revenue for the fiscal year ended March 31, 2013; and Medical devices (i.e., family planning and birth control products, early pregnancy test products, portable electronic diagnostic apparatus, rehabilitation equipment, and surgical tools such as hemostats, needle forceps and surgical scissors), sales of which accounted for approximately 2.8% of our retail revenue for the fiscal year ended March 31, 2013.

We favor retail locations in well-established residential communities with relatively concentrated consumer purchasing power, and evaluate potential store sites to assess consumer traffic, visibility and convenience. Depending on its size, each drugstore has between two to twelve pharmacists on staff, all of whom are properly licensed. We accept prescriptions only from licensed health care providers, and verify the validity, accuracy and completeness of all prescriptions. We also ask all prescription customers to disclose their drug allergies, current medical conditions and current medications. Each pharmacy also maintains a TCM counter staffed by licensed herbalists.

After opening, a location may take up to 180 days to achieve our projected revenue goals for that particular location. Various factors influence individual store revenue including, but not limited to: location, nearby competition, local population demographics, square footage and government insurance coverage. During the fiscal year ended March 31, 2013, we closed 17 locations due to underperformance, including five "Jiuying Grand Pharmacy" and 11 "Jiuzhou Grand Pharmacy" stores, as well as the only "Quannuo Grand Pharmacy" location. The "Quannuo Grand Pharmacy" store ceased operation in the last quarter of fiscal 2013, and we intend to unwind the store and dissolve Hangzhou Quannuo, the subsidiary operating it, in the near future.

Of our 51 drugstores:

46 are "Jiuzhou Grand Pharmacy" stores in Hangzhou; and

Five are "Lydia Grand Pharmacy" stores in Shanghai, including a "Lydia Chaling Grand Pharmacy," a "Lydia Weifang Grand Pharmacy," a "Lydia Zhenguang Grand Pharmacy" and a "Lydia Zhongxing Grand Pharmacy."



We currently operate each location in Shanghai through a separate subsidiary, and intend to continue doing so until we have at least 10 stores in the city. At such time, we would be allowed, and intends, to submit our application to operate a pharmacy chain in Shanghai, which approval would enable us to accept the city-sponsored health insurance.

To enhance customer experience, we have licensed physicians available at several of “Jiuzhou Grand Pharmacy” locations for consultation, examination and treatment of common ailments at scheduled hours. In addition, our Dagan and Wenhua stores have adjoining medical clinics that provide urgent care (such as sprains, minor lacerations and dizziness), TCM treatments (including acupuncture, therapeutic massage, moxibustion and cupping), and minor outpatient surgical treatments (such as suturing). As described in Note 19 to our audited financial statements for the fiscal years ended March 31, 2013 and 2012 (the “Financial Statements”), included elsewhere in this report, we are planning to open more clinics to boost sales at our pharmacies.

To ensure quality and personal attention for patients, we employ only licensed doctors and certified nurses and technicians, and patient treatments at the two clinics follow nationally established clinical practice guidelines from China’s Ministry of Health. We currently have 35 physicians and 22 clinic staff. In-store consultations and examinations by our physicians are provided free-of-charge to ensure that customers are being prescribed and taking the appropriate medicines for their ailments, and to afford customers convenience.

We view our medical service as more consumer-driven than other health care specialties, because consumers requiring the types of medical service that we provide often seek treatment on their own accord. We have developed our medical service to respond to the public need for convenient access to medical consultation and/or care and the significant savings that we can provide as compared to a more traditional medical setting such as a hospital. Many of our patients often need immediate access, do not have a regular physician, or may lack suitable alternatives. Patient flow is derived from the physical presence of our drugstores, and not from pre-existing doctor-patient relationships or referrals from other healthcare providers.

We generate nominal revenue from our clinics.

#### Online Sales

Since May 2010, we have been retailing OTC drugs and nutritional supplements on the Internet at [www.dada360.com](http://www.dada360.com). Our subsidiary Quannuo Technology operates and maintains the website pursuant to the Internet Pharmaceutical Transaction Service Qualification Certificate issued by the State Food and Drug Administration (the “SFDA”) of Zhejiang Province, which allows us to engage in online retail pharmaceutical sales throughout China. We have established payment methods with banks and online intermediaries such as Alipay, and are cooperating with business-to-consumer online vendors such as Taobao. By using Taobao’s platform, we can be exposed to a wider range of customers.

Online sales accounted for approximately 7.5% of our retail revenue, and 3.4% of our total revenue, for the fiscal year ended March 31, 2013.

#### Wholesale

Since acquiring Jiuxin Medicine in August 2011, we have been distributing similar third-party products offered at our pharmacies primarily to drug distributors throughout China, including:

- Approximately 4,066 prescription drugs, the sales of which accounted for approximately 58.7% of our wholesale revenue for the fiscal year ended March 31, 2013;

- Approximately 2,523 OTC drugs, the sales of which accounted for approximately 19.6% of our wholesale revenue for the fiscal year ended March 31, 2013;

- Approximately 2,054 nutritional supplements, the sales of which accounted for approximately 18.3% of our wholesale revenue for the fiscal year ended March 31, 2013;

- TCM products, the sales of which accounted for approximately 0.5% of our wholesale revenue for the fiscal year ended March 31, 2013;

- Sundry products, the sales of which accounted for approximately 2.7% of our wholesale revenue for the fiscal year ended March 31, 2013; and

- Medical devices, the sales of which accounted for approximately 0.2% of our wholesale revenue for the fiscal year ended March 31, 2013.

Our initial wholesale strategy was to scale the size of Jiuxin Medicine’s business as quickly as possible through very competitive prices so that we can qualify to sell directly to hospital-affiliated pharmacies, which we estimate to represent over 80% of the pharmacies in China. As such strategy has largely proven unprofitable, however, we have refocused our strategy on profitability starting in the third quarter of fiscal 2013. Wholesale revenue accounted for approximately 51.7% of our total revenue for the fiscal year ended March 31, 2013.

#### Herb Farming

Since 2010, we have been cultivating ten types of herbs used for TCM in Lin'an approximately 30 miles from Hangzhou. Herbs such as 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), are planted on approximately 48 acres of leased land, and have been harvested since the third quarter of fiscal 2013.

Actual planting, cultivating and harvesting are done by local farmers organized and managed by the local village government. The farmers are compensated for their labor on an hourly basis. We also employ agricultural specialists under Qianhong Agriculture to monitor the farming activities. Harvested herbs are currently sold to a local vendor.

Herb farming revenue accounted for approximately 2.8% of our total revenue for the fiscal year ended March 31, 2013.

## Our Customers

### Retail Customers

For the fiscal year ended March 31, 2013, our pharmacies collectively served an average of approximately 11,690 customers per day. We periodically conduct qualitative customer surveys to help us build a stronger understanding of our market position and our customers' purchasing habits.

Pharmacy customers pay by cash, debit or credit cards, or medical insurance cards under Hangzhou and Zhejiang's medical insurance programs. During the fiscal year ended March 31, 2013, approximately 43% of our pharmacy revenue came from cash sales, 41% from Hangzhou's medical insurance cards (where most of our pharmacies are located), and 16% from debit and credit cards, Zhejiang's medical insurance cards and other charge cards.

We maintain strict cash control procedures at our pharmacies. Our integrated information management system records the details of each sale, which we control from our headquarters. Depending on each location's sales activities, cash may be deposited daily or several times per week in designated bank accounts.

For sales made to eligible participants in the national medical insurance program, we generally obtain payments from the relevant government social security bureaus on a monthly basis. See "Relevant PRC Regulations — Reimbursement under the National Medical Insurance Program." According to relevant regulations, a drugstore must operate for at least one year before it can apply to be licensed to accept Hangzhou's medical insurance cards. As of the date of this report, 44 of our 46 "Jiuzhou Grand Pharmacy" stores are licensed to accept medical insurance cards while two are awaiting approval. Our stores accepting medical insurance cards are designated as such on their outer signage. Our Shanghai stores currently do not accept medical insurance cards.

Our online customers mainly consist of consumers under 35 years old. While our website is accessible throughout China, approximately 50% of online sales during the fiscal year ended March 31, 2013, were from Zhejiang and neighboring Jiangsu and Shanghai.

### Wholesale Customers

Our wholesale customers are primarily third-party trading companies that purchase from us to resell pharmacies throughout China. We also supply some hospitals and pharmacies, although they collectively make up less than 3% of our wholesale customers currently. North China Pharmaceutical Group International Trade Co., Ltd. accounted for approximately 22.6% of our wholesale revenue, and 11.7% of our total revenue, for the fiscal year ended March 31, 2013. This customer is neither related to nor affiliated with us.

### Herb Farming Customers

For the fiscal year ended, March, 31, 2013, we sold the majority of the harvested herbs to a local vendor.

### Marketing and Promotion

Our marketing and promotion efforts are focused on our retail segment, particularly our pharmacies, and our strategy is to build brand recognition, increase customer traffic to our stores, attract new customers, build strong customer loyalty, maximize repeat customer visits and develop incremental revenue opportunities.

Our marketing department designs chain-wide marketing efforts while each store designs local promotions based on local demographics and market conditions. We also launch single store promotional campaigns and community

activities in connection with the openings of new stores. Our store managers and staff are also encouraged to propose their own advertising and promotion plans, including holiday promotions, posters and billboards. In addition, we offer special discounts and gift promotions for selected merchandise periodically in conjunction with our suppliers' marketing programs. We also provide ancillary services such as providing free blood pressure measurements in our stores.

Many of our promotion programs are designed to encourage manufacturers to invest resources to market their brands within our stores. We charge manufacturers promotional fees in exchange for granting them the right to promote and display their products in our stores during promotional periods. We also allow manufacturers and distributors to station salespeople in our stores to promote their products, for which we receive a fee. We believe that manufacturer promotions improve our customers' shopping experience because manufacturers provide purchasing incentives and information to help customers to make informed purchase decisions. We work to maintain strong inventory positions for merchandise featured in our promotions, as we believe this increases the effectiveness of our spending on promotion activities.

We run advertisements periodically in selected newspapers to promote our brands and the products carried in our stores. Under our agreements with certain newspapers, we run one-page weekly or monthly advertisements in these newspapers, and the newspapers publish healthcare-related feature articles relating to the products we advertise near the dates of our advertisements. We also promote our brands and products using billboards and radio and television commercials. Advertising expenses are borne either by the manufacturers of the products being advertised or us, or are shared, depending on our agreement with the particular manufacturer. Our advertisements are designed to promote our brands, our corporate image and the prices of products available for sale in our stores.

As part of our marketing campaign, we offer rewards card to customers which provide certain exclusive discounts. After a customer signs up for the rewards card, we communicate via the customer's preferred method: e-mail, traditional mail or text messages. For the fiscal year ended March 31, 2013, approximately 69.5% of our customers used the rewards card to make purchases. We intend to further extend this program to enhance customer experience and for customer retention.

Our clinic staff also regularly offers free seminars and outreach programs covering various health issues that are topical to the communities where our stores are located. Such events are designed to not only raise public health awareness, but to reach potential customers for our drugstores.

To promote our online business, we are cooperating with Taobao, the largest online vendor in China, to help raise awareness among potential customers. Taobao lists our products on their platform, which then directs consumers back to our website to make their purchases.

#### Logistics

We use Jiuxin Medicine's resources to support our logistics needs in Hangzhou. Such resources include its 8,000 square meters facility located approximately 7 miles from our headquarters that serves as our central distribution center. Jiuxin Medicine's staff and vehicles make regular deliveries to our pharmacies and wholesale customers.

We employ third-party logistics companies for deliveries to our pharmacies and wholesale customers outside Hangzhou. We believe that reliable logistics providers are readily available and can be replaced without material interruptions to our business.

#### Suppliers

We currently source retail products from approximately 180 suppliers, including trading companies and direct manufacturers. We source wholesale products from approximately 197 suppliers, including many of those that provide our retail products. For the fiscal year ended March 31, 2013, only one supplier, Shanxi Tianshili Pharmaceutical Co., Ltd., accounted for more than 10% of our total purchases and total purchase deposits. This supplier is neither related to nor affiliated with us.

We believe that competitive sources are readily available for substantially all of the products we require for our retail and wholesale businesses. As such, we believe that we can change suppliers without a material interruption to our business. To date, we have not experienced any significant difficulty in sourcing our requirements.

#### Quality Control

We place strong emphasis on quality control, which starts with procurement. In addition to their market acceptance and costs, we select products based on the GMP (Good Manufacturing Practice) and GSP (Good Supply Practice) compliance status of their suppliers. We also assess quality based on the facilities and capabilities of their

manufacturers, including technology, packaging and logistics. We conduct random quality inspections of each batch of products we procure, and replace any supplier who fails to pass such inspections.

We also enforce strict quality control measures at our distribution center. All products are screened upon their arrival, and those evidencing defects or damages are immediately rejected. Products that pass the screening process are recorded and stored strictly according to each manufacturer's temperature and other requirements. Products (for both our pharmacies and wholesale customers) are verified against the appropriate delivery orders prior to leaving the facility. We use vehicles with cold-temperature storage to make deliveries as necessary.

All of our pharmacy employees participate in a mandatory 36-hour training program regarding quality control annually, and we regularly dispatch quality inspectors to our stores to monitor the service quality of our staff.

### Competition

The drugstore industry in China is intensely competitive, rapidly evolving and highly fragmented. We compete on the basis of store location, merchandise selection, prices and brand recognition. Many of our competitors include large, national drugstore chains that may have more financial resources and stronger brand strength and management expertise than us, including China Nepstar Chain Drugstore Ltd. (“Nepstar”), LBX Pharmacy (“LBX”) and Tian Tian Hao Grand Pharmacy (“Tian Tian”). Other competitors include local and independent drugstores and government-operated pharmacies, as well as discount stores, convenience stores and supermarkets with respect to sundry and other non-medicinal products that we carry.

The wholesale pharmaceutical distribution industry in China is likewise competitive and highly fragmented. We compete with regional distributors, such as Zhengchen Pharmaceutical Co., Ltd. and Hangzhou Xiaoran Pharmaceutical Co., Ltd., as well as national operators such as Fengwoda Pharmaceutical Co., Ltd. and Jiuzhoutong Pharmaceutical Co., Ltd. These competitors have substantially greater logistics capacities and more financial resources, as well as more industry-relevant experience, than us.

Online pharmacy is an emerging business in China. We are competing with other online vendors that may be supported by major drugstore chains or initiated by smaller local drugstore chains. In order to compete effectively, we are cooperating with Taobao, the largest online vendor in China. We also spend significant efforts selecting products we believe are most suitable for online sales, such as those we have exclusive right to sell.

China’s herb market is highly specialized. As we have very limited experience in such market, we currently sell the majority of our harvested herbs to a local vendor.

### Intellectual Property

We currently have the following trademarks registered with the Trademark Office of China’s State Administration for Industry and Commerce (the “SAIC”):

“Jiuzhou Tongxin,” a Classes 5 and 35 trademark (for pharmaceuticals and advertisement) issued on February 14, 2011 and registered under Jiuzhou Pharmacy, that we plan to use to brand certain products that we may sell in our stores;

“Jiuzhou,” a Class 44 trademark (for medical service) issued in June 2012 and registered under Jiuzhou Pharmacy, that we plan to use to brand our medical service;

“Lydia,” a Classes 5, 10, 30, 35 and 44 trademark (for pharmaceuticals, construction, food, advertisement and medical service) issued on October 2011 and registered under Jiuzhou Pharmacy, that we plan to use to brand certain products that we may sell in our stores in Shanghai; and

“Shouantang,” a Classes 5, 10, 30, 35 and 44 trademark (for pharmaceuticals, construction, food, advertisement and medical service) issued on October 2011 and registered under Jiuzhou Pharmacy, that we are using to brand certain products that we sell in our stores.

We have also applied to register one trademark under Jiuzhou Service, and expect it to be registered sometime in 2013. We own and operate the following websites: [www.dada360.com](http://www.dada360.com) (for online sales), [www.jiuzhou-drugstore.com](http://www.jiuzhou-drugstore.com) (our corporate website used in China), and [www.chinajojodrugstores.com](http://www.chinajojodrugstores.com) (our English-language corporate website). We also own two inactive domain names. We do not own any patents, nor do we have any pending patent applications, and we are not a beneficiary of any licenses, franchises, concessions or



royalty agreements.

All our employees are required to enter into written employment agreements with us, pursuant to which they are subject to confidentiality obligations.

## Employees

As of March 31, 2013, we had 711 employees combined in our retail and wholesale operations, including 690 fulltime and 21 part-time employees. The number of employees for each area of operations, and such employees as a percentage of our total workforce, are as follows:

|                             | As of March 31, 2013 |            |
|-----------------------------|----------------------|------------|
|                             | Employees            | Percentage |
| Non-pharmacist store staff  | 321                  | 45.1%      |
| Pharmacists                 | 164                  | 23.1%      |
| Management- non-pharmacists | 91                   | 12.8%      |
| Physicians                  | 35                   | 4.9%       |
| Non-physician clinic staff  | 22                   | 3.1%       |
| Wholesale – non-warehouse   | 33                   | 4.6%       |
| Wholesale – warehouse       | 45                   | 6.4%       |
| Total                       | 711                  | 100.0%     |

We place strong emphasis on the quality of our employees at all levels, including in-store pharmacists and store staff who directly interact with our customers. We provide extensive training for newly recruited employees in the first three months of their employment. The training is designed to encompass a number of areas, such as knowledge about our products and how best to interact with our customers. In addition, we regularly carry out training programs on medicine information, nutritional information, selling skills for our store staff and in-store pharmacists. We believe these programs have played an important role in strengthening the capabilities of our employees.

Various drug manufacturers also pay us to have their representatives in our drugstores, and we train them in our store policies and procedures.

## Relevant PRC Regulations

### SAFE Registration

In October 2005, the SAFE issued the Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents Engaging in Financing and Roundtrip Investments via Overseas Special Purpose Vehicles (“Circular 75”). Circular 75 regulates foreign exchange matters in relation to the use of a “special purpose vehicle” (“SPV”) by PRC residents to seek offshore equity financing and conduct “round trip investment” in China. Our three cofounders, who are PRC residents, are in compliance with the Circular 75 and its implementing circulars.

### Dividend Distribution

Under current applicable laws and regulations, each of our consolidated PRC entities, including WFOEs and domestic companies, may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, each of our consolidated PRC entities is required to set aside at least 10% of its after-tax profit based on PRC accounting standards each year to its statutory surplus reserve fund until the accumulative amount of such reserve reaches 50% of its registered capital. These reserves are not distributable as cash dividends. As of March 31, 2013, the accumulated balance of our statutory reserve funds reserves amounted to \$1.309 million, and the accumulated profits of our consolidated PRC entities that were available for dividend distribution amounted to \$19.1 million.

## Taxation

Under the EIT Law, enterprises are classified as either resident or non-resident enterprises. An enterprise established outside of China with its “de facto management bodies” located within China is considered a “resident enterprise,” meaning that it can be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementing rules of the EIT Law define “de facto management bodies” as a managing body that in practice exercises “substantial and overall management and control over the production and operations, personnel, accounting, and properties” of the enterprise; however, it remains unclear whether the PRC tax authorities would deem our managing body as being located within China. Due to the relatively short history of the EIT Law and lack of applicable legal precedents, the PRC tax authorities determine the PRC tax resident treatment of entities organized under the laws of foreign jurisdictions on a case-by-case basis.

If the PRC tax authorities determine that we are a resident enterprise for PRC enterprise income tax purposes, a number of PRC tax consequences could follow. First, we may be subject to enterprise income tax at a rate of 25% on our respective worldwide taxable income, as well as PRC enterprise income tax reporting obligations. Second, although the EIT Law provides that “dividends, bonuses and other equity investment proceeds between qualified resident enterprises” is exempted income, and the implementing rules of the EIT Law refers “dividends, bonuses and other equity investment proceeds between qualified resident enterprises” as the investment proceeds obtained by a resident enterprise from its direct investment in another resident enterprise, it is still unclear whether the dividends we receive from Jiuxin Management constitute “dividend between qualified resident enterprises” and would therefore qualify for tax exemption.

If we are treated as a non-resident enterprise under the EIT Law, then dividends that we may receive from Jiuxin Management (assuming such dividends were considered sourced within the PRC) (i) may be subject to a 5% PRC withholding tax, provided that we own more than 25% of the registered capital of Jiuxin Management incessantly within 12 months immediately prior to obtaining dividend from Jiuxin Management, and if the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income is applicable, or (ii) if such treaty does not apply (i.e., because the PRC tax authorities may deem us to be a conduit not entitled to treaty benefits), may be subject to a 10% PRC withholding tax. Similarly, if we are treated as a non-resident enterprise, and Renovation is treated as a resident enterprise, then dividends that we receives from Renovation (assuming such dividends were considered sourced within the PRC) may be subject to a 10% PRC withholding tax. Any such taxes on dividends could materially reduce the amount of dividends, if any, that we could pay to our shareholders.

Finally, the new “resident enterprise” classification could result in a situation in which a 10% PRC tax is imposed on dividends we pay to our investors that are non-resident enterprises so long as such non-resident enterprise investors do not have an establishment or place of business in China or, despite the existence of such establishment or place of business in China, the relevant income is not effectively connected with such establishment or place of business in China, to the extent that such dividends have their sources within the PRC. Similarly, any gain realized on the transfer of our shares by such investors is also subject to a 10% PRC income tax if such gain is regarded as income derived from sources within China. In such event, we may be required to withhold a 10% PRC tax on any dividends paid to its investors that are non-resident enterprises. Our investors that are non-resident enterprises also may be responsible for paying PRC tax at a rate of 10% on any gain realized from the sale or transfer of our common shares in certain circumstances. We would not, however, has an obligation to withhold PRC tax with respect to such gain.

Moreover, the State Administration of Taxation issued “Circular 698” on December 10, 2009, that reinforces taxation on transfer of non-listed shares by non-resident enterprises through overseas holding vehicles. Circular 698 applies retroactively and was deemed to be effective as of January 2008. Pursuant to Circular 698, where (i) a foreign investor who indirectly holds equity interest in a PRC resident enterprise through an offshore holding company indirectly transfers equity interests in a PRC resident enterprise by selling the shares of the offshore holding company, and (ii) the offshore holding company is located in a jurisdiction where the effective tax rate is lower than 12.5% or where the offshore income of its residents is not taxable, the foreign investor is required to provide the tax authority in charge of that PRC resident enterprise with certain relevant information within 30 days of the transfer. The tax authorities in charge will evaluate the offshore transaction for tax purposes. In the event that the tax authorities determine that such transfer is abusing forms of business organization and there is no reasonable commercial purpose other than avoidance of PRC enterprise income tax, the tax authorities will have the power to conduct a substance-over-form re-assessment of the nature of the equity transfer. A reasonable commercial purpose may be established when the overall offshore structure is set up to comply with the requirements of supervising authorities of international capital markets. If the State Administration of Taxation’s challenge of a transfer is successful, they will deny the existence of the offshore holding company that is used for tax planning purposes. Since Circular 698 has a short history, there is uncertainty as to its application.

#### General PRC Government Approval

As a wholesale distributor and retailer of pharmaceutical products, we are subject to regulation and oversight by different levels of the food and drug administration in China, in particular, the SFDA. The Drug Administration Law of the PRC, as amended, provides the basic legal framework for the administration of the production and sale of pharmaceutical products in China and governs the manufacturing, distributing, packaging, pricing and advertising of pharmaceutical products in China. The corresponding implementation regulations set out detailed rules with respect to the administration of pharmaceuticals in China. We are also subject to other PRC laws and regulations that are applicable to business operators, retailers and foreign-invested companies.

#### Distribution of Pharmaceutical Products

A distributor of pharmaceutical products must obtain a distribution permit from the relevant provincial- or designated municipal- or county-level SFDA. The grant of such permit is subject to an inspection of the distributor's facilities, warehouses, hygienic environment, quality control systems, personnel and equipment. The distribution permit is valid for five years, and the holder must apply for renewal of the permit within six months prior to its expiration. In addition, a pharmaceutical product distributor needs to obtain a business license from the relevant administration for industry and commerce prior to commencing its business. All of our consolidated entities that engage in retail pharmaceutical business have obtained necessary pharmaceutical distribution permits, and we do not expect any difficulties for us to renew these permits and/or certifications.

In addition, under the Supervision and Administration Rules on Pharmaceutical Product Distribution promulgated by the SFDA on January 31, 2007, and effective May 1, 2007, a pharmaceutical product distributor is responsible for its procurement and sales activities and is liable for the actions of its employees or agents in connection with their conduct of distribution on behalf of the distributor. A retail distributor of pharmaceutical products is not allowed to sell prescription pharmaceutical products, or Tier A OTC pharmaceutical products, listed in the national or provincial medical insurance catalogs without the presence of a certified in-store pharmacist. See "Reimbursement under the National Medical Insurance Program."

### Restrictions on Foreign Ownership of Wholesale or Retail Pharmaceutical Business in China

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, these regulations restrict the number and size of pharmacies 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, the foreign investor's ownership interests in the stores are limited to 49%.

In lieu of equity ownership, our WFOE, Jiuxin Management, has entered into contractual arrangements with Jiuzhou Pharmacy and our three cofounders.

### Good Supply Practice Standards

GSP standards regulate wholesale and retail pharmaceutical product distributors to ensure the quality of distribution of pharmaceutical products in China. All wholesale and retail pharmaceutical product distributors are required to apply for GSP certification within 30 days after obtaining the drug distribution permit. The current applicable GSP standards require pharmaceutical product distributors to implement strict controls on the distribution of medicine products, including standards regarding staff qualifications, distribution premises, warehouses, inspection equipment and facilities, management and quality control. Specifically, the warehouse must be able to store the pharmaceutical products at various required temperatures and humidity, handle transport, warehouse entries, delivery and billing by computerized logistics management systems. The GSP certificate is usually valid for five years. Currently, Jiuzhou Pharmacy, Jiuxin Medicine, Hangzhou Quannuo and Shanghai Lydia are GSP certified.

### Prescription Administration

Under the Rules on Administration of Prescriptions promulgated by the SFDA, effective May 1, 2007, doctors are required to include the chemical ingredients of the medicine they prescribe in their prescription and are not allowed to include brand names in their prescription. This regulation is designed to provide consumers with choices among different pharmaceutical products that contain the same chemical ingredients.

### Advertisement of Pharmaceutical Products

Under the Advertising Law of PRC, the contents of an advertisement must be true, lawful, without falsehood, and must neither deceive nor mislead consumers. Accordingly, advertisement must be examined by the competent authority prior to its publication or broadcast through any form of media. In addition, advertisement of pharmaceutical products may only be based on a drug's approved indication of use statement, and may not contain any assurance of a product's efficiency, treatment efficiency, curative rate or any other information prohibited by law. Advertisement for certain drugs should include an admonishment to seek a doctor's advice before purchasing and application. Advertising is prohibited for certain drugs such as anesthetics and psychotropic drugs.

To further prevent misleading advertising of pharmaceutical products, the SAIC and the SFDA jointly promulgated the Standards for Examination and Publication of Advertisements of Pharmaceutical Products and Measures for Examination of Advertisement of Pharmaceutical Products in March 2007. Under these regulations, an approval must be obtained from the provincial level of food and drug administration before a pharmaceutical product may be advertised. In addition, once approved, an advertisement's content may not be altered without further approval. Such approval, once obtained, is valid for one year.

### Product Liability and Consumers Protection

Product liability claims may arise if the products sold have any harmful effect on the consumers. The injured party may make a claim for damages or compensation. The General Principles of the Civil Law of the PRC, which became effective in January 1987, state that manufacturers and sellers of defective products causing property damage or injury shall incur civil liabilities for such damage or injuries.

The Product Quality Law of the PRC was enacted in 1993 and amended in 2000 to strengthen the quality control of products and protect consumers' rights and interests. Under this law, manufacturers and distributors who produce or sell defective products may be subject to confiscation of earnings from such sales, revocation of business licenses and imposition of fines, and in severe circumstances, may be subject to criminal liability.

The Administrative Measures for Drug Recalls was issued by the SFDA in December 2007, and covers two types of drug recalls, namely voluntary recalls and compulsory recalls. Under such regulation, wholesalers are obliged to assist drug manufacturers with any drug recall. In addition, a wholesaler must immediately cease to sell any drug that the wholesaler learns to have any safety issues, and notify the manufacturer or its supplier as well as report the matter to the SFDA.

The Law of the PRC on the Protection of the Rights and Interests of Consumers was promulgated on October 31, 1993 and became effective on January 1, 1994 to protect consumers' rights when they purchase or use goods or services. All business operators must comply with this law when they manufacture or sell goods and/or provide services to customers. In extreme situations, pharmaceutical product manufacturers and distributors may be subject to criminal liability if their goods or services lead to the death or injuries of customers or other third parties.

The Tort Law of the PRC was promulgated on December 26, 2009 and came into force on July 1, 2010. The Tort Law provides that manufacturers and distributors who produce or sell defective products shall be responsible for the damage caused by the defective products.

#### Price Controls

The retail prices of some pharmaceutical products sold in China, primarily those included in the national and provincial medical insurance catalogs and those pharmaceutical products whose production or distribution are deemed to constitute monopolies, are subject to price controls in the form of fixed prices (for non-profit medical institutions) or price ceilings. Manufacturers or distributors cannot freely set or change the retail price for any price-controlled product above the applicable price ceiling or deviate from the applicable government-imposed price. The prices of medicines that are not subject to price controls are determined freely at the discretion of the respective pharmaceutical companies, subject to notification to the provincial pricing authorities.

The retail prices of medicines that are subject to price controls are administered by the Price Control Office of the National Development and Reform Commission ("NDRC"), and implemented by provincial and regional price control authorities. The retail price, once set, also effectively determines the wholesale price of that medicine. From time to time, the NDRC publishes and updates a list of medicines that are subject to price control. Provincial and regional price control authorities have discretion to authorize price adjustments based on the local conditions and the level of local economic development. Only the manufacturer of a medicine may apply for an increase in the retail price of the medicine, and it must either apply to the provincial price control authority where it is incorporated, if the medicine is provincially regulated, or to the NDRC, if the medicine is NDRC regulated.

Since May 1998, China's central government has been ordering reductions in the retail prices of various pharmaceutical products. During the fiscal year ended March 31, 2013, several price reductions occurred and affected 2,824 different pharmaceutical products, which required us to make 326 price adjustments. Currently, 2,845 pharmaceutical products and OTC drugs we offered are subject to price controls.

The NDRC may grant premium pricing status to certain pharmaceutical products that are under price control. The NDRC may set the retail prices of pharmaceutical products that have obtained premium pricing status at a level that is significantly higher than comparable products.

#### Reimbursement under the National Medical Insurance Program

Eligible participants in the national medical insurance program, mainly consisting of urban residents, are entitled to purchase medicine when presenting their medical insurance cards in an authorized pharmacy, provided that the medicine they purchase have been included in the national or provincial medical insurance catalogs. Depending on relevant local regulations, authorized pharmacies either sell medicine on credit and obtain reimbursement from relevant government social security bureaus on a monthly basis, or receive payments from the participants at the time of their purchases, and the participants in turn obtain reimbursement from relevant government social security bureaus.



Medicine included in the national and provincial medical insurance catalogs is divided into two tiers. Purchases of Tier A pharmaceutical products are generally fully reimbursable, except that certain Tier A pharmaceutical products are only reimbursable to the extent the medicine are used for specifically stated purposes in the medical insurance catalogs. Purchasers of Tier B pharmaceutical products, which are generally more expensive than those in Tier A, are required to make a certain percentage of co-payments, with the remaining amount being reimbursable. The percentage of reimbursement for Tier B OTC products varies in different regions in the PRC. Factors that affect the inclusion of medicine in the medical insurance catalogs include whether the medicine is consumed in large volumes and commonly prescribed for clinical use in China and whether it is considered to be important in meeting the basic healthcare needs of the general public.

China's Ministry of Labor and Social Security, together with other government authorities, has the power to determine every two years which medicine are included in the national medical insurance catalog, under which of the two tiers the included medicine falls, and whether an included medicine should be removed from the catalog.

### Sales of Nutritional Supplements and other Food Products

A distributor of nutritional supplements and other food products must obtain a food circulation permit from local Administration of Industry and Commerce. The grant of such permit is subject to an inspection of the distributor's facilities, warehouses, hygienic environment, quality control systems, personnel and equipment. The food circulation permit is valid for three years, and the holder must apply for renewal of the certificate within 30 days prior to its expiration. Currently, Jiuxin Medicine, Jiuzhou Pharmacy, Shanghai Lydia and our drugstores all hold a valid Food Circulation Permit, except for our Lin'an store as it does not sell food products and therefore does not require such permit. We are in the process of renewing the permits for 14 stores are expiring in 2013, and believe that there is no difficulty in renewing such permits.

### Medical Practice

Healthcare providers in China are required to comply with many laws and regulations at the national and local government levels. The laws and regulations applicable to our medical practice include the following:

We must register with and maintain an operating license from the local public health authority for each clinic that we operate, and is subject to annual review by the public health authority;

The Licensed Physician Act requires that we only hire PRC licensed physicians;

All waste material from our clinics must be properly collected, sterilized, deposited, transported and disposed of, and we are required to keep records of the origin, type and amount of all waste materials that we generate for at least three years;

We must have at least 3 physicians, 5 nurses and 1 technician on staff at each clinic; and

We must establish and follow protocols to prevent medical malpractice, which require us to: (i) insure that patients are adequately informed before they consent to medical operations or procedures; (ii) maintain complete medical records which are available for review by the patient, physicians and the courts; (iii) voluntarily report any event of malpractice to a local government agency; and (iv) support and justify the medical services we provide in any administrative investigation or litigation. If we fail to comply with applicable laws and regulations, we could suffer penalties, including the loss of our license to operate.

### Interim Regulations on Administration of Sino-Foreign Joint Venture and Cooperative Medical Institutions

As per China commitments to the World Trade Organization, "foreign service suppliers are permitted to establish joint venture hospitals or clinics with local Chinese partners with quantitative limitations in line with China's needs. Foreign majority ownership is permitted." In accordance with the Interim Regulations on Administration of Sino-Foreign Joint Venture and Cooperative Medical Institutions jointly issued by the Ministry of Health ("MOH") and MOFCOM in 2000, the Chinese party of Sino-foreign joint ventures and cooperative medical institutions shall hold no less than 30% of shares and legal rights or interest, which also mean foreign investors are allowed to hold a maximum stake of 70%. Such regulations also specify that the establishment of Sino-foreign joint venture and cooperative medical institutions should be approved respectively by MOH and MOFCOM. In other words, foreigners are allowed to run hospitals or clinics in the form of equity or co-operative joint ventures with an equity interest of up to 70% and a duration for co-operation of up to 20 years.

### Internet Pharmaceutical Sales

China's central government regulates Internet access, the distribution of online information and the conduct of online commerce through strict business licensing requirements and other government regulations. Companies which sell pharmaceutical products to consumers through Internet are required to obtain: (1) a drug distribution permit; (2) an Internet pharmaceutical information provider qualification certificate (renewable every five years); (3) an Internet pharmaceutical transaction service qualification certificate (renewable every five years); (4) a value-added telecommunication operation permit; and (5) registration with the Administration of Information Industry. Internet pharmacies are not allowed to distribute prescription drugs. The websites that sell pharmaceutical products must ensure transaction security and enable the consumers to consult with licensed pharmacists. Also, Internet-based business in China is required to obtain and maintain certain assets relevant to its business, such as delivery and storage facilities. Jiuzhou Pharmacy obtained all above-mentioned certificates and registration and launched [www.dada360.com](http://www.dada360.com) in May 2010. Quannuo Technology has been operating the website and providing software and technical supports since November 2010.

#### TCM Manufacturing

The SFDA has adopted a non-mandatory licensing process for TCM manufacturers according to the GAP (Good Agricultural Practice) for Chinese Crude Drugs. Manufacturers who meet the government-set requirements will be granted a GAP certificate. Since we do not process the herbs that we harvest and the GAP certification is not mandatory, we have not applied for such certification, and currently have no plan to do so.

#### Environmental Matters

Our drugstore and wholesale operations do not involve any activities subject to specific PRC environmental regulations. Our medical clinics are in compliance with applicable regulations regarding the administration of medical wastes, including collections, temperate storage, and packaging and labeling of medical wastes. Pursuant to such regulations, we contract with Dadi Weikang Medical Wastes Disposal Center to dispose of all medical wastes generated by our clinics.

## Principal Executive Office

Our principal executive office is located at Room 507-513, 5th Floor, A Building, Meidu Plaza, Gongshu District, Hangzhou, Zhejiang, China. Our main telephone number is +86-571-88077078, and fax number is +86-571-88077108.

## ITEM RISK FACTORS

### 1A.

## RISK FACTORS

You should carefully consider the risks described below together with all of the other information included in this report before making an investment decision with regard to our securities. The statements contained in or incorporated into this report that are not historic facts are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those set forth in or implied by forward-looking statements. If any of the following risks actually occurs, our business, financial condition or results of operations could be harmed. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

### Risks Relating to Our Business in General

Our relatively limited operating history makes it difficult to evaluate our future prospects and results of operations.

We have a relatively limited operating history. We opened our first drugstore in March 2004, and entered the wholesale pharmaceutical distribution business in August 2011. Accordingly, you should consider our future prospects in light of the risks and uncertainties experienced by early stage companies in evolving industries such as the pharmaceutical industry in China. Some of these risks and uncertainties relate to our ability to:

- maintain our market position;
- attract additional customers and increase spending per customer;
- respond to competitive market conditions;
- increase awareness of our brand and continue to develop customer loyalty;
- respond to changes in our regulatory environment;
- maintain effective control of our costs and expenses;
- raise sufficient capital to sustain and expand our business;
- attract, retain and motivate qualified personnel; and
- ability to find and open new locations.

If we are unsuccessful in addressing any of these risks and uncertainties, our business may be materially and adversely affected.

We face significant competition, and if we do not compete successfully against existing and new competitors, our revenue and profitability would be materially and adversely affected.

Both drugstore and wholesale pharmaceutical distribution industries in China are highly competitive, and we expect competition to intensify in the future. Our primary drugstore competitors include other drugstore chains and independent drugstores. We also increasingly face competition from discount stores, convenience stores and supermarkets as we increase our offering of non-drug convenience products and services. We compete for customers and revenue primarily on the basis of store location, merchandise selection, price, services that we offer and our brand

name. Our primary wholesale competitors include regional and national players. In addition, we may be subject to additional competition from new entrants to both industries in China. We could also face increased competition from foreign companies if the Chinese government removes the barriers against foreign companies into these industries.

Some of our larger competitors may enjoy competitive advantages, such as:

- greater financial and other resources;
- larger variety of products;
- more extensive and advanced supply chain management systems;
- greater pricing flexibility;
- larger economies of scale and purchasing power;
- more extensive advertising and marketing efforts;
- greater knowledge of local market conditions;

stronger brand recognition; and  
larger sales and distribution networks.

As a result, we may be unable to offer products similar to, or more desirable than, those offered by our competitors, market our products as effectively as our competitors or otherwise respond successfully to competitive pressures. In addition, our competitors may be able to offer larger discounts on competing products, and we may not be able to profitably match those discounts. Furthermore, our competitors may offer products that are more attractive to our customers or that render our products uncompetitive. In addition, the timing of the introduction of competing products into the market could affect the market acceptance and market share of our products. Our failure to compete successfully could materially and adversely affect our business, financial condition, results of operation and prospects.

We have significant cash deposits with our suppliers and landlords in order to obtain and maintain our inventory and maintain and establish store locations, which we may not be able to recover in the event of bankruptcy by our suppliers or landlords or other events beyond our control.

Our ability to obtain products and maintain inventory at, and to maintain and establish leases for, our pharmacies, is dependent upon our ability to post and maintain significant cash deposits with our suppliers and landlords. Many vendors in China are unwilling to extend credit terms and instead require cash deposits, and landlords may require 12 months or longer of cash deposit as security. At March 31, 2013, we had approximately \$15.6 million on deposit with suppliers and approximately \$2.8 million as deposits with landlords for our pharmacies. If we are unable or unwilling to establish such advances and deposits our ability to generate sales and expand our business would be adversely affected. In general, we expect the amounts required for advances and deposits to increase as we undertake our expansion plans, complete store openings and expand our business through acquisitions or otherwise. We do not generally receive interest on the deposits made to suppliers or landlords, and such deposits are subject to loss as a result of the creditworthiness or bankruptcy of the party who holds our funds, as well as the risk from illegal acts such as conversion, fraud, theft or dishonesty associated with the third party. If these circumstances were to arise, we would find it difficult or impossible, due to the unpredictability of legal proceedings in China, to recover all or a portion of the amount on deposit with our vendors or landlords.

If we are unable to optimize management of our procurement and distribution activities, we may be unable to meet customer demand while increasing burden on managing our supply chain.

Since May 2011, we have been using Jiuxin Medicine's facility as our distribution center for both our retail and wholesale businesses. Our ability to meet customer demand may be significantly limited if we do not successfully and efficiently conduct our distribution activities, or if Jiuxin Medicine's facility is destroyed or shut down for any reason, including as the result of a natural disaster. Any disruption in the operation of our distribution could result in higher costs or longer lead times associated with distributing our products. In addition, as it is difficult to predict accurate sales volume in our industry, we may be unable to optimize our distribution activities, which may result in excess or insufficient inventory, warehousing, fulfillment or distribution capacity. Furthermore, failure to effectively control product damage during distribution process could decrease our operating margins and reduce our profitability.

In addition, all product procurement is handled through our corporate headquarters. Such centralization is intended to reduce cost of goods sold as a result of volume purchase benefits. However, we may be less successful than anticipated in achieving these volume purchase benefits. In addition, such centralization is expected to increase the complexity of tracking inventory and place additional burdens on the management of our supply chain. If we cannot successfully reduce our costs through centralizing procurement, our profitability and prospects would be materially and adversely affected.

Failure to maintain optimal inventory levels could increase our inventory holding costs or cause us to lose sales, either of which could have a material adverse effect on our business, financial condition and results of operations.

We need to maintain sufficient inventory levels to operate both our retail and wholesale businesses successfully as well as meet customer expectations. However, we must also guard against the risk of accumulating excess inventory. We are exposed to inventory risks as a result of rapid changes in product life cycles, changing consumer preferences, uncertainty of success of product launches, seasonality, and manufacturer backorders and other vendor-related problems. We cannot assure you that we can accurately predict these trends and events and avoid over-stocking or under-stocking products. In addition, demand for products could change significantly between the time product inventory is ordered and the time it is available for sale.

When we begin selling a new product, it is particularly difficult to forecast product demand accurately. The purchase of certain types of inventory may require significant lead-time. As we carry a broad selection of products and maintain significant inventory levels for a substantial portion of our merchandise, we may be unable to sell such inventory in sufficient quantities or during the relevant selling seasons. Carrying too much inventory would increase our inventory holding costs, and failure to have inventory in stock when a customer orders or purchases it could cause us to lose that order or lose that customer, either of which could have a material adverse effect on our business, financial condition and results of operations.

We rely on computer software and hardware systems in managing our operations, the capacity of which may restrict our growth and the failure of which could adversely affect our business, financial condition and results of operations.

We are dependent upon our integrated information management system to monitor daily operations of our retail and wholesale businesses, and to maintain accurate and up-to-date operating and financial data for compilation of management information. In addition, we rely on our computer hardware and network for the storage, delivery and transmission of the data of our retail and wholesale systems. Any system failure which causes interruptions to the input, retrieval and transmission of data or increase in the service time could disrupt our normal operation. Although we believe that our computer software and hardware systems are current and that our disaster recovery plan is adequate in handling their failure, we cannot assure you that we can effectively carry out this disaster recovery plan and that we will be able to restore our operation within a sufficiently short time frame to avoid our business being disrupted. Any failure in our computer software and/or hardware systems could have a material adverse effect on our business, financial condition and results of operations. In addition, if the capacity of our computer software and hardware systems fails to meet the increasing needs of our expanding operations, our ability to grow may be constrained.

As a distributor of pharmaceutical and other healthcare products, we are exposed to inherent risks relating to product liability and personal injury claims.

Distributors of pharmaceutical and other healthcare products are exposed to risks inherent in the packaging and distribution of such products. Such risks include unintentional distribution of counterfeit drugs and, with respect to our pharmacies, improper filling of prescriptions, labeling of prescriptions and adequacy of warnings. Furthermore, the applicable laws, rules and regulations require our in-store pharmacists to offer counseling, without additional charge, to our customers about medication, dosage, delivery systems, common side effects and other information the in-store pharmacists deem significant. Our in-store pharmacists may also have a duty to warn customers regarding any potential negative effects of a prescription drug if the warning could reduce or negate these effects, and we may be liable for claims arising from advices given by our in-store pharmacists. In addition, product liability claims may be asserted against us with respect to any of the products we distribute, and we may be required to pay for damages for any successful product liability claim against us, although we may have the right under applicable PRC laws, rules and regulations to recover from the relevant manufacturer for compensation we paid to our customers in connection with such claim. We may also be obligated to recall affected products. If we are found liable for product liability claims, we could be required to pay substantial monetary damages. Furthermore, even if we successfully defend ourselves against this type of claim, we could be required to spend significant management, financial and other resources, which could disrupt our business, and our reputation as well as our brand names may also suffer. We, like many other similar companies in China, do not carry product liability insurance. As a result, any imposition of product liability could materially harm our business, financial condition and results of operations. In addition, we do not have any business interruption insurance due to the limited coverage of any business interruption insurance in China, and as a result, any business disruption or natural disaster could severely disrupt our business and operations and significantly decrease our revenue and profitability.



We depend substantially on the continuing efforts of our cofounders, and our business and prospects may be severely disrupted if we lose their services.

Our future success is dependent on the continued services of our three cofounders, Messrs. Lei Lu and Chong'an Jin and Ms. Li Qi. We do not maintain key-man insurance. If we lose the services of any one of our cofounders, we may not be able to locate suitable or qualified replacements, which could severely disrupt our business and prospects. Each of our three cofounders has entered into a confidentiality and non-competition agreement with us regarding these agreements. However, if any disputes arise between our cofounders and us, we cannot assure you, in light of uncertainties associated with the PRC legal system, that any of these agreements could be enforced in China, where the three cofounders reside and hold some of their assets. See "Risks Related to Doing Business in China — You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions in China based on United States or other foreign laws against us or our management."

We depend on the continued service of, and on the ability to attract, motivate and retain a sufficient number of qualified and skilled personnel for our business.

The implementation of our business strategy and our future success also depend in large part on our continued ability to attract and retain highly qualified and skilled personnel. We cannot assure you that we will be able to attract, hire and retain sufficient numbers of skilled personnel necessary to continue to develop and grow our business. We face competition for personnel from both retail and wholesale pharmaceutical distribution operators. Competition for these individuals could cause us to offer higher compensation and other benefits in order to attract and retain them, which could materially and adversely affect our financial condition and results of operations. We may be unable to attract or retain the personnel required to achieve our business objectives and failure to do so could severely disrupt our business and prospects. The process of hiring suitably qualified personnel is also often lengthy. In the past, we have had two major challenges to our recruiting efforts: (1) unqualified candidates who represent themselves as being qualified, and (2) talented and competent candidates who do not match our job requirements. If our recruitment and retention efforts are unsuccessful in the future, it may be more difficult for us to execute our business strategy.

Our retail and wholesale operations require a number of permits and licenses in order to carry on their business.

We are required to obtain certain permits and licenses from various PRC governmental authorities, including Drug Distribution Permit and GSP certification. We are also required to obtain food hygiene certificates for the distribution of nutritional supplements and food products. We cannot assure you that we can maintain all required licenses, permits and certifications to carry on our business at all times, and from time to time we may have not been in compliance with all such required licenses, permits and certifications. Moreover, these licenses, permits and certifications are subject to periodic renewal and/or reassessment by the relevant PRC governmental authorities and the standards of such renewal or reassessment may change from time to time. We intend to apply for the renewal of these licenses, permits and certifications when required by applicable laws and regulations. Any failure by us to obtain and maintain all licenses, permits and certifications necessary to carry on our business at any time could have a material adverse effect on our business, financial condition and results of operations. In addition, any inability to renew these licenses, permits and certifications could severely disrupt our business, and prevent us from continuing to carry on our business. Any changes in the standards used by governmental authorities in considering whether to renew or reassess our business licenses, permits and certifications, as well as any enactment of new regulations that may restrict the conduct of our business, may also decrease our revenue and/or increase our costs and materially reduce our profitability and prospects. Furthermore, if the interpretation or implementation of existing laws and regulations changes or if new regulations come into effect requiring us to obtain any additional licenses, permits or certifications that were previously not required to operate our existing businesses, we cannot assure you that we may successfully obtain such licenses, permits or certifications.

The continued penetration of counterfeit products into the pharmaceutical market in China may damage our reputation and have a material adverse effect on our business, financial condition, results of operations and prospects.

There has been continued penetration of counterfeit products into the pharmaceutical market in China. Counterfeit products are generally sold at lower prices than the authentic products due to their low production costs, and in some cases are very similar in appearance to the authentic products. Counterfeit pharmaceuticals may or may not have the same chemical content as their authentic counterparts, and are typically manufactured without proper licenses or approvals as well as fraudulently mislabeled with respect to their content and/or manufacturer. Although China's central government has been increasingly active in combating counterfeit pharmaceutical and other products, there is not yet an effective counterfeit pharmaceutical product regulation control and enforcement system in China. Although we have implemented a series of quality control procedures in our procurement process, we cannot assure you that we would not be selling counterfeit pharmaceutical products inadvertently. Any unintentional sale of counterfeit products may subject us to negative publicity, fines and other administrative penalties or even result in litigation against us. Moreover, the continued proliferation of counterfeit products and other products in recent years may reinforce the negative image of drug distributors among consumers in China. The continued proliferation of counterfeit products in China could have a material adverse effect on our business, financial condition, and results of operation.

We may need additional capital, and the sale of equity securities could result in dilution to our stockholders, while debts may require us to make covenants restricting how we operate.

We believe that our current cash and anticipated cash flow from operations, as well as bank facilities and personal loans from our principal shareholders, should be sufficient to meet our anticipated cash needs for the near future. We may, however, require additional cash resources due to changed business conditions or other future developments. If our resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain credit facility. The sale of additional equity securities could result in dilution to our stockholders. The incurrence of additional indebtedness would result in increased debt service obligations and could result in further operating and financing covenants that would further restrict our freedom to operate our business, such as conditions that:

- limit our ability to pay dividends or require us to seek consent for the payment of dividends;
- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a portion of our cash flow from operations to payments on our debt, thereby reducing the availability of our cash flow to fund capital expenditures, working capital and other general corporate purposes; and
- limit our flexibility in planning for, or reacting to, changes in our business and our industry.

We cannot guarantee that we will be able to obtain any additional financing on terms that are acceptable to us, or at all.

#### Risks Relating to Our Pharmacy Operations

Our operating results are difficult to predict, and we may experience significant fluctuations in our operating results.

Our operating results may fluctuate significantly. As a result, you may not be able to rely on period to period comparisons of our operating results as an indication of our future performance. Factors causing these fluctuations include, among others:

- our ability to maintain and increase sales to existing customers, attract new customers and satisfy our customers' demands;
- the frequency of customer visits to our drugstores and the quantity and mix of products our customers purchase;
- the price we charge for our products or changes in our pricing strategies or the pricing strategies of our competitors;
- timing and costs of marketing and promotional programs organized by us and/or our suppliers, including the extent to which we or our suppliers offer promotional discounts to our customers;
- our ability to acquire merchandise, manage inventory and fulfill orders;
- technical difficulties, system downtime or interruptions that may affect our product selection, procurement, pricing, distribution and retail management processes;
- the introduction by our competitors of new products or services;
- the effects of strategic alliances, potential acquisitions and other business combinations, and our ability to successfully and timely integrate them into our business;
- changes in government regulations with respect to pharmaceutical and retail industries; and
- current economic and geopolitical conditions in China and elsewhere.

In addition, a significant percentage of our operating expenses are fixed in the short term. As a result, a delay in generating revenue for any reason could result in substantial operating losses.

Moreover, our business is subject to seasonal variations in demand. In particular, traditional retail seasonality affects the sales of certain pharmaceuticals and other non-pharmaceutical products. Sales of our pharmaceutical products during our fiscal third quarter (October 1st through December 31st) benefit from the winter cold and flu season, and are lower in our fiscal fourth quarter (January 1st through March 31st ) because Chinese New Year falls into that quarter each year and our customers generally pay fewer visits to drugstores during this period. In addition, sales of some health and beauty products are driven, to some extent, by seasonal purchasing patterns and seasonal product changes. Failure to manage the increased sales effectively in the high sale season, and increases in inventory in anticipation of sales increase could have a material adverse effect on our financial condition, results of operations and cash flow.

Many of the factors discussed above are beyond our control, making our quarterly results difficult to predict, which could cause the trading price of our securities to decline below investor expectations. You should not rely on our operating results for prior periods as an indication of our future results.

We may not be able to timely identify or otherwise effectively respond to changing customer preferences, and we may fail to optimize our product offering and inventory position.

The drugstore industry in China is rapidly evolving and is subject to rapidly changing customer preferences that are difficult to predict. Our success depends on our ability to anticipate and identify customer preferences and adapt our product selection to these preferences. In particular, we must optimize our product selection and inventory positions based on sales trends. We cannot assure you that our product selection, especially our selections of nutritional supplements and food products, will accurately reflect customer preferences at any given time. If we fail to anticipate accurately either the market for our products or customers' purchasing habits or fail to respond to customers' changing preferences promptly and effectively, we may not be able to adapt our product selection to customer preferences or make appropriate adjustments to our inventory positions, which could significantly reduce our revenue and have a material adverse effect on our business, financial condition and results of operations.

Our success depends on our ability to establish effective advertising, marketing and promotional programs.

Our success depends on our ability to establish effective advertising, marketing and promotional programs, including pricing strategies implemented in response to competitive pressures and/or to drive demand for our products. Our advertisements are designed to promote our brand, our corporate image and the prices of products available for sale in our stores. Our pricing strategies and value proposition must be appropriate for our target customers. If we are not able to maintain and increase the awareness of our pharmacy brand, products and services, we may not be able to attract and retain customers and our reputation may also suffer. We expect to incur substantial expenses in our marketing and promotional efforts to both attract and retain customers. However, our marketing and promotional activities may be less successful than we anticipate, and may not be effective at building our brand awareness and customer base. In addition, the government may impose restrictions on how marketing and promotional activities can be conducted. We also cannot assure you that our current and planned spending on marketing activities will be adequate to support our future growth. Failure to successfully execute our advertising, marketing and promotional programs may result in material decreases in our revenue and profitability.

Our brand names, trade secrets and other intellectual property are valuable assets. If we are unable to protect them from infringement, our business and prospects may be harmed.

We consider our pharmacy brand names to be valuable assets. We may be unable to prevent third parties from using such brand names without authorization, which may adversely affect our business and reputation, including the perceived quality and reliability of our products and services. We have four registered trademarks and one trademark application pending in China. We also own five domain names, three of which are currently active.

We rely on trade secrets to protect our know-how and other proprietary information, including pricing, purchasing, promotional strategies, customer lists and/or suppliers lists. However, trade secrets are difficult to protect. While we believe we use reasonable efforts to protect our trade secrets, our employees, consultants, contractors or advisors may unintentionally or willfully disclose our information to competitors. In addition, confidentiality agreements, if any, executed by the foregoing persons may not be enforceable or provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure. Our employees are required to sign an employment agreement as a condition of employment, which contains a confidentiality provision.

If we were to enforce a claim that a third party had illegally obtained and was using our trade secrets, such efforts could be expensive and time-consuming, and the outcome unpredictable. In addition, if our competitors independently develop information that is equivalent to our trade secrets or other proprietary information, it will be even more difficult for us to enforce our rights and our business and prospects could be harmed.

Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the intellectual property rights of others. However, because the validity, enforceability and scope of protection of intellectual property rights in the PRC are uncertain and still evolving, we may not be successful in prosecuting these cases. In addition, any litigation or proceeding or other efforts to protect our intellectual property rights could result in substantial costs and diversion of our resources and could seriously harm our business and operating results. Furthermore, the degree of future protection of our proprietary rights is uncertain and may not adequately protect our rights or permit us to gain or keep our competitive advantage. If we are unable to protect our trade names, trade secrets and other propriety information from infringement, our business, financial condition and results of operations may be materially and adversely affected.

We may be exposed to intellectual property infringement and other claims by third parties which, if successful, could disrupt our business and have a material adverse effect on our financial condition and results of operations.

Our success depends, in large part, on our ability to use our proprietary information and know-how without infringing third party intellectual property rights. As litigation becomes more common in China, we face a higher risk of being the subject of claims for intellectual property infringement, invalidity or indemnification relating to other parties' proprietary rights. Our current or potential competitors, many of which have substantial resources, may have or may obtain intellectual property protection that will prevent, limit or interfere with our ability to conduct our business in China. Moreover, the defense of intellectual property suits, including trademark infringement suits, and related legal and administrative proceedings can be both costly and time consuming and may significantly divert the efforts and resources of our management personnel. Furthermore, an adverse determination in any such litigation or proceedings to which we may become a party could cause us to:

- pay damage awards;
- seek licenses from third parties;

- pay ongoing royalties;
- redesign our product offerings; or
- be restricted by injunctions,

each of which could effectively prevent us from pursuing some or all of our business and result in our customers or potential customers deferring or limiting their purchase from our stores, which could have a material adverse effect on our financial condition and results of operations.

Future acquisitions are expected to be a part of our growth strategy, and could expose us to significant business risks.

One of our strategies is to grow our business through acquisition. However, we cannot assure you that we will be able to identify and secure suitable acquisition opportunities. Our ability to consummate and integrate effectively any future acquisitions on terms that are favorable to us may be limited by the number of attractive acquisition targets, internal demands on our resources and, to the extent necessary, our ability to obtain financing on satisfactory terms for larger acquisitions, if at all. Moreover, if an acquisition target is identified, the third parties with whom we seek to cooperate may not select us as a potential partner or we may not be able to enter into arrangements on commercially reasonable terms or at all. The negotiation and completion of potential acquisitions, whether or not ultimately consummated, could also require significant diversion of management's time and resources and potential disruption of our existing business. Furthermore, we cannot assure you that the expected synergies from future acquisitions will actually materialize. In addition, future acquisitions could result in the incurrence of additional indebtedness, costs, and contingent liabilities. Future acquisitions may also expose us to potential risks, including risks associated with:

- the integration of new operations, services and personnel;
- unforeseen or hidden liabilities;
- the diversion of financial or other resources from our existing businesses;
- our inability to generate sufficient revenue to recover costs and expenses of the acquisitions; and
- potential loss of, or harm to, relationships with employees or customers.

Any of the above could significantly disrupt our ability to manage our business and materially and adversely affect our business, financial condition and results of operations.

Changes in economic conditions and consumer confidence in China may influence the drugstore industry, consumer preferences and spending patterns.

Our business and revenue growth primarily depend on the size of the drugstore market in China. As a result, our revenue and profitability may be negatively affected by changes in national, regional or local economic conditions and consumer confidence in China. In particular, as we focus our expansion of pharmacies in metropolitan markets, where living standards and consumer purchasing power are relatively high, we are especially susceptible to changes in economic conditions, consumer confidence and customer preferences of the urban Chinese population. External factors beyond our control that affect consumer confidence include unemployment rates, levels of personal disposable income, national, regional or local economic conditions and acts of war or terrorism. Changes in economic conditions and consumer confidence could adversely affect consumer preferences, purchasing power and spending patterns. In addition, acts of war or terrorism may cause damage to our facilities, disrupt the supply of the products and services we offer in our stores or adversely impact consumer demand. Any of these factors could have a material adverse effect on our business, financial condition and results of operations.

The prices of certain pharmaceutical products are subject to control, including periodic downward adjustment, by PRC governmental authorities.

An increasing percentage of pharmaceutical products that our pharmacies carry, primarily those included in the national and provincial medical insurance catalogs, are subject to price controls in the form of fixed retail prices or retail price ceilings. See “Relevant PRC Regulations — Price Controls” above. In addition, the retail prices of these products are also subject to periodic downward adjustments as China’s central government seeks to make pharmaceutical products more affordable to the general public. Since May 1998, the relevant authorities have ordered price reductions of thousands of pharmaceutical products. During the fiscal year ended March 31, 2013, several price reductions occurred and affected 2,824 different prescription pharmaceutical products, which required us to make 326 price adjustments. Currently, 2,845 prescription and OTC drugs that we offer are subject to price controls. Any future price controls or government mandated price reductions may have a material adverse effect on our financial condition and results of operations, including significantly reducing our revenue and profitability.



We may be subject to fines and penalties if we fail to comply with the applicable PRC laws and regulations governing sales of medicines under China's National Medical Insurance Program.

Eligible participants in China's national medical insurance program, mainly consisting of urban residents in China, are entitled to buy medicines using their medical insurance cards from an authorized pharmacy, provided that the medicines they purchase have been included in the national or provincial medical insurance catalogs. The pharmacy, in turn, obtains reimbursement from the relevant government social security bureaus. Moreover, the applicable PRC laws, rules and regulations prohibit pharmacies from selling goods other than pre-approved medicines when purchases are made with medical insurance cards. We have established procedures to prohibit our drugstores from selling unauthorized goods to customers who make purchases with medical insurance cards. However, we cannot assure you that those procedures will be strictly followed by all of our employees in all of our stores.

#### Risks Relating to Our Medical Services

If we do not attract and retain qualified physicians and other medical personnel, our ability to provide medical services would be adversely affected.

The success of our medical services will be, in part, dependent upon the number and quality of doctors, nurses and other medical support personnel that we employ and our ability to maintain good relations with them. Our medical staff may terminate their employment with us at any time. If we are unable to successfully maintain good relationships with them, our ability to provide medical services may be adversely affected.

The provision of medical services is heavily regulated in the PRC and failure to comply with those regulations could result in penalties, loss of licensure, additional compliance costs or other adverse consequences.

Healthcare providers in China, as in most other populous countries, are required to comply with many laws and regulations at the national and local government levels. These laws and regulations relate to: licensing; the conduct of operations; the ownership of facilities; the addition of facilities and services; advertising; confidentiality, maintenance and security issues associated with medical records; billing for services; and prices for services. If we fail to comply with applicable laws and regulations, we could suffer penalties, including the loss of our licenses to operate. In addition, further healthcare legislative reform is likely, and could materially adversely affect our business and results of operations in the event we do not comply or if the cost of compliance is expensive. The above list of certain regulated areas is not exhaustive and it is not possible to anticipate the exact nature of future healthcare legislative reform in China. Depending on the priorities determined by the Chinese Ministry of Health, the political climate at any given time, the continued development of the Chinese healthcare system and many other factors, future legislative reforms may be highly diverse, including stringent infection control policies, improved rural healthcare facilities, increased regulation of the distribution of pharmaceuticals and numerous other policy matters. Consequently, the implications of these future reforms could result in penalties, loss of licensure, additional compliance costs or other adverse consequences.

As a provider of medical services, we are exposed to inherent risks relating to malpractice claims.

As a provider of medical services, any misdiagnosis or improper treatment may result in adverse publicity regarding us, which would harm our reputation. If we are found liable for malpractice claims, we could be required to pay substantial monetary damages. Furthermore, even if we successfully defend ourselves against this type of claim, we could be required to spend significant management, financial and other resources, which could disrupt our business, and our reputation as well as our brand name may also suffer. Because malpractice claims are not common in China, we do not carry malpractice insurance. As a result, any imposition of malpractice liability could materially harm our business, financial condition and results of operations.

We face competition that could adversely affect our results of operations.

Our clinics compete with a large number and variety of healthcare facilities in their respective markets. There are numerous government-run and private hospitals and clinics available to the general populace. There can be no assurance that these or other clinics, hospitals or other facilities will not commence or expand such operations, which would increase their competitive position. Further, there can be no assurance that a healthcare organization, having greater resources in the provision or management of healthcare services, will not decide to engage in operations similar to those being conducted by us in Hangzhou.

#### Risks Related to Our Herb Farming

Our herb farming business is subject to the volatility of prices for raw TCM herbs.

We currently sell the herbs that we harvest in bulk to a third-party vendor, based on local market prices primarily determined by TCM manufacturers and trading companies. Such market prices have increased significantly in recent years in response to changes in the supply of and demand for raw herbs, market uncertainty and a variety of additional factors that are beyond our control, including inflation, changes of weather, outbreak of disease, domestic government regulation, market speculation and overall economic conditions. There can be no assurance that market prices, which historically have fluctuated widely, will continue to increase or remain stable and any future declines in prices may negatively impact the viability of our herb farming business.

Unforeseen and severe weather can reduce cultivation activities and lead to a decrease in anticipated harvest.

The climatic and seasonal factors such as weather conditions, level of rainfall and temperature may, among other things, affect the quality, overall supply and availability of raw herbs. Sustained adverse weather conditions in Zhejiang Province in general and in Lin'an in particular where our herbs are planted, such as rain, extreme cold or snow, could disrupt or curtail cultivation activities which in turn could reduce our anticipated harvest yields, delay the timing of our anticipated harvest and distribution, and negatively affect the quality of our harvest. In addition, natural disasters such as fires, earthquakes, snowstorms, extreme climatic or weather conditions such as floods or droughts, or natural conditions such as crop disease, pests or soil erosion, may negatively impact our cultivation and harvest.

In addition, the actual climatic conditions of Zhejiang Province and of Lin'an in particular may not conform to historical patterns and may be affected by variations in weather patterns, including any potential impact of climate change. The effects of climate change may produce more variable or severe weather events that can adversely affect our ability to cultivate and harvest successfully.

The occurrence of any of these may materially harm our herb farming business.

Should the herbs that we harvest ever become contaminated or deteriorate, we may be exposed to negative publicity about product safety which could have a negative impact on our financial condition.

Any contamination or deterioration of the herbs that we harvest could harm our reputation and business. Any such contamination or deterioration could result in their recall and criminal or civil liability, and restrict our ability for further distribution. Any resulting negative publicity could also drive consumers away from our other business segments, which would have a material and adverse effect on our business, financial condition and results of operations.

We may also be affected by factors such as negative publicity resulting from the publication of industry findings, research reports or health concerns concerning the safety of TCM products produced in China or the herbs that we harvest in particular. Such complaints and negative publicity may lead to a loss of consumer confidence and a reduction in the demand for TCM.

We have limited control over the availability and the quality of the local farmers with whom we cooperate because we do not employ them directly.

We rely on local farmers to farm and harvest our herbs, but do not employ them directly. Instead, they are recruited and employed by the local villagers' committees that we negotiate with. We have limited control over the availability and the quality of this labor force. A shortage of suitable laborers may adversely affect our harvest yields.

#### Risks Related to Our Online Sales

We rely on computer software and hardware systems in managing our online sales, the capacity of which may restrict our growth and the failure of which could adversely affect our business, financial condition and results of operations.

We are dependent upon our electronic commerce system to carry out our online sales. Any system failure which causes interruptions to the input, retrieval and transmission of data or increases in service time could disrupt our normal operation. Although we believe we have a disaster recovery plan, which can handle the failure of our computer software and hardware systems, we cannot assure you that we can effectively carry out this disaster recovery plan and that we will be able to restore our operation within a sufficiently short time frame to avoid disruption to our

business. Any failure in our computer software and/or hardware systems could have a material adverse effect on our business, financial condition and results of operations. In addition, if the capacity of our computer software and hardware systems fails to meet the increasing needs of our operations, our ability to grow may be constrained.

As our online business is fairly new, it may be difficult to evaluate its performance and prospects.

We launched [www.dada360.com](http://www.dada360.com) to sell OTC drugs and nutritional supplements online in May 2010. Given such limited operating history, it may be difficult for you to evaluate its performance and prospects. Our ability to generate a profit from online sales remains largely unproven, our online business strategy has not been tested over time, and we cannot be certain that we will be able to successfully manage or grow our online business. We may incur significant costs as we continue to implement and improve our website.

Uncertainties regarding the growth and sustained profitability of e-commerce in China could adversely affect the prospects of our online business.

While e-commerce has existed in China since the 1990s, only recently have certain e-commerce companies in China become profitable. Thus, the long-term viability and prospects of various e-commerce business models, and e-commerce generally, in China remain relatively untested. Future operating results from our online business will depend on numerous factors affecting the development of e-commerce in China, which may be beyond our control. These factors include:

the growth of personal computer, Internet and broadband usage and penetration in China, and the rate of any such growth;

the trust and confidence level of consumers in online shopping in China, as well as changes in customer demographics and consumers' tastes and preferences;  
the selection, price and popularity of products that we and our competitors offer online;  
whether alternative retail channels or business models that better address the needs of consumers emerge in China;  
the development of fulfillment, payment and other ancillary services associated with online purchases; and  
general economic conditions, particularly economic conditions affecting discretionary consumer spending.

A decline in the popularity of shopping on the Internet in general, or failure by us to adapt our website and improve the online shopping experience of our customers in response to trends and consumer needs, may adversely affect our online business prospects.

If our online business fails to obtain and maintain the requisite assets, licenses, qualified personnel and approvals required under the complex regulatory environment for Internet-based businesses in China, the business prospects for such business may be materially and adversely affected.

Internet-based businesses in China are highly regulated by China's central government, and numerous regulatory authorities are empowered to issue and implement regulations governing various aspects of these businesses. Our online business is operated by our PRC subsidiary, Quannuo Technology, which is required to obtain and maintain certain assets relevant to its business, such as computers and other electrical equipment, as well as applicable licenses or approvals from different regulatory authorities. These assets and licenses are essential to the operation of an e-commerce business and are generally subject to annual review by the relevant governmental authorities. Furthermore, we may be required to obtain additional licenses. If we fail to obtain or maintain any of the required assets, licenses or approvals, our Internet business may be deemed illegal and it may be subject to various penalties, such as confiscation of illegal income, fines and the discontinuation or restriction of its operations. Any such disruption may materially and adversely affect the prospects of our online business.

#### Risks Related to Our Corporate Structure

Chinese regulations limit foreign ownership of any pharmacy operator with 30 or more stores, and limit foreign ownership of medical clinics to Sino-foreign joint venture. The entities that operate our pharmacies and clinics are controlled by us by means of contractual arrangements. The validity of such contractual arrangements is uncertain. If the Chinese government determines that these contractual arrangements do not comply with applicable regulations, we could be subject to severe penalties and our business could be adversely affected. In addition, changes in such Chinese laws and regulations may materially and adversely affect our business.

Current PRC regulations limit foreign ownership of a pharmacy operator to 49.0% if such operator owns interests in 30 or more drugstores in China that sell a variety of branded pharmaceutical products sourced from different suppliers. Since we do not own any equity interests in Jiuzhou Pharmacy (or its subsidiary Shanghai Lydia), but controls them through contractual arrangements, the regulations limiting foreign ownership should not apply to us even if Jiuzhou Pharmacy or Shanghai Lydia expands beyond 30 stores.

Similarly, PRC regulations restrict foreign ownership of medical practice in China to Sino-foreign joint venture. Since we do not have actual equity interest in Jiuzhou Clinic or Jiuzhou Service, but control these entities through contractual arrangements, such PRC regulations should not be applicable to us or our structure.

There are, however, uncertainties regarding the interpretation and application of PRC laws, rules and regulations, including but not limited to the laws, rules and regulations governing the validity and enforcement of our contractual arrangements. Although the structure for operating our business in China (including our corporate structure and

contractual arrangements with Jiuzhou Pharmacy, Jiuzhou Clinic, Jiuzhou Service and our three cofounders) comply with all applicable PRC laws, rules and regulations, and do not violate, breach, contravene or otherwise conflict with any applicable PRC laws, rules or regulations, we cannot assure you that a regulatory authority will not determine that our corporate structure and contractual arrangements violate PRC laws, rules or regulations. If any such authority determines that our contractual arrangements are in violation of applicable PRC laws, rules or regulations, our contractual arrangements will become invalid or unenforceable, and we may not be able to consolidate the operations of HJ Group with our results of operations. In addition, new PRC laws, rules and regulations may be introduced from time to time to impose additional requirements that may be applicable to our contractual arrangements. For example, pursuant to the PRC Property Rights Law that became effective on October 1, 2007, the pledge of any equity interests of a PRC private entity shall become effective once it is duly registered with the local branches of the State Administration for Industry and Commerce (the “SAIC”). Following the promulgation of the Property Law, the SAIC further issued the Administrative Measures for Registrations of Share Pledge on September 1, 2008, which provided detailed procedural guidance for the local SAIC offices to handle the registrations of share pledge. The Equity Pledge Agreement that forms a part of the contractual arrangements creates a legally binding obligation on the parties upon the execution date; however, the pledge established under such agreement does not become effective until due registration with local SAIC office. On May 18, 2010, registration of the pledged equity interests in Jiuzhou Pharmacy was completed.

The Chinese government has broad discretion in dealing with violations of laws and regulations, including levying fines, revoking business and other licenses and requiring actions necessary for compliance. In particular, licenses and permits issued or granted to us by relevant governmental bodies may be revoked at a later time by higher regulatory bodies. We cannot predict the effect of the interpretation of existing or new Chinese laws or regulations on our businesses. We cannot assure you that our current ownership and operating structure would not be found in violation of any current or future Chinese laws or regulations. As a result, we may be subject to sanctions, including fines, and could be required to restructure our operations or cease to provide certain services. Any of these or similar actions could significantly disrupt our business operations or restrict us from conducting a substantial portion of our business operations, which could materially and adversely affect our business, financial condition and results of operations.

If we are determined to be in violation of any existing or future PRC laws, rules or regulations or fail to obtain or maintain any of the required governmental permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including:

- revoking the business and operating licenses of the HJ Group entities;
- discontinuing or restricting the operations of the HJ Group entities;
- imposing conditions or requirements with which we or the HJ Group entities may not be able to comply;
- requiring us or the HJ Group entities to restructure the relevant ownership structure or operations; or
- imposing fines.

The imposition of any of these penalties would severely disrupt our ability to conduct business and have a material adverse effect on our financial condition, results of operations and prospects.

We may be adversely affected by complexity, uncertainties and changes in Chinese regulation of drugstores and the practice of medicine.

The Chinese government regulates drugstores and the practice of medicine including foreign ownership, and the licensing and permit requirements. These laws and regulations are relatively new and evolving, and their interpretation and enforcement involve significant uncertainty. As a result, in certain circumstances it may be difficult to determine what actions or omissions may be deemed to be a violation of applicable laws and regulations. Issues, risks and uncertainties relating to Chinese government regulation of the industry include the following:

We only have contractual control over the HJ Group entities. We do not own them due to the restriction of foreign ownership in such companies.

Uncertainties relating to the regulation of drugstores and medical practice in China, including evolving licensing practices, means that permits, licenses or operations at our company may be subject to challenge. This may disrupt our business, or subject us to sanctions, requirements to increase capital or other conditions or enforcement, or compromise enforceability of related contractual arrangements, or have other harmful effects on us.

The interpretation and application of existing Chinese laws, regulations and policies and possible new laws, regulations or policies have created substantial uncertainties regarding the legality of existing and future foreign investments in, and the businesses and activities of, pharmaceutical businesses in China, including our business.

Our contractual arrangements with HJ Group and our cofounders may not be as effective in providing control over these entities as direct ownership, and the .

We have no equity ownership interest in HJ Group, and rely on contractual arrangements to control and operate the HJ Group companies and their businesses. These contractual arrangements may not be as effective in providing control

over these companies as direct ownership. For example, any one of them could fail to take actions required for our business despite its contractual obligation to do so. If this were to happen, we may have to rely on legal remedies under Chinese law, which may not be effective. In addition, we cannot assure you that our three cofounders will act in our best interests.

Because we rely on contractual arrangements to control HJ Group and for substantially all of our revenue, the termination of such agreements will severely and detrimentally affect our continuing business viability under our current corporate structure.

Because we do not own equity interests of HJ Group, the termination of our contractual arrangements with them would sever our ability to continue receiving payments from them under our current holding company structure. In the event the contractual arrangements terminate, we will lose our control over them and their business operations, as well as our primary sources of revenue. Should this occur, we may seek to acquire control of HJ Group through other means, although we cannot guarantee that we will do so, nor can we guarantee that we will be successful if we do.



We cannot assure you that there will not be any event or reason that may cause the contractual arrangements to terminate. In the event that the contractual arrangements are terminated for any reason, this may have a severe and detrimental effect on our continuing business viability under our current corporate structure, which in turn may affect the value of your investment.

We rely principally on dividends paid by our consolidated operating entities to fund any cash and financing requirements we may have, and any limitation on the ability of our consolidated PRC entities to pay dividends to us could have a material adverse effect on our ability to conduct our business.

We are a holding company, and rely principally on dividends paid by our consolidated PRC operating entities for cash requirements, including the funds necessary to service any debt we may incur, which are passed on to us through Jiuxin Management. If any of the consolidated operating entities incurs debt in its own name in the future, the instruments governing the debt may restrict dividends or other distributions on its equity interest to us. In addition, the PRC tax authorities may require us to adjust our taxable income under the contractual arrangements in a manner that would materially and adversely affect our ability to pay dividends and other distributions on our equity interest.

Furthermore, applicable PRC laws, rules and regulations permit payment of dividends by our consolidated PRC entities only out of their retained earnings, if any, determined in accordance with PRC accounting standards. Under PRC laws, rules and regulations, our consolidated PRC entities are required to set aside at least 10.0% of their after-tax profit based on PRC accounting standards each year to their statutory surplus reserve fund until the accumulative amount of such reserves reach 50.0% of their respective registered capital. As a result, our consolidated PRC entities are restricted in their ability to transfer a portion of their net income to us whether in the form of dividends, loans or advances. As of March 31, 2013, our restricted reserves totaled RMB 9,460,695 (\$1,309,109) and we had unrestricted retained earnings of RMB 115,685,741 (\$17,095,369). Our restricted reserves are not distributable as cash dividends. Any limitation on the ability of our consolidated operating entities to pay dividends to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay dividends or otherwise fund and conduct our business.

Certain management members of HJ Group have potential conflicts of interest with us, which may adversely affect our business and your ability for recourse.

Mr. Lei Liu, our chairman and chief executive officer, is also the executive director of Jiuzhou Pharmacy, a general partner of Jiuzhou Clinic, and the supervising director of Jiuzhou Service. Ms. Li Qi, our corporate secretary and also a member of the board of directors, is the general manager of each of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service and a general partner of Jiuzhou Clinic. Conflicts of interests between their respective duties to our company and HJ Group may arise. As our directors and executive officers, they have a duty of loyalty and care to us under U.S. and Hong Kong law when there are any potential conflicts of interests between our company and HJ Group. We cannot assure you, however, that when conflicts of interest arise, every one of them will act completely in our interests or that conflicts of interests will be resolved in our favor. For example, they may determine that it is in HJ Group's interests to sever the contractual arrangements with Jiuxin Management, irrespective of the effect such action may have on us. In addition, any one of them could violate his or her legal duties by diverting business opportunities from us to others, thereby affecting the amount of payment that HJ Group is obligated to remit to us under the consulting services agreement.

In the event that you believe that your rights have been infringed under the securities laws or otherwise as a result of any one of the circumstances described above, it may be difficult or impossible for you to bring an action against HJ Group, or our officers or directors who are members of their management, all of whom reside within China. Even if you are successful in bringing an action, the laws of China may render you unable to enforce a judgment against the assets of HJ Group and its management, all of which are located in China.

## Risks Related to Doing Business in China

Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service are subject to restrictions on making payments to us.

We rely substantially on our contractual arrangements with Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service for our revenue. The Chinese government also imposes controls on the conversion of RMB into foreign currencies and the remittance of currencies out of China. We may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currency. See “Governmental control of currency conversion may affect the value of your investment.” Furthermore, if these companies incur debt on their own in the future, the instruments governing the debt may restrict their ability to make payments. If we are unable to receive all of the revenues from our operations through these contractual arrangements, we may be unable to pay dividends on our common shares.

Uncertainties with respect to the Chinese legal system could adversely affect us.

We conduct our business through our subsidiaries and controlled companies in the PRC. Our operations in China are governed by Chinese laws and regulations. We are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to wholly foreign-owned enterprises. The Chinese legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value.

Since 1979, Chinese legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, China has not developed a fully integrated legal system and recently enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their nonbinding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. In addition, the Chinese legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until sometime after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions in China based on United States or other foreign laws against us or our management.

We are a holding company and conduct our business through our subsidiaries and controlled companies in the PRC. In addition, all of our operating assets are located in, and all of our other senior executive officers reside within, China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon our senior executive officers and directors not residing in the United States, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, our Chinese counsel has advised us that China does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of judgment of courts. As a result, our public shareholders may have substantial difficulty in protecting their interests through actions against our management or directors than would shareholders of a corporation with assets and management members located in the United States.

We may need to obtain additional governmental approvals to open new drugstores. Our inability to obtain such approvals will have a material adverse effect on our business and growth.

According to the Measures on the Administration of Foreign Investment in the Commercial Sector (the “Measures”) promulgated by China’s Ministry of Commerce (the “MOC”), which became effective on June 1, 2004, a company that is directly owned by a foreign invested enterprise needs to obtain relevant governmental approvals before it opens new retail stores. However, there are no specific laws, rules or regulations with respect to whether it is necessary for a company contractually controlled by a foreign invested enterprise to obtain approvals to open new retail stores. In addition, the Measures state that the MOC will promulgate a detailed implementation regulation to govern foreign invested enterprises engaging in drug sale. However, such implementation regulation has not yet been promulgated. Therefore we cannot assure you that the MOC will not require that such approvals to be obtained. If additional governmental approval is deemed to be necessary and we are not able to obtain such approvals on a timely basis or at all, our business, financial condition, results of operations and prospects, as well as the trading price of our common stock, will be materially and adversely affected.

The advent of recent healthcare reform directives from China’s central government may increase both competition and our cost of doing business.

Under the auspices of the Healthy China 2020 program (the “Program”), published by China’s National Development and Reform Commission in October 2008, the central government has set in motion a series of policies in fairly rapid successions aimed to improve China’s healthcare system. Such policies include (1) discouraging hospitals from both prescribing and dispensing medication, (2) the unveiling of formal healthcare reform guidelines in April 2009, aimed to improve the availability of and subsidies for “essential” drugs, and (3) the announcement of China’s National Essential Drugs List (“NEDL”) in August 2009, initially listing approximately 300 medicines to be sold at government-controlled prices. While an underlying goal of these policies is to make drugs more accessible to China’s poorer populations, such policy as discouraging hospitals from both prescribing and dispensing medication also serve to create opportunities that in turn will intensify business competition in the Chinese retail drugstore industry, as well as competition for skilled labor and retail spaces. Additionally, we expect the NEDL to lead to a rise in the number of government-subsidized community healthcare service centers, which will erode the convenience and price advantage that our drugstores traditionally enjoy against hospitals.

Governmental control of currency conversion may affect the value of your investment.

The Chinese government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in RMB. Under our current structure, our income is primarily derived from payments from the three HJ Group companies. Shortages in the availability of foreign currency may restrict the ability of our subsidiaries and our PRC affiliated entities to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy their foreign currency denominated obligations. Under existing Chinese foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from the SAFE by complying with certain procedural requirements. However, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of bank loans denominated in foreign currencies. The Chinese government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our stockholders.

Fluctuation in the value of RMB may have a material adverse effect on your investment.

The value of RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. Our revenues, costs, and financial assets are mostly denominated in RMB while our reporting currency is the U.S. dollar. Accordingly, this may result in gains or losses from currency translation on our financial statements. We rely entirely on fees paid to us by our affiliated entities in China. Therefore, any significant fluctuation in the value of RMB may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, our stock in U.S. dollars. For example, an appreciation of RMB against the U.S. dollar would make any new RMB denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into RMB for such purposes. An appreciation of RMB against the U.S. dollar would result in foreign currency translation gain for financial reporting purposes when we translate our RMB denominated financial assets into U.S. dollar, as U.S. dollar is our reporting currency.

Dividends we receive from our subsidiaries located in the PRC may be subject to PRC withholding tax.

The current PRC Enterprise Income Tax Law, or the EIT Law, and the implementation regulations for the EIT Law issued by China's State Council, became effective as of January 1, 2008. The EIT Law provides that a maximum income tax rate of 20% is applicable to dividends payable to non-PRC investors that are "non-resident enterprises," to the extent such dividends are derived from sources within the PRC, and the State Council has reduced such rate to 10% through the implementation regulations. We are a Nevada holding company and substantially all of our income is derived from our subsidiaries and controlled companies located in the PRC. Therefore, dividends paid to us from China may be subject to the 10% income tax if we are considered as a "non-resident enterprise" under the EIT Law. If we are required under the EIT Law and its implementation regulations to pay income tax for any dividends we receive from our PRC subsidiaries, it may have a material and adverse effect on our net income and materially reduce the amount of dividends, if any, we may pay to our shareholders.

We face risks related to health epidemics and other outbreaks.

Our business could be adversely affected by the effects of an epidemic outbreak. Any prolonged recurrence of such adverse public health developments in China may have a material adverse effect on our business operations. For instance, health or other government regulations adopted in response may require temporary closure of our stores or

offices. Such closures would severely disrupt our business operations and adversely affect our results of operations. We have not adopted any written preventive measures or contingency plans to combat any future epidemic outbreak.

If relations between the United States and China worsen, investors may be unwilling to hold or buy our stock and our stock price may decrease.

At various times during recent years, the United States and China have had significant disagreements over political and economic issues. Controversies may arise in the future between these two countries. Any political or trade controversies between the United States and China, whether or not directly related to our business, could reduce the price of our common stock.

#### Risks Related to an Investment in Our Securities

To date, we have not paid any cash dividends and no cash dividends will be paid in the foreseeable future.

We do not anticipate paying cash dividends on our common stock in the foreseeable future and we may not have sufficient funds legally available to pay dividends. Even if the funds are legally available for distribution, we may nevertheless decide not to pay any dividends. We intend to retain all earnings for our operations.

NASDAQ may delist our common stock from trading on the NASDAQ Capital Market for failing to maintain a minimum bid price of \$1.00, which could limit investors' ability to effect transactions in our common stock and subject us to additional trading restrictions.

On May 9, 2013, we received a letter from The NASDAQ Stock Market LLC ("NASDAQ"), notifying our failure to maintain a minimum closing bid price of \$1.00 over the then preceding 30 consecutive trading days for its common stock as required by NASDAQ Listing Rule 5550(a)(2) (the "Bid Price Rule"). The letter stated that the Company has until November 5, 2013, to demonstrate compliance by maintaining a minimum closing bid price of at least \$1.00 for a minimum of 10 consecutive trading days. In the meantime, we will be included in a list of non-compliant companies posted on NASDAQ's website commencing on May 16, 2013. We intend to monitor the bid price of its common stock and consider available options if our common stock does not trade at a level likely to result in the registrant regaining compliance with the Bid Price Rule by November 5, 2013.

The letter also states that in the event we do not regain compliance with the Bid Price Rule by November 5, 2013, we may be eligible for additional time by meeting certain continued listing requirements and the initial listing criteria for The NASDAQ Capital Market (excepting the bid price requirement), and providing written notice of its intention to cure its deficiency during the second compliance period. If it meets these criteria, NASDAQ will notify us that we have been granted an additional 180-day compliance period. If, however, it appears that we will not be able to cure the deficiency or is otherwise not eligible, NASDAQ will notify that our common stock will be subject to delisting. At such time, we may appeal the delisting determination to a NASDAQ Hearings Panel.

If NASDAQ delists our common stock from trading on its exchange, we could face significant material adverse consequences including:

- a limited availability of market quotations for our common stock;
- a limited amount of news and analyst coverage for our company; and
- a decreased ability to issue additional securities or obtain additional financing in the future.

Although publicly traded, the trading market in our common stock may be substantially less liquid than the average stock quoted on the NASDAQ Capital Market, and such low trading volume may adversely affect the price of our common stock.

Although our common stock has been listed on the NASDAQ Capital Market since April 22, 2010, the historical trading volume of our common stock has generally been very low. Limited trading volume will subject our shares of common stock to greater price volatility and may make it difficult for you to sell your shares of common stock at a price that is attractive to you.

The market price for our stock may be volatile, and such volatility may subject us to securities litigation.

The market price for our stock may be volatile and subject to wide fluctuations when compared to seasoned issuers, and may be in response to factors including the following:

- actual or anticipated fluctuations in our quarterly operating results;
- changes in financial estimates by securities research analysts;
- conditions in the retail pharmacy markets;
- changes in the economic performance or market valuations of other retail pharmacy operators;
- announcements by us or our competitors of new products, acquisitions, strategic partnerships, joint ventures or capital commitments;
- addition or departure of key personnel;

fluctuations of exchange rates between RMB and the U.S. dollar;  
intellectual property litigation; and  
general economic or political conditions in China.

As an illustration of such volatility, the closing price of our common stock during the 52 weeks preceding the date of this report ranged from a low of \$0.55 to a high of \$1.28. In addition, the securities market has from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our stock.

In the past, plaintiffs have often initiated securities class action litigation against a company following periods of volatility in the market price of its securities. We may, in the future, be the target of similar litigation. Securities litigation could result in substantial costs and liabilities and could divert management's attention and resources.

Techniques employed by manipulative short sellers in Chinese small-cap stocks may drive down the market price of our common stock.

Short selling is the practice of selling securities that the seller does not own but rather has, supposedly, borrowed from a third party with the intention of buying identical securities back at a later date to return to the lender. The short seller hopes to profit from a decline in the value of the securities between the sale of the borrowed securities and the purchase of the replacement shares, as the short seller expects to pay less in that purchase than it received in the sale.

As it is therefore in the short seller's best interests for the price of the stock to decline, many short sellers (sometime known as "disclosed shorts") publish, or arrange for the publication of, negative opinions regarding the relevant issuer and its business prospects in order to create negative market momentum and generate profits for themselves after selling a stock short. While traditionally these disclosed shorts were limited in their ability to access mainstream business media or to otherwise create negative market rumors, the rise of the Internet and technological advancements regarding document creation, videotaping and publication by weblog ("blogging") have allowed many disclosed shorts to publicly attack a company's credibility, strategy and veracity by means of so-called research reports that mimic the type of investment analysis performed by large Wall Street firm and independent research analysts. These short attacks have, in the past, led to selling of shares in the market, on occasion in large scale and broad base. Issuers with business operations based in the PRC and who have limited trading volumes and are susceptible to higher volatility levels than U.S. domestic large-cap stocks can be particularly vulnerable to such short attacks.



These short seller publications are not regulated by any governmental, self-regulatory organization or other official authority in the U.S., are not subject to the certification requirements imposed by the Securities and Exchange Commission in Regulation AC (Regulation Analyst Certification) and, accordingly, the opinions they express may be based on distortions of actual facts or, in some cases, fabrications of facts. In light of the limited risks involved in publishing such information, and the enormous profit that can be made from running just one successful short attack, unless the short sellers become subject to significant penalties, it is more likely than not that disclosed shorts will continue to issue such reports.

While we intend to strongly defend our public filings against any such short seller attacks, oftentimes we are constrained, either by principles of freedom of speech, applicable state law (often called “Anti-SLAPP statutes”), or issues of commercial confidentiality, in the manner in which we can proceed against the relevant short seller. You should be aware that in light of the relative freedom to operate that such persons enjoy – oftentimes blogging from outside the U.S. with little or no assets or identity requirements – should we be targeted for such an attack, our stock will likely suffer from a temporary, or possibly long term, decline in market price should the rumors created not be dismissed by market participants.

Our officers and directors own a substantial portion of our outstanding common stock, which will enable them to influence many significant corporate actions and in certain circumstances may prevent a change in control that would otherwise be beneficial to our shareholders.

As of June 20, 2013, our directors and executive officers collectively controlled approximately 44.54% of our outstanding shares of stock entitled to vote on all corporate actions. These stockholders, acting together, could have a substantial impact on matters requiring the vote of the shareholders, including the election of our directors and most of our corporate actions. This control could delay, defer or prevent others from initiating a potential merger, takeover or other change in our control, even if these actions would benefit our shareholders and us. This control could adversely affect the voting and other rights of our other shareholders and could depress the market price of our common stock.

The elimination of monetary liability against our directors, officers and employees under Nevada law and the existence of indemnification rights to our directors, officers and employees may result in substantial expenditures by us and may discourage lawsuits against our directors, officers and employees.

Our bylaws contain specific provisions that eliminate the liability of our directors for monetary damages to our company and shareholders, and we are prepared to give such indemnification to our directors and officers to the extent provided by Nevada law. We may also have contractual indemnification obligations under our employment agreements with our officers. The foregoing indemnification obligations could result in our company incurring substantial expenditures to cover the cost of settlement or damage awards against directors and officers, which we may be unable to recoup. These provisions and resultant costs may also discourage our company from bringing a lawsuit against directors and officers for breaches of their fiduciary duties, and may similarly discourage the filing of derivative litigation by our shareholders against our directors and officers even though such actions, if successful, might otherwise benefit our company and shareholders.

Legislative actions, higher insurance costs and potential new accounting pronouncements may impact our future financial position and results of operations.

There have been regulatory changes, including the Sarbanes-Oxley Act of 2002, and there may potentially be new accounting pronouncements or additional regulatory rulings that will have an impact on our future financial position and results of operations. In addition, insurers are likely to increase premiums as a result of high claims rates over the past several years, which we expect will increase our premiums for insurance policies. These and other potential changes could materially increase the expenses we report under generally accepted accounting principles, and

adversely affect our operating results.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

We are subject to reporting obligations under the U.S. securities laws. The SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, as amended, adopted rules requiring every public company to include a management report on such company's internal controls over financial reporting in its annual report, which contains management's assessment of the effectiveness of our internal controls over financial reporting. We reported certain material weaknesses involving control activities, specifically control deficiency over accounting and finance personnel, in light of the continuing lack of sufficient experience by our accounting staff in U.S. GAAP-based reporting and SEC rules and regulations. Such material weaknesses were noted for the past four fiscal years, based on factors including: (i) the number of adjustments proposed by our independent auditors during our quarterly review and annual audit processes; (ii) the significance of the audit adjustments impact on the overall financial statements; (iii) how appropriately we complied with U.S. GAAP on transactions; and (iv) how accurately we prepared supporting information to provide to our independent auditors on a quarterly and annual basis. As such, we did not maintain effective controls and did not implement adequate and proper supervisory review to ensure that significant internal control deficiencies can be detected or prevented.

Although we believe that we have made significant efforts to address the foregoing weaknesses, we believe that our efforts to date have not yet been sufficient to fully remediate such weaknesses. We will continue our efforts during the current fiscal year, although there can be no assurance that compliance will be achieved in this time frame.

Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems for the foreseeable future. Effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to help prevent fraud. As a result, our failure to achieve and maintain effective internal controls over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading price of our common stock. Furthermore, we anticipate that we will incur considerable costs and use significant management time and other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

Shares eligible for future sale may adversely affect the market.

From time to time, certain of our stockholders may be eligible to sell all or some of their shares of common stock by means of ordinary brokerage transactions in the open market pursuant to Rule 144, promulgated under the Securities Act, subject to certain limitations. In general, pursuant to amended Rule 144, non-affiliate stockholders may sell freely after six months subject only to the current public information requirement (which disappears after one year). Affiliates may sell after six months subject to the Rule 144 volume, manner of sale (for equity securities), current public information and notice requirements. Of the 13,609,002 shares of our common stock outstanding as of June 20, 2013, approximately 7,610,497 shares are, or will be, freely tradable without restriction, unless held by our affiliates as of such date. Any substantial sale of our common stock pursuant to Rule 144 or pursuant to any resale prospectus may have a material adverse effect on the market price of our common stock. If our cofounders and service consultants were to sell their shares, they would be subject to volume and/or other restrictions imposed by Rule 144.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

#### ITEM 2. PROPERTIES

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We are headquartered in Hangzhou, China. We do not own any property. Our current leased properties are as follows:

| Description                          | Location   | Size<br>(square meters)   | Lease expiration date |
|--------------------------------------|--|---------------------------|-----------------------|
| Principal executive office (1)       | Room 507-513, 5th Floor A Building,<br>Meidu Plaza, Gongshu District,<br>Hangzhou, Zhejiang Province | 7,855                     | December 1, 2014      |
| Distribution center                  | 3rd Floor, Building 3, No. 10,<br>Kanghui Road ,Gongshu District,<br>Hangzhou, Zhejiang Province     | 44,133                    | January 14, 2016      |
| Office for Shouantang Technology (2) | Room 616, No. 33, Xiangyuan Road,<br>Gongshu District, Hangzhou, Zhejiang<br>Province                | 538                       | August 24, 2014       |
| Office for Quannuo Technology (2)    | 4rd Floor, Building 3, No. 10,<br>Kanghui Road ,Gongshu District,<br>Hangzhou, Zhejiang Province     | 523                       | January 14, 2016      |
| Pharmacies (2)                       | Various locations in Hangzhou and<br>Shanghai  | Range from<br>60 to 1,713 | Various               |
| Farmland for herb cultivation (3)    | Qianhong Township, Hangzhou,<br>Zhejiang Province  | 48.6 acres                | February 1, 2040      |
| Land (3)                             | Qianhong Township, Hangzhou,<br>Zhejiang Province  | 4.6 acres                 | February 1, 2040      |

(1) We are leasing our principal executive office from our chairman Mr. Lei Liu. Rent was \$81,926 and \$93,660 for the fiscal year ended March 31, 2013 and 2012, respectively.

(2)As of the date of this report, we have 2 operating leases in connection with offices for Shouantang Technology and Quannuo Technology, as well as our 51 pharmacies. See Note 8, “Long Term Deposits,” and Note 18, “Commitments and Contingencies” to the Financial Statements. The leases do not contain any material escalating lease payments or contingent rental payment terms. We must negotiate with the landlords for an extension of the old leases or enter into new leases upon their termination, and our landlords may request a rent increase. Under applicable PRC law, we have priority over other potential lessees with respect to the leased store space on the same terms. We also do not expect any significant difficulties in renewal of existing leases upon their expiration, where desired. Our community stores are normally relatively small in size and the facilities inside the store are easily movable. As a result, we do not expect our drugstore operations to be materially and adversely affected by any failure to renew or enter into new leases.

(3)We are leasing the land from The People’s Government of Qianhong Village under a 30-year lease entered in February 2010. The lease amount for the land was prepaid in full in May 2010. See Note 9, “Other Noncurrent Assets,” and Note 18, “Commitments and Contingencies,” to the Financial Statements.

### ITEM 3. LEGAL PROCEEDINGS

Except as described below, we know of no material, existing or pending legal proceedings against us, nor are we involved as a plaintiff in any material proceeding or pending litigation. There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial stockholder, is an adverse party or has a material interest adverse to our company.

On December 8, 2009, Jiuzhou Pharmacy filed suit against The Ventana Group, LLC and Michael Hom in the California Superior Court for the County of San Mateo (Case Number CV490272), alleging breach of contract of an agreement entered into with the defendants in 2008 and seeking damages of \$25,000. The suit was subsequently amended to remove Mr. Hom as a defendant. In May 2010, Jiuzhou Pharmacy sought for default judgment against the remaining defendant. On July 14, 2010, a default judgment was entered in favor of Jiuzhou Pharmacy.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

### ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASE OF EQUITY SECURITIES

#### Market Information

Our common stock trades on the NASDAQ Capital Market under the symbol “CJJD”. The following table sets forth the high and low bid information for our common stock for the periods indicated. The bid prices reflect inter-dealer quotations, do not include retail markups, markdowns, or commissions, and do not necessarily reflect actual transactions.

|                              | Low     | High    |
|------------------------------|---------|---------|
| 2013                         |         |         |
| Quarter ended June 30, 2013* | \$ 0.55 | \$ 1.01 |
| Quarter ended March 31, 2013 | \$0.76  | \$1.14  |

2012

|                                  |        |        |
|----------------------------------|--------|--------|
| Quarter ended December 31, 2012  | \$0.65 | \$1.15 |
| Quarter ended September 30, 2012 | 0.60   | 1.25   |
| Quarter ended June 30, 2012      | 0.60   | 1.37   |
| Quarter ended March 31, 2012     | 1.11   | 1.41   |

2011

|                                  |        |        |
|----------------------------------|--------|--------|
| Quarter ended December 31, 2011  | \$1.08 | \$1.78 |
| Quarter ended September 30, 2011 | 0.98   | 2.38   |
| Quarter ended June 30, 2011      | 2.76   | 1.65   |
| Quarter ended March 31, 2011     | 5.60   | 2.50   |

\* Through June 20, 2013.

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Based on the records of our transfer agent, we had 13,690,002 shares of common stock issued and outstanding as of June 20, 2013.

#### Holders

Based on the records of our transfer agent, there were 11 stockholders of record of our common stock as of June 20, 2013 (not including beneficial owners who hold shares at broker/dealers in “street name”).

#### Transfer Agent

Our transfer agent is American Stock Transfer & Trust Company, LLC, whose address is 6201 15th Avenue, Brooklyn, New York 11219, and whose telephone number is (718) 921-8206.

#### Dividends

While there are no restrictions that limit our ability to pay dividends, we have not paid, and do not currently intend to pay cash dividends on our common stock in the foreseeable future. Our policy is to retain all earnings, if any, to provide funds for operation and expansion of our business. The declaration of dividends, if any, will be subject to the discretion of our board of directors, which may consider such factors as our results of operations, financial condition, capital needs and acquisition strategy, among others.

#### Securities Authorized for Issuance under Equity Compensation Plans

Please see the discussion in Item 12 titled “Equity Compensation Plan Information” below.

#### Recent Sales of Unregistered Securities

None during the three months ended March 31, 2013.

#### ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

#### ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

The following discussion and analysis of our results of operations and financial condition for fiscal years ended March 31, 2013 and 2012 should be read in conjunction with our financial statements and the notes to those financial statements that are included elsewhere in this report. Our discussion includes forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions. Actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth under the “Risk Factors,” “Cautionary Notice Regarding Forward-Looking Statements” and “Description of Business” sections and elsewhere in this report. We use words such as “anticipate,” “estimate,” “plan,” “project,” “continuing,” “ongoing,” “expect,” “believe,” “intend,” “will,” “should,” “could,” “predict” and similar expressions to identify forward-looking statements. Although we believe the expectations expressed in these forward-looking statements are based on reasonable assumptions within the bound of our knowledge of our business, our actual results could differ materially from those discussed in these statements. Factors that could contribute to such differences include, but are not limited to, those discussed in the “Risk Factors” section of this report. We undertake no obligation to update publicly any forward-looking statements for

any reason even if new information becomes available or other events occur in the future.

Our financial statements are prepared in United States Dollars (“\$” or “USD”) and in accordance with accounting principles generally accepted in the United States. See “Exchange Rates” below for information concerning the exchanges rates at which Renminbi (“RMB”) were translated into USD at various pertinent dates and for pertinent periods.



## Overview

We currently operate in three business segments in China: (i) retail pharmacies (which we include our clinics and online sales), (2) wholesale of similar products that we carry in our pharmacies, and (3) farming and selling herbs used for TCM.

Our drugstores offer a wide variety of third-party medicinal products, including prescription and OTC drugs, nutritional supplements, TCM products, personal care products, family care products, medical devices, as well as convenience products including consumable, seasonal and promotional items. We also have licensed doctors of both western medicine and TCM onsite for consultation, examination and treatment of common ailments at scheduled hours. We currently have 51 pharmacies in Hangzhou and Shanghai under two store brand names. During the year ended March 31, 2013, we closed 17 pharmacies that did not meet our performance expectations, including 11 “Jiuzhou Grand Pharmacy” stores, five “Jiuying Grand Pharmacy” stores and the only “Quannuo Grand Pharmacy” store. Since May 2010, we have also been selling certain OTC drugs and nutritional supplements online.

We operate a wholesale business through Jiuxin Medicine distributing third-party pharmaceutical products (similar to those we carry in our own pharmacies) primarily to trading companies throughout China. We also farm certain herbs used in TCM that we currently sell to a local vendor.

## Critical Accounting Policies and Estimates

In preparing our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, we are required to make judgments, estimates and assumptions that affect: (i) the reported amounts of our assets and liabilities; (ii) the disclosure of our contingent assets and liabilities at the end of each reporting period; and (iii) the reported amounts of revenue and expenses during each reporting period. We continually evaluate these estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and reasonable assumptions, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ materially from those estimates.

We believe that any reasonable deviation from those judgments and estimates would not have a material impact on our financial condition or results of operations. To the extent that the estimates used differ from actual results, however, adjustments to the statement of operations and corresponding balance sheet accounts would be necessary. These adjustments would be made in future financial statements.

When reading our financial statements, you should consider: (i) our critical accounting policies; (ii) the judgment and other uncertainties affecting the application of such policies; and (iii) the sensitivity of reported results to changes in conditions and assumptions. The critical accounting policies and related judgments and estimates used to prepare our financial statements are identified in Note 2 to our consolidated financial statements accompanying in this report. We have not made any material changes in the methodology used in our accounting policies

## Results of Operations

Comparison of years ended March 31, 2013 and 2012

The following table summarizes our results of operations for the years ended March 31, 2013 and 2012:

|  | Years Ended March 31, |                             |      |  |               |                             |      |  |
|--|-----------------------|-----------------------------|------|--|---------------|-----------------------------|------|--|
|  | 2013                  |                             | 2012 |  | 2013          |                             | 2012 |  |
|  | Amount                | Percentage of total revenue |      |  | Amount        | Percentage of total revenue |      |  |
| Revenues   | \$ 89,495,546         | 100.0 %                     |      |  | \$ 94,352,885 | 100.0 %                     |      |  |
| Gross Profit   | \$ 14,634,993         | 16.4 %                      |      |  | \$ 27,562,801 | 29.2 %                      |      |  |
| Selling Expenses                                       | \$ 12,216,984         | 13.7 %                      |      |  | \$ 8,498,240  | 9.0 %                       |      |  |
| General and Administrative Expenses                    | \$ 15,000,364         | 16.8 %                      |      |  | \$ 8,582,389  | 9.1 %                       |      |  |
| Goodwill Impairment Loss                               | \$ 1,473,606          | 1.6 %                       |      |  | \$ -          | -                           |      |  |
| (Loss) Income from Operations                          | \$ (14,055,961)       | (15.7 )%                    |      |  | \$ 10,482,172 | 11.1 %                      |      |  |
| Other Income (Expense)                                 | \$ 56,428             | 0.1 %                       |      |  | \$ 187,865    | 0.2 %                       |      |  |
| Changes in Fair Value of Purchase Option               |                       |                             |      |  |               |                             |      |  |
| Derivative Liability                                   | \$ 18,810             | 0.0 %                       |      |  | \$ 118,807    | 0.1 %                       |      |  |
| Income Tax Expenses                                    | \$ 353,802            | 0.4 %                       |      |  | \$ 2,648,365  | 2.8 %                       |      |  |
| Net (loss) income attributable to controlling interest | \$ (14,334,525)       | (16.0 )%                    |      |  | \$ 8,141,626  | 8.6 %                       |      |  |
| Net (loss) attributable to noncontrolling interest     | (794 )                | (0.0 )%                     |      |  | (1,147 )      | (0.0 )%                     |      |  |

## Revenue.

Revenue decreased by \$4,857,339 or 5.1% year over year, primarily due to a decrease in our retail business, despite the fast expansion of our wholesale business and the addition of our herb farming business:

- (1) Retail sales, which accounted for approximately 45.5% of total revenue for the year ended March 31, 2013, decreased by \$25,348,268 or 38.4% to \$40,726,080, due to price control on many popular prescription drugs and an increasingly competitive retail market. Our retail margin also fell from 33.0% to 24.4%. Same-store sales decreased by approximately \$22,489,343 or 36.2%, while new stores and online sales collectively contributed approximately \$3,165,271 in revenue. Our store count decreased to 51 as of March 31, 2013, from 61 a year ago. We do not expect same-store sales will recover quickly in the near future as the frequency of government-mandated price controls and the number of drugs subject thereto continue to increase.
- (2) Since inception, our wholesale business expanded rapidly through competitive pricing and represented 51.7% of total revenue for the year ended March 31, 2013, up from 26.0% a year ago. However, our wholesale margin is significantly lower than our other operating segments, and fell from 7.4% to 5.2%. Since our third fiscal quarter, we have ceased certain low margin sales and are focusing on profitability rather than sales volume, and our wholesale margin rose to over 10% in the fourth fiscal quarter. Because we have little access to lucrative sales channels such as hospitals, we have qualified as a first-tier distributor with only a limited number of vendors thus far. Until we are able to achieve first-tier distributor status with more vendors, we do not expect our wholesale business to significantly expand in the immediate future.

- (3) Sales from our herb farming business accounted for \$2,534,380 or approximately 2.8% of our total revenue for the year ended March 31, 2013 as compared to \$4,217,574 a year ago. Our margin from this business is significant: 91.2% for fiscal 2013 and 94.9% for fiscal 2012. In fiscal 2013, we planted and harvested herbs based on our best estimate as to future market demands. We anticipate that we will continue doing so in upcoming fiscal year, but do not expect a significant increase from fiscal 2013 in terms of revenue or gross profit.

## Revenue by Segment.

The following table breaks down the revenue for our three business segments for the years ended March 31, 2013 and 2012:

|                                    | Years ended December 31, |                    |   | 2012         |                    |   | Variance by amount | % of change |    |
|------------------------------------|--------------------------|--------------------|---|--------------|--------------------|---|--------------------|-------------|----|
|                                    | 2013                     | % of total revenue |   | Amount       | % of total revenue |   |                    |             |    |
| Amount                             |                          |                    |   |              |                    |   |                    |             |    |
| Revenue from retail business       |                          |                    |   |              |                    |   |                    |             |    |
| Revenue from drugstores            | \$37,678,835             | 42.1               | % | \$64,981,643 | 69                 | % | \$(27,302,808)     | (42.0)      | )% |
| Revenue from online sales          | 3,047,245                | 3.4                | % | 1,092,705    | 1                  | % | 1,954,540          | 178.9       | %  |
| Sub-total of retail revenue        | 40,726,080               | 45.5               | % | 66,074,348   | 70                 | % | (25,348,268)       | (38.4)      | )% |
| Revenue from wholesale business    | 46,235,086               | 51.7               | % | 24,060,963   | 26                 | % | 22,174,123         | 92.2        | %  |
| Revenue from herb farming business | 2,534,380                | 2.8                | % | 4,217,574    | 4                  | % | (1,683,194 )       | (39.9)      | )% |
| Total revenue                      | \$89,495,546             | 100                | % | \$94,352,885 | 100.0              | % | \$(4,857,339 )     | (5.1)       | )% |

The revenue fluctuation year over year reflected the following combined factors:

- (1) Drugstore revenue decreased by approximately \$27.3 million or 42.0% year over year, primarily due to three factors. Local government has been controlling the cost of its insurance programs by reducing the number and types of subsidized drugs. In addition, as more drugs are subject to price control, we must either reduce our prices accordingly or stop carrying the affected drugs. The retail drug market in Hangzhou, where our stores are still predominantly located, has also become very competitive with many neighborhood drugstores opening. Accordingly, we do not expect our retail sales to recover quickly in the near future.
- (2) The growth in wholesale revenue is a reflection of our volume-driven strategy during the first half of fiscal 2013. Sales during that period amounted to approximately \$37,535,949, or 81.2% of total wholesale revenue. Starting in the third quarter of fiscal 2013, however, we have halted efforts to achieve sales volume through low margin sales and are focusing on profitability. Wholesale revenue for fiscal 2012 was also less because we only had eight months of wholesale operation, as Jiuxin Medicine was acquired in August 2011.
- (3) Online sales increased by \$1,954,540 or 178.9% year over year, and we expect the business to grow as we gain wider consumer awareness through our continuing cooperation with business-to-consumer online vendors such as Taobao.

## Gross Profit.

Gross profit decreased by \$12,927,808 or 46.9% year over year from substantial decline in retail sales. Gross margin also decreased, from 29.2% to 16.4%, as a result of lower retail and wholesale profit margins. The average gross margin for each of our three business segments for the years ended March 31, 2013 and 2012 are as follows:

|                       | Years ended<br>March 31, |       |
|-----------------------|--------------------------|-------|
|                       | 2013                     | 2012  |
| Retail business       | 24.4%                    | 33.0% |
| Wholesale business    | 5.2%                     | 7.4%  |
| Herb farming business | 91.2%                    | 94.9% |

Retail gross margin decreased primarily due to price adjustments we were forced to make. Some adjustments were made to comply with government price controls. Others were made to stay competitive with local community hospitals that are able to sell near cost due to government subsidies. We also adjusted prices to match or beat other competitors. As a result, our overall retail gross profit margin decreased.

The first half of fiscal 2013 is responsible for the decrease in wholesale gross margin. As we were relying on very competitive prices to stimulate sales during that period, our profit margin from that period is only 3.0%. We ceased certain low profit margin wholesale business since then, and profit margin accordingly improved in the second half of fiscal 2013. Profit margin was over 10% in the fourth fiscal quarter.

The gross margin for our herb farming business is achieved through our ability to control quality through monitoring the cultivation process which, in turn, has enabled us to command good pricing. Provided that market demands remain robust, we expect profit margin to remain high even if we continue to sell our harvests to just the vendor that we have been selling to.

#### Selling and Marketing Expenses.

Sales and marketing expenses increased by \$3,718,744 or 43.8% year over year primarily due to promotional activities and advertising, as well as \$573,461 in year-end employee bonuses to retain talent and address labor cost inflation. Included in selling and marketing expense is one-time leasehold improvement impairment of \$275,805 and \$1,993,483 related to store closings and the termination of a new store project, respectively, and \$384,276 in amortization of leasehold improvement for Jiuxin Medicine. In fiscal 2013, we closed 17 stores and charged the residual value of store improvements (such as immovable store decoration) into expense. We also shut down construction for a new pharmacy and terminated the project when the scheduled paving for a nearby thoroughfare to the city center was suspended indefinitely by the Hangzhou government. As a result, we recorded a direct write-off of a construction-in-progress. Rental expense in fiscal 2013 was also \$273,599 more than in fiscal 2012 due to the booming Chinese real estate market. We expect our labor and rental cost will continue to rise in the future.

### General and Administrative Expenses.

General and administrative expenses increased by \$6,417,975 or 74.8% year over year. Such expenses as a percentage of our revenue increased to 16.8% from 9.1% for the same period a year ago. The increase in absolute dollars as well as a percentage of revenue mainly resulted from write-offs and allowances of bad debt, including \$846,094 of direct write-offs from government health insurance, as well as allowances from our wholesale operations, including \$4,700,924 related to accounts receivable and \$2,846,822 related to advances to suppliers. Because most aged receivables were reserved in fiscal 2013, we anticipate that general and administrative expenses should decrease in the future.

### Impairment of Goodwill.

During the year ended March 31, 2013, we recorded a goodwill impairment charge of \$1,473,606 previously recognized in connection with the acquisitions of Jiuxin Medicine and Shanghai Zhongxing. Such impairment was made after we estimated the fair value of each of these businesses and determined that the implied fair value was lower than the carrying value. Accordingly, we fully impaired goodwill by writing down goodwill of \$1,403,933 for Jiuxin Medicine and \$69,673 for Shanghai Zhongxing.

### Income (Loss) from Operations.

Income from operations decreased by \$24,538,133 year over year, resulting in operating loss of \$14,055,961 for the year ended March 31, 2013, as compared to operating income of \$10,482,172 a year ago. Operating margin for the fiscal years ended March 31, 2013 and 2012 was (25.1)% and 11.1%, respectively.

### Income Taxes.

Income tax expense decreased by \$2,294,563 year over year, as a result of our operating loss and an income tax waiver granted to Qianhong Agriculture.

### Net Loss.

For the fiscal year ended March 31, 2013, we recorded net loss of \$14,334,525. Included in net loss are bad debt allowances of \$7,615,067, bad debt write-offs of \$846,094, goodwill impairment of \$1,473,606, and a charge to expense of \$2,269,288 in leasehold improvement for our closed stores.

### Liquidity

#### Accounts receivable

Accounts receivable, which are unsecured, are stated at the amount we expect to collect. We continuously monitor collections and payments from our customers (our distributors) and maintain a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified. In fiscal 2013, the collections of certain accounts were delayed. To prepare for potential loss in such accounts, we made corresponding reserves.

Our accounts receivable aging was as follows for the periods described below:

|                                  | Retail     | Drug      | Herb    | Total  |
|----------------------------------|------------|-----------|---------|--------|
| From date of invoice to customer | drugstores | wholesale | farming | amount |

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|                                 |              |              |              |               |
|---------------------------------|--------------|--------------|--------------|---------------|
| 1- 3 months                     | \$ 4,724,698 | \$ 4,133,868 | \$ -         | \$ 8,858,566  |
| 4- 6 months                     | 293,117      | 1,362,800    | -            | 1,655,917     |
| 7- 9 months                     | 106,120      | 593,077      | -            | 699,197       |
| 10 - 12 months                  | -            | 515,057      | 2,154,925    | 2,669,982     |
| Over one year                   | 5,941        | 4,116,173    | 1,275        | 4,123,389     |
| Allowance for doubtful accounts | (86,946)     | (4,631,449)  | (309,848)    | (5,028,242)   |
| Total accounts receivable       | \$ 5,042,930 | \$ 6,089,526 | \$ 1,846,352 | \$ 12,978,808 |

Accounts receivable from our retail business mainly consists of reimbursements from government health insurance bureaus and commercial health insurance programs. Usually we collect our receivables within one to two months.

Accounts receivable from our drug wholesale business and herb farming business consist of receivables from our customers such as drug distributors. Usually we collect our receivable within six months. Our ability to collect is attributed to the steps that we take prior to extending credit to our customers as discussed above. If we are having difficulty collecting, we take the following steps: cease existing shipments to the customer, visit the customer to request payment on past due invoice, and if necessary, take legal recourse. If all of these steps are unsuccessful, management would then determine whether or not the receivable should be reserved or written off. The aggressive volume-driven sales strategy that Jiuxin Medicine initially pursued loosed certain customer credit policy such as background check. The lack of timely customer account reconciliation caused by several accounting staff rotations also impacted the collection for several wholesale accounts. To accommodate for potential loss in account receivable, we put up reserve for what we do not believe to be collectible, and most aged receivables were reserved in fiscal 2013. As discussed earlier, Jiuxin Medicine transitioned away from focusing on sales volume beginning in the second half of fiscal 2013, and we tightened our customer credit policy and strengthened monitoring of uncollected receivables. As a result, we do not expect a significant increase in bad debts going forward and believe the charge to these accounts is more than likely one-time in nature.

Subsequent to March 31, 2013 and through May 31, 2013, we collected \$3,967,458 in receivables relating to our drugstore business, \$1,766,982 relating to our wholesale business, and \$1,541,849 relating to our herb farming business.

#### Advances to suppliers

Advances to suppliers are mainly prepayments to secure certain products or services and favorable pricing. The aging of our advances to suppliers is as follows for the periods described below:

| From date of cash prepayment to customer | Retail<br>drugstores | Drug<br>wholesale | Herb<br>farming | Total<br>amount |
|--|----------------------|-------------------|-----------------|-----------------|
| 1- 3 months                              | \$ 57,815            | \$ 9,959,910      | \$ -            | \$ 10,017,725   |
| 4- 6 months                              | 18,516               | 4,193,702         | -               | 4,212,219       |
| 7- 9 months                              | 3,207                | 1,307,564         | 55,790          | 1,366,561       |
| 10 - 12 months                           | 759                  | 479,999           | -               | 480,758         |
| Over one year                            | -                    | 3,041,968         | -               | 3,041,968       |
| Allowance for doubtful accounts          | -                    | (3,596,197)       | -               | (3,596,197)     |
| Total advances to suppliers              | \$ 80,297            | \$ 15,386,947     | \$ 55,790       | \$ 15,523,034   |

Advances to suppliers for our retail business mainly consist of deposits and prepayments to contractors, which will be transferred into leasehold improvement once store construction is completed.

Advances to suppliers for our drug wholesale business consist of prepayments to our vendors such as drug manufacturers and other distributors. We typically receive products from vendors within three to six months after making prepayments. We continuously monitor delivery from and payments to our vendors and maintain a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified. If we are having difficulty receiving products from a vendor, we take the following steps: cease purchasing products from the vendor, ask for return of our prepayment promptly, and if necessary, take legal recourse. If all of these steps are unsuccessful, management would then determine whether or not the prepayments should be reserved or written off. To facilitate its initial expansion, Jiuxin Medicine made significant prepayments to certain vendors. Lack of timely supplier account reconciliation caused by several accounting staff rotations delayed the monitoring of such accounts. To accommodate potential loss in advances to suppliers, we made full reserve for all accounts over a year and 50% reserve for accounts over 10 months.



In summary, our cash flows for the periods indicated are as follows:

|   | Years ended<br>March 31 |                |
|---|-------------------------|----------------|
|   | 2013                    | 2012           |
| Net cash (used in) provided by operating activities | \$(313,339 )            | \$19,967,243   |
| Net cash used in investing activities               | \$(2,404,359)           | \$(14,862,667) |
| Net cash provided by (used in) financing activities | \$3,369,122             | \$(7,934,286 ) |

For the fiscal year ended March 31, 2013, net cash used in operating activities amounted to \$313,340, as opposed to net cash provided by operating activities of \$19,967,243 a year ago. The change is primarily due to decreased net income of \$21,905,161.

For the fiscal year ended March 31, 2013, net cash used in investing activities amounted to \$2,404,359 as opposed to net cash used in investing activities of \$14,892,667 a year ago. The decrease of \$12,458,308 was a result of decreased expenditures for leasehold improvements of \$4,650,061, a decrease in equipment purchases of \$4,500,089, and a business acquisition made during fiscal 2012 of \$3,308,158.

Net cash provided by financing activities was \$3,369,122 for the fiscal year ended March 31, 2013, primarily from increase in notes payable of \$2,928,146 and restricted cash of \$675,380, as opposed to net cash used in financing activities of \$7,934,286 during the prior fiscal year as a result of a paydown of \$8,230,193 of notes payable.

As of March 31, 2013, we had cash of approximately \$4,524,094. Our total current assets as of March 31, 2013, were \$45,727,120 and our total current liabilities were \$29,674,803, which resulted in a net working capital of \$15,480,317.

#### Capital Resources

As reflected in our consolidated financial statements, we had net loss for the year ended March 31, 2013. Several factors contributed to such loss, such as bad debt expenses from our drug wholesale operation, reserving against advances to suppliers that will potentially not be utilized, increasing price controls and competitions that have continued to pressure our retail drugstore operation, as well as stricter insurance requirements that have tightened the buying habits of our drugstore customers. We have taken measures to address some of these challenges, such as closing 17 underperforming pharmacies and looking to open additional in-store clinics to drive customer traffic. We have also adjusted our wholesale strategy to favor profitability over immediate growth, even though we anticipate that this will lower our wholesale revenue in the near term.

Our principal sources of liquidity consist of existing cash on hand, bank facilities from local banks as well as personal loans from our principal shareholders, and such bank facilities and personal loans were significant sources of our funding during fiscal 2013. We have an agreement to borrow up to \$5.3 million from a local bank. Any borrowing therefrom is secured by our assets pursuant to a collateral agreement, as well as the personal guarantees of some of our principal shareholders. As of March 31, 2013, \$3.1 million remains available for future borrowing from such bank. Our good credit history with local banks may also enable us to obtain additional credit lines from the same banks or seek new loans from other banks if necessary. In addition, our CEO Mr. Lei Liu has agreed to provide the necessary financial support to meet our financial obligations in the event that we require additional liquidity.

We believe that the foregoing sources will collectively provide sufficient liquidity for us to meet our liquidity and capital obligations for the next twelve months.

#### Contractual Obligations and Off-Balance Sheet Arrangements

##### Contractual Obligations

When we open store locations, we typically enter into lease agreements that are generally between three to ten years. Our commitments for minimum rental payments under our leases for the next five years and thereafter are as follows:

| Years ending March 31, | Retail<br>drugstores | Drug<br>wholesale | Herb<br>farming | Total<br>amount |
|------------------------|----------------------|-------------------|-----------------|-----------------|
| 2014                   | \$ 3,078,343         | \$ 222,955        | \$ -            | \$ 3,301,298    |
| 2015                   | 1,346,835            | 251,881           | -               | 1,598,716       |
| 2016                   | 259,358              | 277,588           | -               | 536,946         |
| 2017                   | 214,565              | 283,253           | -               | 497,818         |
| 2018                   | 66,853               | 283,253           | -               | 350,106         |
| Thereafter             | 20,920               | 481,398           | -               | 502,318         |

##### Off-balance Sheet Arrangements

We do not have any outstanding financial guarantees or commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as stockholder's equity or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

##### Exchange Rates

Our subsidiaries and affiliated companies in the PRC maintain their books and records in RMB. In general, for consolidation purposes, we translate their assets and liabilities into USD using the applicable exchange rates prevailing at the balance sheet date, and the statement of income is translated at average exchange rates during the reporting period. Adjustments resulting from the translation of their financial statements are recorded as accumulated other comprehensive income.

The exchange rates used to translate amounts in RMB into USD for the purposes of preparing the consolidated financial statements or otherwise disclosed in this report were as follows:

|   | March 31,<br>2013      | March 31,<br>2012      |
|---|------------------------|------------------------|
| Balance sheet items, except for the<br>registered and paid-up capital, as of end of period/year           | USD1:<br>RMB<br>0.1594 | USD1:<br>RMB<br>0.1581 |
| Amounts included in the statement of<br>Operations and statement of cash flows for the period/ year ended | USD1:<br>RMB<br>0.1586 | USD1:<br>RMB<br>0.1561 |

No representation is made that RMB amounts have been, or would be, converted into USD at the above rates.

#### Inflation

We believe that inflation has not had a material effect on our operations to date.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our audited financial statements for the fiscal years ended March 31, 2013 and 2012, together with the report of the independent certified public accounting firm thereon and the notes thereto, are presented beginning at page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

I T E M CONTROLS AND PROCEDURES

9A.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of March 31, 2013, the end of the fiscal year covered by this report, our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934).

Based on the evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2013, our disclosure controls and procedures were ineffective at the reasonable assurance level. Such conclusion is due to the presence of material weakness in internal control over financial reporting as described below. Management anticipates that our disclosure controls and procedures will remain ineffective until such material weaknesses are remediated.

Management's Report on Internal Control over Financial Reporting

We are responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation, management concluded that our internal control over financial reporting was not effective as of March 31, 2013 due to the following material weaknesses:

Accounting and Finance Personnel Weaknesses - As noted in Item 9A of our annual reports on Form 10-K for the preceding three fiscal years, management concluded that in light of the inexperience of our accounting staff with respect to the requirements of U.S. GAAP-based reporting and SEC rules and regulations, we did not maintain effective controls and did not implement adequate and proper supervisory review to ensure that significant internal control deficiencies can be detected or prevented.

Management's assessment of the control deficiency over accounting and finance personnel as of March 31, 2013, considered the same factors, including:

the number of adjustments proposed by our independent auditors during our quarterly review and annual audit processes;  
the significance of the audit adjustments impact on the overall financial statements;  
how appropriately we complied with U.S. GAAP on transactions; and  
how accurately we prepared supporting information to provide to our independent auditors on a quarterly and annual basis.

Based on the above factors, management concluded that the control deficiency over accounting and finance personnel should continue to be a material weakness as of March 31, 2013, as our accounting staff continues to lack sufficient U.S. GAAP experience and requires further substantial training.

Subsequent to the fiscal year ended March 31, 2010, our management identified steps it believed were necessary to address the weaknesses described above. During the fiscal year ended March 31, 2011, we hired additional accounting staff, and during the fiscal year ended March 31, 2012, we engaged an outside consultant. We had expected to satisfactorily address such weaknesses by the end of our fiscal year ended March 31, 2013. Although we believe that we have made significant progress, our efforts to date have not yet been sufficient to fully remediate such weaknesses. As such, we will continue our efforts during the fiscal year ending March 31, 2014, although there can be no assurance that compliance will be achieved in this time frame.

This report does not include an attestation report of our independent registered accounting firm regarding internal control over financial reporting. The management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit the Company to provide only management's report in this report.

#### Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rule 13a-15 or Rule 15d-15 that occurred during the fourth quarter ended March 31, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Limitations on Controls

Management does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent or detect all errors and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

#### ITEM 9B. OTHER INFORMATION

None.

### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table identifies our current executive officers and directors as of the date of this report, their respective offices and positions, and their respective dates of election or appointment:

| Name        | Age | Position   | Date of Appointment |
|-------------|-----|--|---------------------|
| Lei Liu     | 48  | Chief Executive Officer and Chairman of the Board of Directors | September 17, 2009  |
| Ming Zhao   | 37  | Chief Financial Officer  | August 1, 2011      |
| Li Qi       | 40  | Secretary and Director   | October 23, 2009    |
| Yuehai Ke   | 41  | Director   | March 15, 2010      |
| Zhimin Su   | 36  | Director   | November 30, 2012   |
| Taihong Guo | 62  | Director   | January 1, 2013     |

#### Biographical Information of Our Current Directors and Executive Officers

Lei Liu is one of our three cofounders, and is the executive director of Jiuzhou Pharmacy, a general partner of Jiuzhou Clinic, and the supervising director of Jiuzhou Service. From December 1997 to August 2003, Mr. Liu worked as a general manager of Tai He Drugstore, which is not related to or affiliated with us. From September 1992 to November 1997, Mr. Liu was an administration official of Hangzhou Medical Junior College, his alma mater, where he was also a researcher and an anatomy instructor from September 1983 to July 1992. Mr. Liu has been a licensed researcher in the PRC since September 1988. As the founder responsible for our vision and direction, Mr. Liu is invaluable to us and our board of directors.

Ming Zhao is our chief financial officer. From September 2010 to July 2011, Mr. Zhao was a senior manager at CFO Oncall, Inc., a financial consulting firm providing CFO services to U.S.-listed, China-based publicly traded companies. Through CFO Oncall, Inc., Mr. Zhao had been consulting for us since January 2010. From December 2006 through August 2010, Mr. Zhao was a senior auditor at Sherb & Co., LLP. From January through June 2003, Mr. Zhao worked as a financial analyst at Microsoft Corporation. None of these companies is related to or affiliated with us. Mr. Zhao is a licensed certified public accountant. He graduated with a bachelor's degree in accounting from Central University of Finance and Economic in Beijing in July 1999, and obtained a master's degree in professional accounting from the University of Washington in December 2002.

Li Qi is one of our three cofounders and is currently the general manager of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, as well as a general partner of Jiuzhou Clinic. From January 2000 to June 2003, Ms. Qi worked as a general manager of Zhejiang Yikang Drugstore, which is not related or affiliated to us. From October 1991 to January 2000, Ms. Qi worked in the Branch Hospital of Hangzhou No. 1 People's Hospital as a nurse. Ms. Qi is a licensed TCM pharmacist in the PRC and is a 1991 graduate of Hangzhou Nurse School. As the founder overseeing our day-to-day corporate operations, Ms. Qi is invaluable to us and our board of directors.

Yuehai Ke is a professor of molecular genetics and cell signal transduction at the Department of Basic Medicine at Zhejiang University's School of Medicine since September 2007, where he also advises doctorate candidates. Dr. Ke graduated from Zhejiang University in 1995, where he majored in biochemistry. After graduation, Dr. Ke joined the Chinese Center for Disease Control and Prevention from September 1995 to July 1998. Dr. Ke obtained his master degree in medicine in 1998 from Fudan University, where he studied genetic disease of human multiple genes, and his doctorate degree in 2001 also from Fudan University. In 2000, Dr. Ke was an exchange student at the School of Public Health at the University of Texas in Houston. From February 2002 to September 2007, Dr. Ke studied cell signal transduction at the Cancer and Stem Cell Research Center of the Burnham Medical Research Institute in California. From September 2005 to September 2007, Dr. Ke was an associate professor at the Chinese Academy of Medical Sciences & Peking Union Medical College, focusing his research and studies on the application development of cell kinetics models and genetic analysis. Given Dr. Ke's academic stature and accomplishments, his presence on our board of directors enhances our Company reputation and image in the markets where we operate.

Zhimin Su has been a senior investment manager with Go Capital Limited, a private equity investment firm in Shanghai, since December 2010, performing due diligence and risk evaluation of potential industry-specific investments. From July 2009 to October 2010, Ms. Su was a senior analyst for Caitong Securities, a Chinese state-owned securities broker in Hangzhou, analyzing and researching companies in the tourism and media industries as well as the macro-economy and capital markets in the United States. From August 2007 to December 2008, Ms. Su was a senior financial analyst with The Los Angeles Times, Inc., conducting forecasts and budget reviews, and preparing financial plans, analyses and recommendations for senior management. None of these companies is related to or affiliated with the registrant. Ms. Su holds a master's degree in business administration from the University of Southern California, Marshall School of Business. She is a graduate of the Central University of Finance and Economics in Beijing with a bachelor's degree in economics. The Board has determined that Ms. Su should serve as a director given her extensive financial and accounting experience, as well as her English and Chinese bilingual capabilities to facilitate the Board's supervision of the management. In addition, the Board has determined that Ms. Su satisfies the requirements of an "audit committee financial expert," and has designated her chairperson of the audit committee in place of Mr. Serrio.

Taihong Guo has been the President of the Zhejiang Province Pharmaceutical Industry Association, which has over 300 local pharmaceutical enterprises as members, since December 2012, and serves as a bridge between its members and the Zhejiang Food and Drug Administration ("FDA"). He was previously the Chief of the Hangzhou FDA from January 2003 to September 2009, and an Inspector from September 2009 to June 2012. From February 2010 to January 2012, he also chaired the Board of Supervisors at three private companies in Hangzhou: Hangzhou Industrial Assets Management Co., Ltd., a state-owned asset management company, Hangzhou Qingcunbao Group Co., Ltd., a leading supplier of traditional Chinese medicine and nutritional supplements throughout China, and Hangzhou Information Technology Co., Ltd., a state-owned asset management focusing on technology companies. None of these companies is related to or affiliated with the registrant. Mr. Guo holds a bachelor degree in automotive designs from Jiangsu University (formerly Zhengjiang Nongji Institute), an associate degree in law from the Open University of China, Zhejiang Campus, and a bachelor degree in business management from the Central Party School. The Board has determined that Mr. Guo should serve as a director given his experience with and working knowledge of the Hangzhou FDA, as well as his considerable contacts within the pharmaceutical industry in Hangzhou.

#### Family Relationships

There are no family relationships between or among any of the current directors, executive officers or persons nominated or charged to become directors or executive officers. There are no family relationships among our officers and directors and those of our subsidiaries and affiliated companies.

#### Involvement in Certain Legal Proceedings



There are no orders, judgments, or decrees of any governmental agency or administrator, or of any court of competent jurisdiction, revoking or suspending for cause any license, permit or other authority to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining any of our officers or directors from engaging in or continuing any conduct, practice or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security, or any aspect of the securities business or of theft or of any felony. Nor are any of the officers or directors of any corporation or entity affiliated with us so enjoined.

#### Compliance with Section 16(a) of the Exchange Act

Based solely on review of the copies of such forms furnished to us, or written representations that no reports were required, we believe that for the fiscal year ended March 31, 2013, our directors, executive officers and holders of 10% or more of our common stock complied with Section 16(a) filing requirements applicable to them except as follows: the Form 5s filed on June 28, 2013, by Marc Thomas Serrio and Bennet P. Tchaikovsky, who resigned from the board of directors on November 30, 2012 and January 1, 2013, respectively, were not timely filed.

## The Board of Directors and Committees

We seek directors with established strong professional reputations and experience in areas relevant to the strategy and operations of our businesses. We also seek directors who possess the qualities of integrity and candor, who have strong analytical skills and who are willing to engage management and each other in a constructive and collaborative fashion. We also seek directors who have the ability and commitment to devote significant time and energy to service on the board and its committees. We believe that all of our directors meet the foregoing qualifications.

Based on the information submitted by Ms. Zhimin Su and Messrs. Yuehai Ke and Taihong Guo, our board of directors has determined that each of them is independent under Rule 5605(a)(2) of The NASDAQ Listing Rules.

Our board of directors has three committees. During the fiscal year ended March 31, 2013, our board of directors and its committees held the following number of meetings and took the following number of actions by unanimous written consent:

|                        | Meetings | Unanimous<br>written<br>consents |
|------------------------|----------|----------------------------------|
| Board of directors     | 4        | 4                                |
| Audit committee        | 1        | 1                                |
| Compensation committee | 1        | 1                                |
| Nominating committee   | 1        | 1                                |

### Audit Committee

Our audit committee operates under a written charter, and is composed of our three independent directors. Our board of directors has determined, based on information furnished by Ms. Zhimin Su and other available information, that she meets the requirements of an “audit committee financial expert” as such term is defined in the rules promulgated under the Securities Act and the Exchange Act, and has accordingly designated her as such as well as chairperson of the committee.

The responsibilities of our audit committee include:

- meeting with our management periodically to consider the adequacy of our internal control over financial reporting and the objectivity of our financial reporting;
- appointing the independent registered public accounting firm, determining the compensation of the independent registered public accounting firm and pre-approving the engagement of the independent registered public accounting firm for audit and non-audit services;
- overseeing the independent registered public accounting firm, including reviewing independence and quality control procedures and experience and qualifications of audit personnel that are providing us audit services;
- meeting with the independent registered public accounting firm and reviewing the scope and significant findings of the audits performed by them, and meeting with management and internal financial personnel regarding these matters; and
- reviewing our financing plans, the adequacy and sufficiency of our financial and accounting controls, practices and procedures, the activities and recommendations of the auditors and our reporting policies and practices, and reporting recommendations to our full board of directors for approval.

### Compensation Committee

Our compensation committee operates under a written charter, and is made up of our three independent directors. Dr. Yuehai Ke is chairperson of the committee. Our compensation committee will oversee and, as appropriate, making recommendations to the board of directors regarding the annual salaries and other compensation of our executive officers and our employees, and other policies, and provide assistance and recommendations with respect to our compensation policies and practices.

#### Nominating Committee

Our nominating committee operates under a written charter, and is made up of our three independent directors. Dr. Yuehai Ke is chairperson of the committee. Our compensation committee will assist in the selection of director nominees, approve director nominations to be presented for stockholder approval at our annual general meeting and fill any vacancies on our board of directors, consider any nominations of director candidates validly made by stockholders, and review and consider developments in corporate governance practices.

#### Code of Ethics

We have adopted a code of ethics that applies to our officers, directors and employees, including our chief executive officer, senior executive officers, principal accounting officer, and other senior financial officers. A copy of our code of ethics will also be provided to any person without charge, upon written request sent to us at our principal executive office.

## ITEM 11. EXECUTIVE COMPENSATION

## Summary of Compensation

The following summary compensation table indicates the cash and non-cash compensation earned during our fiscal years ended March 31, 2013 and 2012 by our principal executive officer and each of our other two highest paid executives.

| Summary Compensation Table         |                             |             |            |                      |                    |                                      |                                     |                             |            |
|------------------------------------|-----------------------------|-------------|------------|----------------------|--------------------|--------------------------------------|-------------------------------------|-----------------------------|------------|
| Name and Principal Position        | Fiscal Year ended March 31, | Salary (\$) | Bonus (\$) | Stock Awards (\$)(1) | Option Awards (\$) | Nonqualified Non-Equity Compensation |                                     |                             | Total (\$) |
|                                    |                             |             |            |                      |                    | Incentive Plan Compensation (\$)     | Deferred Compensation Earnings (\$) | All Other Compensation (\$) |            |
| Lei Liu, CEO (2)(3)                | 2012                        | 23,700      | -0-        | 1,776                | -0-                | -0-                                  | -0-                                 | -0-                         | 25,476     |
|                                    | 2013                        | 31,845      | -0-        | -0-                  | -0-                | -0-                                  | -0-                                 | -0-                         | 31,845     |
| Bennet Tchaikovsky, former CFO (4) | 2012                        | 25,000      | -0-        | 15,944               | -0-                | -0-                                  | -0-                                 | -0-                         | 40,944     |
|                                    | 2013                        | n/a         | n/a        | n/a                  | n/a                | n/a                                  | n/a                                 | n/a                         | n/a        |
| Ming Zhao, Current CFO (5)         | 2012                        | 66,000      | -0-        | 22,636               | -0-                | -0-                                  | -0-                                 | -0-                         | 88,636     |
|                                    | 2013                        | 100,000     | -0-        | 19,864               | -0-                | -0-                                  | -0-                                 | 0                           | 119,864    |
| Li Qi, Secretary (2)(6)            | 2012                        | 21,600      | -0-        | 1,534                | -0-                | -0-                                  | -0-                                 | -0-                         | 23,134     |
|                                    | 2013                        | 29,143      | -0-        | -0-                  | -0-                | -0-                                  | -0-                                 | -0-                         | 29,143     |

- (1) Reflects dollar amount expensed by the Company during the applicable fiscal year for financial statement reporting purposes.
- (2) Salary as reported is based on interbank exchange rate of RMB 6.3251 to \$1.00 on March 31, 2012, and RMB 6.3051 to \$1.00 on March 31, 2013.
- (3) Mr. Liu's compensation under "Stock Awards" for the fiscal year ended March 31, 2012, comes from the restricted stock award granted to him on January 16, 2012 under our 2010 Equity Incentive Plan (the "Plan").
- (4) Mr. Tchaikovsky's compensation for the fiscal year ended March 31, 2012, reflects compensation through his resignation as our CFO effective August 1, 2011, including the following shares issued to him under the Plan: 739 shares issued to him pursuant to the vesting schedule in a Loanout Agreement dated May 14, 2010, and 4,613 shares issued to him pursuant to a Restricted Stock Award Agreement dated August 1, 2011.
- (5) Mr. Zhao's compensation for the fiscal year ended March 31, 2012, reflects compensation since his appointment as our CFO effective August 1, 2011. Mr. Zhao's compensation under "Stock Awards" includes 13,315 shares issued to him during the fiscal year ended March 31, 2012, and 10,000 shares issued to him during the fiscal year ended March 31, 2013, under the Plan and pursuant to the vesting schedule in a Restricted Stock Award Agreement dated August 1, 2011.
- (6) Ms. Qi's compensation under "Stock Awards" for the fiscal year ended March 31, 2012, comes from the restricted stock award granted to her on January 16, 2012 under the Plan.

## Outstanding Equity Awards at Fiscal Year Ended March 31, 2013

| Name | Number of securities | Equity incentive | Option Awards    |                 | Option expiration | Number of | Market value | Stock Awards     |                  |
|------|----------------------|------------------|------------------|-----------------|-------------------|-----------|--------------|------------------|------------------|
|      |                      |                  | Equity incentive | Option exercise |                   |           |              | Equity incentive | Equity incentive |

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|                  | underlying<br>unexercised<br>options<br>exercisable | plan<br>awards:<br>number of<br>securities<br>underlying<br>unexercised<br>options<br>unexercisable | plan<br>awards:<br>number<br>of<br>securities<br>underlying<br>unexercised<br>options | price<br>(\$) | date | shares<br>or units<br>of stock<br>that<br>have<br>not<br>vested | of shares<br>or<br>units of<br>stock<br>that<br>have<br>not<br>vested<br>(\$) | plan<br>awards:<br>number of<br>unearned<br>shares,<br>units or<br>other<br>rights that<br>have not<br>vested | plan<br>awards:<br>market or<br>payout<br>value of<br>unearned<br>shares,<br>units or<br>other<br>rights<br>that have<br>not vested<br>(\$) |
|------------------|---|---|---|---------------|------|---|---|---|---|
| Lei Liu (1)      | –   | –   | –   | –             | –    | –   | –   | 22,000  | \$ 23,540   |
| Ming Zhao<br>(1) | –   | –   | –   | –             | –    | –   | –   | 8,000   | \$ 8,560  |
| Li Qi (1)        | –   | –   | –   | –             | –    | –   | –   | 19,000  | \$20,330  |

(1) The shares were granted pursuant to a Restricted Stock Award Agreement dated January 16, 2012, under the Plan. All of the shares will vest on January 16, 2015.

## Employment Agreements, Termination of Employment and Change-in-Control Arrangements

Except as described below, we currently have no employment agreements with any of our executive officers, nor any compensatory plans or arrangements resulting from the resignation, retirement or any other termination of any of our executive officers, from a change-in-control, or from a change in any executive officer's responsibilities following a change-in-control.

## Agreements with Ming Zhao

We entered into an employment agreement with Mr. Zhao dated as of August 1, 2011, under which Mr. Zhao is serving as our chief financial officer for a term of two years commencing August 1, 2011, for annual compensation of \$100,000, payable in monthly installments, as well as a one-time grant of 40,000 shares of our common stock (the "Shares") under our 2010 Equity Incentive Plan. Mr. Zhao is also entitled to expense reimbursement and to be included as an insured under our directors and officers insurance policy with coverage of \$5,000,000. During his employment, Mr. Zhao is subject to certain restrictive covenants, including (i) prohibition against engaging in any work that competes with us and our business and soliciting our customers, potential customers and employees, and (ii) requirement to maintain our confidential information.

Mr. Zhao's employment agreement terminates upon his death or disability. If Mr. Zhao is unable to perform his duties for 60 days during any 12-month period, we may also terminate the employment agreement upon 30-day written notice. We may also terminate the employment agreement for cause, upon notice if at any time Mr. Zhao commits (a) fraudulent, unlawful or grossly negligent conduct in connection with his employment duties; (b) willfully misconduct; (c) willful and continued failure to perform his duties; (d) any felony or any crime involving moral turpitude; (e) violation of any of our material policy; or (f) any material breach of any written agreement with us. Mr. Zhao may terminate his employment agreement immediately upon written notice if we breach our agreement with him.

In connection with the Shares, we entered into a restricted stock award agreement with Mr. Zhao dated as of August 1, 2011, under which the Shares would vest in eight equal quarterly installments on the first day of each quarter commencing on August 1, 2011. In the event we terminate Mr. Zhao's employment for cause, any unvested portion of the Shares at the time of termination would be automatically forfeited. We also have the option to purchase any Shares that Mr. Zhao offers to sell prior to the 91st day from the termination of his employment, provided that if we do not purchase any or all of such Shares within 30 days upon notice of offer, Mr. Zhao may sell such Shares in any lawful manner at no lower price or upon no more favorable terms than those offered to the us. In November 2012, Mr. Zhao agreed to forfeit his right to the last three installments of the Shares.

## Director Compensation

The following table provides compensation information for our directors during the fiscal year ended March 31, 2013:

Director Compensation Table

| Name        | Fiscal Year ended March 31, | Fees Earned or Paid in Cash (\$) | Stock Awards (\$)(1) | Option Awards (\$) | Non-Equity Incentive Plan Compensation (\$) | Nonqualified Deferred Compensation Earnings (\$) | All Other Compensation (\$) | Total (\$) |
|-------------|-----------------------------|----------------------------------|----------------------|--------------------|---|--|-----------------------------|------------|
| Lei Liu (2) | 2013                        | -0-                              | -0-                  | -0-                | -0-   | -0-  | -0-                         | -0-        |
| Li Qi (2)   | 2013                        | -0-                              | -0-                  | -0-                | -0-   | -0-  | -0-                         | -0-        |
|             | 2013                        | -0-                              | -0-                  | -0-                | -0-   | -0-  | -0-                         | -0-        |

|                                  |      |        |        |     |     |     |     |        |
|----------------------------------|------|--------|--------|-----|-----|-----|-----|--------|
| Chong'an Jin<br>(3) (6)          |      |        |        |     |     |     |     |        |
| Marc Thomas<br>Serrio (4)        | 2013 | -0-    | 22,099 | -0- | -0- | -0- | -0- | 22,099 |
| Bennet<br>Tchaikovsky<br>(5) (6) | 2013 | 22,500 | 3,343  | -0- | -0- | -0- | -0- | 25,843 |
| Bowen Zhao<br>(6)                | 2013 | -0-    | -0-    | -0- | -0- | -0- | -0- | -0-    |
| Yuehai Ke                        | 2013 | -0-    | -0-    | -0- | -0- | -0- | -0- | -0-    |
| Shuizhen Wu<br>(6)               | 2013 | -0-    | -0-    | -0- | -0- | -0- | -0- | -0-    |
| Xiaomeng Yu<br>(6)               | 2013 | -0-    | -0-    | -0- | -0- | -0- | -0- | -0-    |
| Zhimin Su                        | 2013 | 4,333  | -0-    | -0- | -0- | -0- | -0- | 4,333  |
| Taihong Guo                      | 2013 | 1,500  | -0-    | -0- | -0- | -0- | -0- | 1,500  |

(1) Reflects dollar amount expensed by the Company during the applicable fiscal year for financial statement reporting purposes.

(2) Compensation is reflected in the Summary Compensation Table on page 49 above.

(3) Mr. Jin's compensation under "Stock Awards" comes from the restricted stock award granted to him on January 16, 2012 under the Plan.

(4) Mr. Serrio's compensation under "Stock Awards" represents 23,638 shares issued to him in connection with his director offer letter dated March 15, 2010, and continued on March 15, 2012. Mr. Serrio resigned on November 30, 2012.

(5) Mr. Tchaikovsky was appointed to the board of directors on August 1, 2011. His compensation under “Stock Awards” represents 1,471 shares issued to him as of March 31, 2013, under the Plan.

(6) Resigned on January 1, 2013.

We do not currently have an established policy to provide compensation to members of our board of directors for their services in that capacity, although we have entered into certain agreements with a director as described below. We intend to develop such a policy in the near future.

#### Agreement with Zhimin Su

On November 30, 2012, we entered into an agreement with Ms. Su in the form of a director offer letter, pursuant to which we have agreed to compensate her \$13,000 annually for her services, payable in monthly installments on the last day of each month. Additionally, she is entitled to be included as an insured under our directors and officers insurance policy.

#### Agreement with Taihong Guo

On January 1, 2013, we entered into an agreement with Mr. Guo in the form of a director offer letter, pursuant to which we have agreed to compensate him \$6,000 annually for his services, payable in monthly installments on the last day of each month. Additionally, he is entitled to be included as an insured under our directors and officers insurance policy.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

### Equity Compensation Plan Information

| Plan Category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans |
|--|---|---|--|
| Equity compensation plans approved by security holders     | 323,897   | 4.98  | 1,701,103  |
| Equity compensation plans not approved by security holders | —   | —   | —  |
| <b>TOTAL</b>   | <b>323,897</b>  | <b>4.98</b>   | <b>1,701,103</b>   |

On September 21, 2010, our board of directors approved a stock incentive plan for officers, directors, employees, and consultants entitled “China Jo-Jo Drugstores, Inc. 2010 Equity Incentive Plan” (the “Plan”). The maximum number of shares that may be issued under the Plan is 2,025,000 shares of our common stock. The Plan was approved by our shareholders at our annual meeting held on November 2, 2010. Under the Plan, the Company may issue common stock and/or options to purchase common stock to our officers, directors, employees and consultants. The Plan is administered either by our board of directors or a committee that it designates comprising of at least two “non-employee” directors. The board (or the committee if one is designated) has full and complete authority, in its discretion, but subject to the express provisions of the Plan, to grant awards, to determine the number of awards to be granted and the time or times at which awards shall be granted; to establish the terms and conditions upon which



awards may be exercised; to remove or adjust any restrictions and conditions upon awards; to specify, at the time of grant, provisions relating to exercisability of awards and to accelerate or otherwise modify the exercisability of any awards; and to adopt such rules and regulations and to make all other determinations deemed necessary or desirable for the administration of the Plan. As of March 31, 2013, there were 1,701,103 shares of our common stock remaining available for future issuance under the Plan.

## Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding our common stock beneficially owned on June 20, 2013, for (i) each stockholder known to be the beneficial owner of 5% or more of our outstanding common stock, (ii) each executive officer and director, and (iii) all executive officers and directors as a group. To the best of our knowledge, subject to community and marital property laws, all persons named have sole voting and investment power with respect to such shares, except as otherwise noted.

## Common Stock Beneficially Owned

|   | Number of<br>Shares<br>beneficially<br>owned (2) | Percentage of<br>class beneficially<br>owned (3) |   |
|---|--|--|---|
| Executive officers and directors: (1)                                       |  |  |   |
| Lei Liu, chief executive officer and chairman of the board of directors (4) | 6,030,000  | 44.31  | % |
| Ming Zhao, chief financial officer  | 31,000   | *  |   |
| Li Qi, Secretary and Director (4)   | 6,030,000  | 44.31  | % |
| Yuehai Ke (5)   | 0  | 0  | % |
| Zhimin Su (6)   | 0  | 0  | % |
| Taihong Guo (7)   | 0  | 0  | % |
| All directors and executive officers as a group (6 persons)                 | 6,056,000  | 44.54  | % |
| 5% Shareholders: (1)  |  |  |   |
| Super Marvel Limited (4)  | 6,030,000  | 44.31  | % |
| Chong'an Jin (4)  | 6,030,000  | 44.31  | % |

\* Less than 1%.

- (1) Unless otherwise noted, the address for each of the named beneficial owners is: Room 507-513, 5th Floor, A Building, Meidu Plaza, Gongshu District, Hangzhou, Zhejiang Province, China.
- (2) Under Rule 13d-3, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (i) voting power, which includes the power to vote, or to direct the voting of shares; and (ii) investment power, which includes the power to dispose or direct the disposition of shares. Certain shares may be deemed to be beneficially owned by more than one person (if, for example, persons share the power to vote or the power to dispose of the shares). In addition, shares are deemed to be beneficially owned by a person if the person has the right to acquire the shares (for example, upon exercise of an option) within 60 days of the date as of which the information is provided. In computing the percentage ownership of any person, the amount of shares outstanding is deemed to include the amount of shares beneficially owned by such person (and only such person) by reason of these acquisition rights. As a result, the percentage of outstanding shares of any person as shown in this table does not necessarily reflect the person's actual ownership or voting power with respect to the number of shares of common stock actually outstanding.
- (3) Unless otherwise noted, the number and percentage of outstanding shares of common stock is based upon 13,609,002 shares outstanding as of June 20, 2013.
- (4) The address of Super Marvel Limited ("Super Marvel") is P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands. The owners of Super Marvel are Mr. Liu (39%), Ms. Qi (30%) and Mr. Jin (31%). Mr. Liu is also its executive directors, and Ms. Qi and Mr. Jin are each a director. The numbers of shares of common stock reported herein as beneficially owned by Ms. Qi Messrs. Liu and Jin are held by Super Marvel, which they in turn own indirectly through their respective ownership of Super Marvel.
- (5) Mr. Ke's address is: 388 Yuhangtang Road, Hangzhou, China 310058.
- (6) Ms. Su's address is: 3601B The Center, Changle Road, Xuhui District, Shanghai, China.

(7) Mr. Guo's address is: 7th Floor, Qingchunbao Group, No. 555 Xixi Road, Hangzhou, China.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

##### Our Officers and Directors' Relationship with Us, Our Subsidiaries and VIE

As described in "Business – Our Corporate History and Structure" above, we control HJ Group through contractual arrangements between Jiuxin Management, our wholly-owned subsidiary, and each of Jiuzhou Pharmacy, Jiuzhou Medical and Jiuzhou Clinic. HJ Group is owned by our three cofounders, two of whom also hold positions as our executive officers and/or directors. Because the three cofounders also collectively own a substantial amount of our issued and outstanding common stock, we believe that our interests are aligned with those of HJ Group and our cofounders. However, see "Risk Factors – Risks Related to Our Corporate Structure – Our contractual arrangements with HJ Group and our cofounders may not be as effective in providing control over these entities as direct ownership," and "Management members of HJ Group have potential conflicts of interest with us, which may adversely affect our business and your ability for recourse."

## Other Related Party Transactions

Set forth below are our related party transactions since April 1, 2011:

|                        | March 31,<br>2013 | March 31,<br>2012 |
|------------------------|-------------------|-------------------|
| Due to cofounders (1): | \$ 576,818        | \$ 880,058        |
| Due to director (2):   | 647,599           | 578,383           |
| Total                  | \$ 1,224,417      | \$ 1,458,441      |

- (1) As of March 31, 2013 and 2012, amount due to cofounders represents contributions from our three founders to Jiuxin Management to enable Jiuxin Management to meet its approved PRC registered capital requirements. Such contributions are to be returned to the directors upon demand.
- (2) Due to banking restriction on foreign exchange transactions, Mr. Lei Liu personally lent U.S. dollars to the Company to facilitate its payments of expenses in the United States.

We also lease our corporate office and a retail space from Mr. Liu under long-term operating lease agreements until December 2013 and August 2014, respectively. For the fiscal years ended March 31, 2013 and 2012, \$0 and \$187,320 was paid to Mr. Liu for such leases, respectively.

## ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Our current principal independent auditor is Friedman, LLP ("Friedman"), whom we engaged on April 19, 2011. The following table shows the fees for audit and other services provided by Friedman in relation to our 2013 and 2012 fiscal years:

|                        | For the Fiscal Years<br>ended<br>March 31, |           |
|------------------------|--|-----------|
|                        | 2013                                       | 2012      |
| Audit Fees (1)         | \$210,000                                  | \$265,000 |
| Audit-related Fees (2) | 15,000                                     | 15,000    |
| Tax Fees (3)           | -  | -         |
| All Other Fees (4)     | -  | -         |
| Total                  | \$225,000                                  | \$280,000 |

- (1) Audit Fees – This category includes the audit of our annual financial statements, review of financial statements included in our Quarterly Reports on Form 10-Q, and services that are normally provided by independent auditors in connection with statutory and regulatory filings or the engagement for fiscal years. This category also includes advice on audit and accounting matters that arose during, or as a result of, the audit or the review of interim financial statements.
- (2) Audit-Related Fees – This category consists of assurance and related services by our independent auditors that are reasonably related to the performance of the audit or review of our financial statements and are not reported above under "Audit Fees." The services for the fees disclosed under this category include consultation regarding our correspondence with the SEC.

(3)

Tax Fees – This category consists of professional services rendered by our independent auditors for tax compliance and tax advice. The services for the fees disclosed under this category include tax return preparation and technical tax advice.

(4) All Other Fees – This category consists of fees for other miscellaneous items.

#### Pre-Approval Policies and Procedures of the Board of Directors

Our board of directors approved the engagement of our independent auditors for 2012. Our audit committee approved the engagement of our independent auditors for 2013, and also pre-approved all audit and non-audit expenses.

### PART IV

#### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

##### (1) Financial Statements

The following consolidated financial statements for the years ended March 31, 2013 and 2012 are included in Part II, Item 8 of this Report:

|   |     |
|---|-----|
| Reports of Independent Registered Public Accounting Firms   | F-1 |
| Consolidated Balance Sheets at March 31, 2013 and 2012  | F-2 |
| Consolidated Statements of Operations and Comprehensive (Loss) Income for the Years Ended March 31, 2013 and 2012 | F-3 |
| Consolidated Statements of Stockholders' Equity for the Years Ended March 31, 2013 and 2012                       | F-4 |
| Consolidated Statements of Cash Flows for the Years Ended March 31, 2013 and 2012                                 | F-5 |
| Notes to Consolidated Financial Statements  | F-6 |

## (2) Financial Statement Schedules

Schedules are omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule or because the information required is given in the consolidated financial statements or the notes thereto.

## (3) Exhibits

## EXHIBIT INDEX

| Exhibit Number | Description   |
|----------------|---|
| 2              | Share Exchange Agreement among Kerrisdale Mining Corporation, certain of its stockholders, Renovation Investment (Hong Kong) Co., Ltd. and its shareholders dated September 17, 2009 (3)                      |
| 3.1            | Articles of Incorporation (1)   |
| 3.2            | Certificate of Amendment to Articles of Incorporation filed with the Nevada Secretary of State on July 14, 2008 (2)   |
| 3.3            | Articles of Merger filed with the Nevada Secretary of State on September 22, 2009 (3)   |
| 3.4            | Bylaws (1)  |
| 3.5            | Text of Amendments to the Bylaws (2)  |
| 3.6            | Certificate of Change Pursuant to NRS 78.209 with an effective date of April 9, 2010 (6)  |
| 4.1            | Specimen of Common Stock Certificate (1)  |
| 4.2            | 2010 Equity Incentive Plan (8)  |
| 10.1           | Consulting Services Agreement between Zhejiang Jiuxin Investment Management Co., Ltd. (“Jiuxin Management”) and Hangzhou Jiuzhou Grand Pharmacy Chain Co., Ltd. (“Jiuzhou Pharmacy”) dated August 1, 2009 (3) |
| 10.2           | Operating Agreement among Jiuxin Management, Jiuzhou Pharmacy and its owners dated August 1, 2009 (3)   |
| 10.3           | Equity Pledge Agreement among Jiuxin Management, Jiuzhou Pharmacy and its owners dated August 1, 2009 (3)   |
| 10.4           | Option Agreement among Jiuxin Management, Jiuzhou Pharmacy and its owners dated August 1, 2009 (3)  |
| 10.5           | Voting Rights Proxy Agreement among Jiuxin Management, Jiuzhou Pharmacy and its owners dated August 1, 2009 (3)   |
| 10.6           | Consulting Services Agreement between Jiuxin Management and Hangzhou Jiuzhou Clinic of Integrated Traditional and Western Medicine (General Partnership) (“Jiuzhou Clinic”) dated August 1, 2009 (3)          |
| 10.7           | Operating Agreement among Jiuxin Management, Jiuzhou Clinic and its owners dated August 1, 2009 (3)   |
| 10.8           | Equity Pledge Agreement among Jiuxin Management, Jiuzhou Clinic and its owners dated August 1, 2009 (3)   |
| 10.9           | Option Agreement among Jiuxin Management, Jiuzhou Clinic and its owners dated August 1, 2009 (3)  |
| 10.10          | Voting Rights Proxy Agreement among Jiuxin Management, Jiuzhou Clinic and its owners dated August 1, 2009 (3)   |
| 10.11          | Consulting Services Agreement between Jiuxin Management and Hangzhou Jiuzhou Medical & Public Health Service Co., Ltd. (“Jiuzhou Service”) dated August 1, 2009 (3)   |
| 10.12          | Operating Agreement among Jiuxin Management, Jiuzhou Service and its owners dated August 1, 2009 (3)  |
| 10.13          | Equity Pledge Agreement among Jiuxin Management, Jiuzhou Service and its owners dated August 1, 2009 (3)  |
| 10.14          | Option Agreement among Jiuxin Management, Jiuzhou Service and its owners dated August 1, 2009 (3)   |
| 10.15          | Voting Rights Proxy Agreement among Jiuxin Management, Jiuzhou Service and its owners dated August 1, 2009 (3)  |
| 10.16          |   |

|       |  |
|-------|--|
|       | Amendment to Consulting Services Agreement between Jiuxin Management and Jiuzhou Pharmacy dated October 27, 2009 (4)                               |
| 10.17 | Amendment to Operating Agreement between Jiuxin Management and Jiuzhou Pharmacy dated October 27, 2009 (4)   |
| 10.18 | Amendment to Option Agreement between Jiuxin Management and Jiuzhou Pharmacy dated October 27, 2009 (4)  |
| 10.19 | Amendment to Voting Rights Proxy Agreement between Jiuxin Management and Jiuzhou Pharmacy dated October 27, 2009 (4)                               |
| 10.20 | Amendment to Consulting Services Agreement between Jiuxin Management and Jiuzhou Clinic dated October 27, 2009 (4)                                 |
| 10.21 | Amendment to Operating Agreement between Jiuxin Management and Jiuzhou Clinic dated October 27, 2009 (4)   |
| 10.22 | Amendment to Option Agreement between Jiuxin Management and Jiuzhou Clinic dated October 27, 2009 (4)  |
| 10.23 | Amendment to Voting Rights Proxy Agreement between Jiuxin Management and Jiuzhou Clinic dated October 27, 2009 (4)                                 |
| 10.24 | Amendment to Consulting Services Agreement between Jiuxin Management and Jiuzhou Service dated October 27, 2009 (4)                                |
| 10.25 | Amendment to Operating Agreement between Jiuxin Management and Jiuzhou Service dated October 27, 2009 (4)  |
| 10.26 | Amendment to Option Agreement between Jiuxin Management and Jiuzhou Service dated October 27, 2009 (4)   |
| 10.27 | Amendment to Voting Rights Proxy Agreement between Jiuxin Management and Jiuzhou Service dated October 27, 2009 (4)                                |
| 10.28 | Consulting Services Agreement between Jiuxin Management and Zhejiang Jiuying Grand Pharmacy Co., Ltd. (“Jiuying Pharmacy”) dated May 15, 2012 (12) |
| 10.29 | Operating Agreement between Jiuxin Management and Jiuying Pharmacy dated May 15, 2012 (12)   |

|         |   |
|---------|---|
| 10.30   | Voting Rights Proxy Agreement between Jiuxin Management and Jiuying Pharmacy dated May 15, 2012 (12)  |
| 10.31   | Equity Pledge Agreement between Jiuxin Management and Jiuying Pharmacy dated May 15, 2012 (12)  |
| 10.32   | Option Agreement between Jiuxin Management and Jiuying Pharmacy dated May 15, 2012 (12)   |
| 10.33   | Employment Agreement with Ming Zhao dated August 1, 2011 (10)   |
| 10.34   | Restricted Stock Award Agreement with Ming Zhao dated August 1, 2011 (10)   |
| 10.35   | Director Offer Letter with Bennet P. Tchaikovsky dated August 1, 2011 (10)  |
| 10.36   | Restricted Stock Award Agreement with Bennet P. Tchaikovsky dated August 1, 2011 (10)   |
| 10.37   | Agreement with Worldwide Officers, Inc. ("Worldwide Officers") dated August 1, 2011 (10)  |
| 10.38   | Restricted Stock Award Agreement with Worldwide Officers dated August 1, 2011 (10)  |
| 10.39   | Director Offer Letter with Zhimin Su dated November 30, 2012 (13)   |
| 10.40   | Director Offer Letter with Taihong Guo dated January 1, 2013 (14)   |
| 10.41   | Consulting Services Agreement with Worldwide Officers dated January 1, 2013 (14)  |
| 14      | Code of Business Conduct and Ethics (5)   |
| 21      | List of subsidiaries *  |
| 23      | Consent of Independent Publicly Registered Accounting Firm, Friedman, LLP *   |
| 31.1    | Section 302 Certification by the Corporation's Chief Executive Officer *  |
| 31.2    | Section 302 Certification by the Corporation's Chief Financial Officer *  |
| 32.1    | Section 906 Certification by the Corporation's Chief Executive Officer *  |
| 32.2    | Section 906 Certification by the Corporation's Chief Financial Officer *  |
| 99.1    | Project Agreement between The People's Government of Qianhong Village, Lin'an, Zhejiang Province (the "Qianhong Local Government") and Jiuzhou Pharmacy dated February 27, 2010 (7) |
| 99.2    | Security Deposit Agreement between the Qianhong Local Government and Jiuzhou Pharmacy dated February 27, 2010 (7)   |
| 99.3    | Equity Interests Transfer Agreement dated April 15, 2011 (11)   |
| 99.4    | Supplemental Agreement to Equity Interests Transfer Agreement dated August 25, 2011 (11)  |
| 101.INS | XBRL Instance Document * **   |
| 101.SCH | XBRL Taxonomy Extension Scheme Document * **  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document * **  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document * **   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document * **  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document * **   |

\* Filed herewith

\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

- (1) Incorporated by reference from the registrant's Registration Statement on Form SB-2 filed on November 28, 2007
- (2) Incorporated by reference from the registrant's Current Report on Form 8-K filed on July 15, 2008
- (3) Incorporated by reference from the registrant's Current Report on Form 8-K filed on September 24, 2009
- (4) Incorporated by reference from the registrant's Current Report on Form 8-K filed on October 30, 2009
- (5) Incorporated by reference from the registrant's Current Report on Form 8-K filed on March 16, 2010
- (6) Incorporated by reference from the registrant's Current Report on Form 8-K filed on April 14, 2010
- (7) Incorporated by reference from the registrant's Annual Report on Form 10-K filed on June 29, 2010
- (8) Incorporated by reference from the registrant's Current Report on Form 8-K filed on November 3, 2010
- (9) Incorporated by reference from the registrant's Quarterly Report on Form 10-Q filed on February 14, 2011



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- (10) Incorporated by reference from the registrant's Current Report on Form 8-K filed on August 2, 2011
- (11) Incorporated by reference from the registrant's Current Report on Form 8-K filed on October 21, 2011
- (12) Incorporated by reference from the registrant's Current Report on Form 8-K filed on May 17, 2012
- (13) Incorporated by reference from the registrant's Current Report on Form 8-K filed on November 30, 2012
- (14) Incorporated by reference from the registrant's Current Report on Form 8-K filed on January 4, 2013

# SIGNATURES

Pursuant to the requirements of section 13 or 15(d) 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 JO-JO DRUGSTORES, INC.  
(Registrant)

By: /s/ Lei Liu  
Lei Liu  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Ming Zhao  
Ming Zhao  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

| Signature                      | Title                                | Date         |
|--------------------------------|--------------------------------------|--------------|
| /s/ Lei Liu<br>Lei Liu         | Chief Executive Officer and Director | July 1, 2013 |
| /s/ Ming Zhao<br>Ming Zhao     | Chief Financial Officer              | July 1, 2013 |
| /s/ Li Qi<br>Li Qi             | Secretary and Director               | July 1, 2013 |
| /s/ Taihong Guo<br>Taihong Guo | Director                             | July 1, 2013 |
| /s/ Yuehai Ke<br>Yuehai Ke     | Director                             | July 1, 2013 |
| /s/ Zhimin Su<br>Zhimin Su     | Director                             | July 1, 2013 |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
China Jo-Jo Drugstore, Inc. and subsidiaries

We have audited the accompanying consolidated balance sheets of China Jo-Jo Drugstore, Inc. and subsidiaries (the “Company”) as of March 31, 2013 and 2012, and the related consolidated statements of operations and comprehensive (loss) income, changes in stockholders’ equity, and cash flows for each of the two years in the periods ended March 31, 2013. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of March 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the two years in the periods ended March 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

/s/Friedman LLP

New York, New York  
July 1, 2013

CHINA JO-JO DRUGSTORES, INC AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

|  | March 31,<br>2013 | March 31,<br>2012 |
|--|-------------------|-------------------|
| <b>A S S E T S</b>   |                   |                   |
| <b>CURRENT ASSETS</b>  |                   |                   |
| Cash   | \$4,524,094       | \$3,833,216       |
| Restricted cash  | 2,162,837         | 2,818,449         |
| Trade accounts receivables, net  | 12,978,808        | 16,516,671        |
| Inventories  | 8,586,999         | 6,875,574         |
| Other receivables, net   | 157,849           | 603,294           |
| Advances to suppliers, net   | 15,523,034        | 14,347,557        |
| Other current assets   | 1,221,499         | 2,853,301         |
| Total current assets   | 45,155,120        | 47,848,062        |
| <b>PROPERTY AND EQUIPMENT, net</b>   | <b>13,288,652</b> | <b>15,647,120</b> |
| <b>OTHER ASSETS</b>  |                   |                   |
| Long term deposits   | 2,760,665         | 2,872,219         |
| Other noncurrent assets  | 5,431,326         | 5,776,667         |
| Intangible assets, net   | 1,202,258         | 2,816,945         |
| Total other assets   | 9,394,249         | 11,465,831        |
| Total assets   | \$67,838,021      | \$74,961,013      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                   |                   |
| <b>CURRENT LIABILITIES</b>   |                   |                   |
| Accounts payable, trade  | \$13,780,211      | \$13,906,383      |
| Notes payable  | 7,186,453         | 4,208,928         |
| Other payables   | 1,327,454         | 782,586           |
| Other payables - related parties   | 1,224,417         | 1,458,441         |
| Customer deposits  | 4,828,293         | 1,332,141         |
| Taxes payable  | 371,633           | 469,606           |
| Accrued liabilities  | 956,342           | 417,184           |
| Total current liabilities  | 29,674,803        | 22,575,269        |
| Purchase option derivative liability   | 15,609            | 34,419            |
| Total liabilities  | 29,690,412        | 22,609,688        |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |                   |                   |
| <b>STOCKHOLDERS' EQUITY</b>  |                   |                   |
| Preferred stock; \$0.001 par value; 10,000,000 shares authorized; nil issued and outstanding as of March 31, 2013 and 2012 | -                 | -                 |
|  | 13,609            | 13,589            |

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|   |              |              |
|---|--------------|--------------|
| Common stock; \$0.001 par value; 250,000,000 shares authorized; 13,609,002 and 13,589,621 shares issued and outstanding |              |              |
| Additional paid-in capital  | 16,609,747   | 16,853,039   |
| Statutory reserves  | 1,309,109    | 1,309,109    |
| Retained earnings   | 17,095,369   | 31,429,100   |
| Accumulated other comprehensive income  | 3,121,654    | 2,747,561    |
| Total stockholders' equity  | 38,149,488   | 52,352,398   |
|   |              |              |
| Noncontrolling interests  | (1,879 )     | (1,073 )     |
| Total equity  | 38,147,609   | 52,351,325   |
|   |              |              |
| Total liabilities and stockholders' equity  | \$67,838,021 | \$74,961,013 |

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

CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME

|  | For the years ended March<br>31, |              |
|--|----------------------------------|--------------|
|  | 2013                             | 2012         |
| REVENUES, NET  | \$89,495,546                     | \$94,352,885 |
| COST OF GOODS SOLD   | 74,860,553                       | 66,790,084   |
| GROSS PROFIT   | 14,634,993                       | 27,562,801   |
| SELLING EXPENSES   | 12,216,984                       | 8,498,240    |
| GENERAL AND ADMINISTRATIVE EXPENSES                            | 15,000,364                       | 8,582,389    |
| GOODWILL IMPAIRMENT LOSS                                       | 1,473,606                        | -            |
| TOTAL OPERATING EXPENSES                                       | 28,690,954                       | 17,080,629   |
| (LOSS) INCOME FROM OPERATIONS                                  | (14,055,961)                     | 10,482,172   |
| OTHER INCOME, NET  | 56,428                           | 187,865      |
| CHANGE IN FAIR VALUE OF PURCHASE OPTION DERIVATIVE LIABILITY   | 18,810                           | 118,807      |
| (LOSS) INCOME BEFORE INCOME TAXES                              | (13,980,723)                     | 10,788,844   |
| PROVISION FOR INCOME TAXES                                     | 353,802                          | 2,648,365    |
| NET (LOSS) INCOME  | (14,334,525)                     | 8,140,479    |
| ADD: NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTEREST          | 794                              | 1,147        |
| NET (LOSS) INCOME ATTRIBUTABLE TO CHINA JO-JO DRUGSTORES, INC. | (14,333,731)                     | 8,141,626    |
| OTHER COMPREHENSIVE INCOME                                     |                                  |              |
| Foreign currency translation adjustments                       | 374,093                          | 1,627,728    |
| COMPREHENSIVE (LOSS) INCOME                                    | \$(13,959,638)                   | \$9,769,354  |
| WEIGHTED AVERAGE NUMBER OF SHARES:                             |                                  |              |
| Basic  | 13,580,731                       | 13,568,481   |
| Diluted  | 13,580,731                       | 13,569,995   |
| EARNINGS PER SHARES:   |                                  |              |
| Basic  | \$(1.06)                         | ) \$0.60     |
| Diluted  | \$(1.06)                         | ) \$0.60     |

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



CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

|   | Common Stock        |           | Paid-in<br>capital | Retained Earnings     |               | Accumulated<br>other<br>comprehensive<br>income/(loss) | Noncontr<br>intere |
|---|---------------------|-----------|--------------------|-----------------------|---------------|--|--------------------|
|   | Number of<br>shares | Amount    |                    | Statutory<br>reserves | Unrestricted  |  |                    |
| BALANCE,<br>March 31, 2011                        | 13,530,477          | \$ 13,530 | \$ 16,333,956      | \$ 1,309,109          | \$ 23,287,474 | \$ 1,119,848   | \$                 |
| Cash injection<br>contributed by<br>shareholders  | -                   | -         | 406,546            | -                     | -             | -  |                    |
| Stock based<br>compensation                       | 59,144              | 59        | 118,993            | -                     | -             | -  |                    |
| Closing of<br>subsidiary<br>Kuaileren             | -                   | -         | (6,456)            | -                     | -             | -  |                    |
| Non-controlling<br>interest in<br>acquiree        | -                   | -         | -                  | -                     | -             | -  |                    |
| Net income  | -                   | -         | -                  | -                     | 8,141,626     | -  |                    |
| Foreign<br>currency<br>translation<br>gains       | -                   | -         | -                  | -                     | -             | 1,627,713  |                    |
| BALANCE,<br>March 31, 2012                        | 13,589,621          | \$ 13,589 | \$ 16,853,039      | \$ 1,309,109          | \$ 31,429,100 | \$ 2,747,561   | \$                 |
| Closing of VIE<br>Jiuying<br>Pharmacy             | -                   | -         | (406,546)          | -                     | -             | -  |                    |
| Stock based<br>compensation                       | 19,381              | 20        | 163,254            | -                     | -             | -  |                    |
| Net loss  | -                   | -         | -                  | -                     | (14,333,731)  | -  |                    |
| Foreign<br>currency<br>translation gain<br>(loss) | -                   | -         | -                  | -                     | -             | 374,093  |                    |
| BALANCE,<br>March 31, 2013                        | 13,609,002          | \$ 13,609 | \$ 16,609,747      | \$ 1,309,109          | 17,095,369    | \$ 3,121,654   | \$                 |

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



CHINA JO-JO DRUGSTORES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | For the years ended March 31, |              |
|---|-------------------------------|--------------|
|   | 2013                          | 2012         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                               |              |
| Net (loss) income   | \$ (14,334,525)               | \$ 8,140,479 |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:        |                               |              |
| Depreciation and amortization   | 2,764,144                     | 2,340,865    |
| Leasehold improvement impairment  | 2,269,288                     | -            |
| Stock compensation  | 163,274                       | 119,052      |
| Bad debt write-off and provision - trade accounts receivables, advance to suppliers and other receivables | 8,184,909                     | 1,669,864    |
| Goodwill Impairment   | 1,473,606                     | -            |
| Change in fair value of purchase option derivative liability  | (18,810)                      | (118,807)    |
| Change in operating assets:   |                               |              |
| Accounts receivable, trade  | (1,045,689)                   | (14,179,193) |
| Inventories   | (1,646,583)                   | 2,018,848    |
| Other receivables   | (503,613)                     | (372,660)    |
| Advances to suppliers   | (3,584,443)                   | 2,132,100    |
| Other current assets  | 1,646,935                     | 5,860,584    |
| Long term deposit   | 134,493                       | (238,630)    |
| Other noncurrent assets   | 390,869                       | 350,885      |
| Change in operating liabilities:  |                               |              |
| Accounts payable, trade   | (239,313)                     | 15,792,680   |
| Other payables and accrued liabilities  | 665,735                       | (1,626,827)  |
| Customer deposits   | 3,467,706                     | (768,651)    |
| Taxes payable   | (101,323)                     | (1,153,346)  |
| Net cash (used in) provided by operating activities   | (313,340)                     | 19,967,243   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                               |              |
| Purchase of equipment   | (415,152)                     | (4,915,241)  |
| Additions to leasehold improvements   | (1,989,207)                   | (6,639,268)  |
| Net payments for business acquisitions  | -                             | (3,308,158)  |
| Net cash used in investing activities   | (2,404,359)                   | (14,862,667) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                               |              |
| Change in restricted cash   | 675,380                       | (1,840,419)  |
| Change in notes payable   | 2,928,146                     | (7,077,596)  |
| Change in other payables-related parties  | (234,404)                     | 577,183      |
| Proceeds from shareholders contribution   | -                             | 406,546      |
| Net cash (used in) provided by financing activities   | 3,369,122                     | (7,934,286)  |
| EFFECT OF EXCHANGE RATE ON CASH   | 39,455                        | 173,021      |
| (DECREASE) INCREASE IN CASH   | 690,878                       | (2,656,689)  |
| CASH, beginning of year   | 3,833,216                     | 6,489,905    |

|                   |    |           |    |           |
|-------------------|----|-----------|----|-----------|
| CASH, end of year | \$ | 4,524,094 | \$ | 3,833,216 |
|-------------------|----|-----------|----|-----------|

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW  
INFORMATION:**

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Cash paid for income taxes                                      | \$ | 70,725    | \$ | 4,113,553 |
| Transfer from construction-in-progress to leasehold improvement | \$ | 2,707,183 | \$ | 2,890,399 |
| Non-cash financing activities                                   |    |           |    |           |
| Notes payable transferred to accounts payable vendors           | \$ | -         | \$ | 8,468,458 |

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

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CHINA JO-JO DRUGSTORES, INC., AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – DESCRIPTION OF BUSINESS AND ORGANIZATION

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

On September 17, 2009, the Company completed a share exchange transaction with Renovation Investment (Hong Kong) Co., Ltd. (“Renovation”), whereby 7,900,000 shares of common stock were issued to the stockholders of Renovation in exchange for 100% of the capital stock of Renovation. The completion of the share exchange transaction resulted in a change of control. The share exchange transaction was accounted for as a reverse acquisition and recapitalization and, as a result, the consolidated financial statements of the Company (the legal acquirer) is, in substance, those of Renovation (the accounting acquirer), with the assets and liabilities, and revenues and expenses, of the Company being included effective from the date of the share exchange transaction. Renovation has no substantive operations of its own except for its holdings of Zhejiang Jiuxin Investment Management Co., Ltd. (“Jiuxin Management”), Zhejiang Shouantang Medical Technology Co., Ltd. (“Shouantang Technology”) and Hangzhou Jiutong Medical Technology Co., Ltd (“Jiutong Medical”), its wholly-owned subsidiaries.

The Company is a retail and wholesale distributor of pharmaceutical and other healthcare products in the People’s Republic of China (“China” or the “PRC”). The Company’s retail business is comprised primarily of pharmacies, a majority of which are operated by Hangzhou Jiuzhou Grand Pharmacy Chain Co., Ltd. (“Jiuzhou Pharmacy”), a company that the Company controls through contractual arrangements. Shanghai Lydia Grand Pharmacy Co., Ltd. (“Shanghai Lydia”), a wholly-owned subsidiary of Jiuzhou Pharmacy, operates two store locations in Shanghai. On July 29, 2011, Shanghai Lydia obtained control of Shanghai Bieyanghong Zhongxing Grand Pharmacy Co. Ltd., which also operates one pharmacy in Shanghai, and which subsequently changed its name to Shanghai Lydia Zhongxing Grand Pharmacy Co., Ltd. (“Shanghai Zhongxing”). Shanghai Lydia has two additional subsidiaries, namely, Shanghai Lydia Trading Co., Ltd. (“Lydia Trading”), which operates one pharmacy in Shanghai, and Shanghai Lydia Zhenguang Grand Pharmacy Co., Ltd. (“Shanghai Zhenguang”), which operates another pharmacy in Shanghai. Five drugstores previously operated by Zhejiang Jiuying Grand Pharmacy Co., Ltd. (“Jiuying Pharmacy”) closed as of March 31, 2013, and Jiuying Pharmacy was dissolved on January 7, 2013. Prior to its dissolution, 39% and 10% of the equity interests of Jiuying Pharmacy were held by Shouantang Technology and Jiuxin Management, respectively, with the remaining 51% held by the three owners of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service (the “Owners”). One drugstore previously operated by Hangzhou Quannuo Grand Pharmacy Co., Ltd. (“Hangzhou Quannuo”) closed as of March 31, 2013. Hangzhou Quannuo is the wholly-owned subsidiary of Zhejiang Quannuo Internet Technology Co., Ltd. (“Quannuo Technology”), which is wholly-owned by Shouantang Technology. At March 31, 2013, Hangzhou Quannuo had not been dissolved but had no operation.

The Company’s retail business also includes two medical clinics through Hangzhou Jiuzhou Clinic of Integrated Traditional and Western Medicine (“Jiuzhou Clinic”) and Hangzhou Jiuzhou Medical and Public Health Service Co., Ltd. (“Jiuzhou Service”), both of which are also controlled by the Company through contractual arrangements.

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

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

herbal plants used for traditional Chinese medicine (“TCM”).

Tonglu Lydia Agriculture Development Co., Ltd. (“Tonglu Lydia”), a wholly-owned subsidiary of Shouantang Technology, was closed on August 1, 2012. Prior to its closure, Tonglu Lydia did not have any operations.

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

| Entity Name           | Background  | Ownership  |
|-----------------------|---|--|
| Renovation HK         | Incorporated in Hong Kong SAR on September 2, 2008  | 100%   |
| Jiuxin Management     | Established in the PRC on October 14, 2008<br>Deemed a wholly foreign owned enterprise (“WFOE”) under PRC law<br>Registered capital of \$4.5 million fully paid   | 100%   |
| Shouantang Technology | Established in the PRC on July 16, 2010 by Renovation with registered capital of \$20 million<br>Registered capital requirement reduced by the SAIC to \$11 million in July 2012 and is fully paid<br>Deemed a WFOE under PRC law<br>Invests and finances the working capital of Quannuo Technology | 100%   |
| Qianhong Agriculture  | Established in the PRC on August 10, 2010 by Jiuxin Management<br>Registered capital of RMB 10 million fully paid<br>Carries out cultivation of TCM herbal plants   | 100%   |
| Quannuo Technology    | Established in the PRC on July 7, 2009<br>Registered capital of RMB 10 million fully paid<br>Acquired by Shouantang Technology in November 2010<br>Operates the Company’s online pharmacy website and provide software and technical support  | 100%   |
| Hangzhou Quannuo      | Established in the PRC on July 8, 2010 by Quannuo Technology<br>Registered capital of RMB 800,000 fully paid<br>Currently has no operation  | 100%   |
| Jiuzhou Pharmacy (1)  | Established in the PRC on September 9, 2003<br>Registered capital of RMB 5 million fully paid<br>Operates the “Jiuzhou Grand Pharmacy” stores in Hangzhou   | VIE by contractual arrangements (2)  |
| Jiuzhou Clinic (1)    | Established in the PRC as a general partnership on October 10, 2003<br>Operates a medical clinic adjacent to one of Jiuzhou Pharmacy’s stores   | VIE by contractual arrangements (2)  |
| Jiuzhou Service (1)   | Established in the PRC on November 2, 2005<br>Registered capital of RMB 500,000 fully paid<br>Operates a medical clinic adjacent to one of Jiuzhou Pharmacy’s stores  | VIE by contractual arrangements (2)  |
| Shanghai Lydia        | Established in the PRC on January 31, 2011 by Jiuzhou Pharmacy<br>Registered capital of RMB 1 million fully paid<br>Operates the “Lydia Grand Pharmacy” and “Chaling Grand Pharmacy” stores in Shanghai   | VIE by contractual arrangements as a wholly-owned subsidiary of Jiuzhou Pharmacy (2) |

|  |  |
|--|--|
| <p> <b>Jiuxin Medicine</b><br/>                     Established in PRC on December 31, 2003<br/>                     Acquired by Jiuzhou Pharmacy in August 2011<br/>                     Registered capital of RMB 10 million fully paid<br/>                     Carries out pharmaceutical distribution services                 </p>   | <p>                     VIE by contractual arrangements as a wholly-owned subsidiary of Jiuzhou Pharmacy (2)                 </p>                  |
| <p> <b>Shanghai Zhongxing</b><br/>                     Established in PRC on June 19, 2006<br/>                     Registered capital of RMB 1 million fully paid<br/>                     99% acquired by Shanghai Lydia in July 2011<br/>                     Operates the “Zhongxing Grand Pharmacy” store in Shanghai                 </p>  | <p>                     VIE by contractual arrangements as a controlled entity of Jiuzhou Pharmacy through Shanghai Lydia (2)                 </p> |
| <p> <b>Jiutong Medical</b><br/>                     Established in the PRC on December 20, 2011 by Renovation with registered capital of \$5 million<br/>                     \$2 million of registered capital paid, and application to reduce the balance of \$3 million, originally due by December 20, 2012, submitted to local Administration of Industry and Commerce<br/>                     Currently has no operation                 </p> | <p>                     100%                 </p>  |
| <p> <b>Jiuying Pharmacy</b><br/>                     Established in the PRC on February 27, 2012 with registered capital of RMB 5 million fully paid<br/>                     Operated “Jiuying Grand Pharmacy” stores in Hangzhou , all of which were closed as of December 31, 2012<br/>                     Dissolved on January 7, 2013                 </p>   | <p>                     VIE by contractual arrangements (3)                 </p>   |

|                    |   |   |
|--------------------|---|---|
| Lydia Trading      | Established in the PRC on June 20, 2012 with registered capital of RMB 1 million fully paid<br>Operates one “Weifang Grand Pharmacy” store in Shanghai    | VIE by contractual arrangements as a wholly owned subsidiary of Jiuzhou Pharmacy through Shanghai Lydia (2) |
| Shanghai Zhenguang | Established in the PRC on October 31, 2012 with registered capital of RMB 500,000 fully paid<br>Operates the “Zhenguang Grand Pharmacy” store in Shanghai | VIE by contractual arrangements as a wholly owned subsidiary of Jiuzhou Pharmacy through Shanghai Lydia (2) |

- (1) Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service have been under the common control of the Owners since their respective establishment dates, pursuant to agreements amongst the Owners to vote their interests in concert as memorialized in a voting agreement. Based on such voting agreement, the Company has determined that common control exists among these three companies in accordance with generally accepted accounting standards. Operationally, the Owners have operated these three companies in conjunction with one another since each company’s respective establishment date. Shanghai Lydia, Shanghai Zhongxing and Jiuxin Medicine are also deemed under the common control of the Owners as they are each a subsidiary of Jiuzhou Pharmacy.
- (2) To comply with certain foreign ownership restrictions of pharmacy and medical clinic operators, Jiuxin Management entered into a series of contractual arrangements with Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service on August 1, 2009. These contractual arrangements are comprised of five agreements: consulting services agreement, operating agreement, equity pledge agreement, voting rights agreement and option agreement. As a result of these agreements, which obligate Jiuxin Management to absorb all of the risks of loss from the activities of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, and enable the Company (through Jiuxin Management) to receive all of their expected residual returns, the Company accounts for all three companies (as well as the two subsidiaries of Jiuzhou Pharmacy) as a variable interest entity (“VIE”) under the accounting standards of the Financial Accounting Standards Board (“FASB”). Accordingly, the financial statements of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, as well as the subsidiaries and entity under the control of Jiuzhou Pharmacy (Shanghai Lydia, Jiuxin Medicine, Shanghai Zhongxing, Leilian Trading and Shanghai Zhenguang), are consolidated into the financial statements of the Company.
- (3) To comply with foreign ownership restrictions, the Company held 49% of the equity interest (39% through Shouantang Technology and 10% through Jiuxin Management). The remaining 51% was held by the Owners but controlled by the Company through contractual arrangements between Jiuxin Management and Jiuying Pharmacy entered into on May 15, 2012. Such contractual arrangements are identical to those that Jiuxin Management entered into with Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service. As such, the Company also accounted for Jiuying Pharmacy prior to its dissolution as a VIE and consolidated its financial statements into those of the Company.

## Note 2 – LIQUIDITY

As reflected in the Company's consolidated financial statements, the Company had net loss and negative cash flow from operating activities for the year ended March 31, 2013. In assessing its liquidity, management monitors and analyzes the Company's cash on-hand, its ability to renew bank facilities, and its operating and capital expenditure commitments. Its principal liquidity needs are to meet its working capital requirements, operating expenses and capital expenditure obligations.

The Company's principal sources of liquidity consist of existing cash on hand, bank facilities from local banks as well as personal loans from its principal shareholders if necessary. The Company has a loan agreement to borrow up to \$3.5 million from a local bank. Any borrowing therefrom is secured by the Company's assets pursuant to a collateral agreement, as well as the personal guarantees of some of its principal shareholders. As of March 31, 2013, \$3.1 million remains available for future borrowing from such bank. In addition, a principal shareholder, Mr. Lei Liu, has agreed to provide necessary financial support to meet the Company's financial obligations in the event that it requires additional liquidity.

On the operating side, the Company plans to fund current operations by adjusting its wholesale business operations to focus on profitability rather than sales volume, closing underperforming pharmacies, and focusing on strengthening and expanding its core business model of integrating pharmacies with medical clinic services, which has proven to be a key profit driver. The Company also plans to control its general and administrative expenses by identifying and eliminating unnecessary administrative costs. Selling expenses and general and administrative expenses related to pharmacies and subsidiaries that were shut down in fiscal 2013 (such as Jiuying Pharmacy) are non-recurring in the forthcoming years.

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

## Note 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of presentation and consolidation

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The consolidated financial statements include the financial statements of the Company, its wholly-owned subsidiaries and VIEs. All significant inter-company transactions and balances between the Company, its subsidiaries and VIEs are eliminated upon consolidation.

### Consolidation of variable interest entities

In accordance with accounting standards regarding consolidation of variable interest entities, VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders lack adequate decision making ability. All VIEs with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. The primary beneficiary is required to consolidate the VIE for financial reporting purposes.



The Company has concluded, based on the contractual arrangements, that Jiuzhou Pharmacy (including its subsidiaries and controlled entities), Jiuzhou Clinic and Jiuzhou Service are each a VIE and that the Company's wholly-owned subsidiary, Jiuxin Management, absorbs a majority of the risk of loss from the activities of these companies, thereby enabling the Company, through Jiuxin Management, to receive a majority of their respective expected residual returns.

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

Control and common control is defined under the accounting standards as "an individual, enterprise, or immediate family members who hold more than 50 percent of the voting ownership interest of each entity." Because the Owners collectively own 100% of Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service, and have agreed to vote their interests in concert since the establishment of each of these three companies as memorialized the Voting Rights Proxy Agreement, the Company believes that the Owners collectively have control and common control of the three companies. Accordingly, the Company believes that Jiuzhou Pharmacy, Jiuzhou Clinic and Jiuzhou Service were constructively held under common control by Jiuxin Management as of the time the Contractual Agreements were entered into, establishing Jiuxin Management as their primary beneficiary. Jiuxin Management, in turn, is owned by Renovation, which is owned by the Company.

Although the Company has determined that the accounting standards regarding consolidation of VIEs do not provide for retroactive accounting treatment, each of Jiuzhou Pharmacy, Jiuzhou Clinic, Jiuzhou Service, and Jiuying Pharmacy was in substance controlled on its establishment date of September 9, 2003, October 10, 2003, November 2, 2005, and February 27, 2013, respectively, by the Owners. Such common control conditions resulted in the share exchange transaction to be a capital transaction in substance, reflected as a recapitalization, and the Company has accordingly recorded the consolidation at its historical cost.

#### Risks and Uncertainties

The operations of the Company are located in the PRC. Accordingly, the Company's business, financial condition, and results of operations may be influenced by the political, economic, and legal environments in the PRC, as well as by the general state of the PRC economy. The Company's operations in the PRC are subject to special considerations and significant risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, the political, economic and legal environment and foreign currency exchange. The Company's results may be adversely affected by changes in the political, regulatory and social conditions in the PRC, and by changes in governmental policies or interpretations with respect to laws and regulations, anti-inflationary measures, currency conversion, remittances abroad, and rates and methods of taxation, among other things.

The Company has significant cash deposits with suppliers in order to obtain and maintain inventory. The Company's ability to obtain products and maintain inventory at existing and new locations is dependent upon its ability to post and maintain significant cash deposits with its suppliers. In the PRC, many vendors are unwilling to extend credit terms for product sales that require cash deposits to be made. The Company does not generally receive interest on any of its supplier deposits, and such deposits are subject to loss as a result of the creditworthiness or bankruptcy of the party who holds such funds, as well as the risk from illegal acts such as conversion, fraud, theft or dishonesty associated with the third party. If these circumstances were to arise, the Company would find it difficult or impossible, due to the unpredictability of legal proceedings in China, to recover all or a portion of the amount on deposit with its vendors or landlords.

Members of the current management team own controlling interests in the Company and are also the Owners of the VIEs in the PRC. The Company only controls the VIEs through contractual arrangements which obligate it to absorb the risk of loss and to receive the residual expected returns. As such, the controlling shareholders of the Company and the VIEs could cancel these agreements or permit them to expire at the end of the agreement terms, as a result of which the Company would not retain control of the VIEs.

#### Use of estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The significant estimates made in the preparation of the accompanying consolidated financial statements relate primarily to the assessment of the carrying values of accounts receivable and advances to suppliers, and related allowance for doubtful accounts, useful lives of property and equipment as well as intangible assets, fair value of purchase option derivative liability and impairment of goodwill. Because of the use of estimates inherent in the financial reporting process, actual results could materially differ from those estimates.

## Intangibles including goodwill

Intangible assets are acquired individually or as part of a group of assets, and are initially recorded at their fair value. The cost of a group of assets acquired in a transaction is allocated to the individual assets based on their relative fair values.

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

|                      | Estimated Useful Life |
|----------------------|-----------------------|
| Goodwill             | Indefinite            |
| Licenses and permits | Indefinite            |
| Software             | 3 years               |

The Company evaluates intangible assets for impairment other than goodwill whenever events or changes in circumstances indicate that the assets might be impaired.

The Company evaluates goodwill and licenses and permits for impairment when a triggering event occurs (See Note 10).

## Revenue recognition

Revenue from sales of prescription medicine at the drugstores is recognized when the prescription is filled and the customer picks up and pays for the prescription.

Revenue from sales of other merchandise at the drugstores is recognized at the point of sale, which is when the customer pays for and receives the merchandise.

Revenue from medical services is recognized after the service has been rendered to the customer.

Revenue from sales of merchandise to non-retail customers is recognized when the following conditions are met: (1) persuasive evidence of an arrangement exists (sales agreements and customer purchase orders are used to determine the existence of an arrangement); (2) delivery of goods has occurred and risks and benefits of ownership have been transferred, which is when the goods are received by the customer at its designated location in accordance with the sales terms; (3) the sales price is fixed or determinable; and (4) collectability is probable. Historically, sales returns have been minimal.

The Company's revenue is net of value added tax ("VAT") collected on behalf of PRC tax authorities in respect to the sales of merchandise. VAT collected from customers, net of VAT paid for purchases, is recorded as a liability in the accompanying consolidated balance sheets until it is paid to the relevant PRC tax authorities.

## Restricted cash

The Company's restricted cash consists of cash in a bank as security for its notes payable. The Company has notes payable outstanding with the bank and is required to keep certain amounts on deposit that are subject to withdrawal restrictions. The notes payable are generally short term in nature due to their short maturity period of six to nine months; thus, restricted cash is classified as a current asset.

## Accounts receivable

Accounts receivable represents the following: (1) amounts due from banks relating to retail sales that are paid or settled by the customers' debit or credit cards, (2) amounts due from government social security bureaus and commercial health insurance programs relating to retail sales of drugs, prescription medicine, and medical services that are paid or settled by the customers' medical insurance cards, and (3) amounts due from non-retail customers for sales of merchandise.

Accounts receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts, as necessary. In its wholesale business, the Company uses the aging method to estimate the allowance for anticipated uncollectible receivable balances. Under the aging method, bad debt percentages are determined by management, based on historical experience and the current economic climate, are applied to customers' balances categorized by the number of months the underlying invoices have remained outstanding. At each reporting period, the allowance balance is adjusted to reflect the amount computed as a result of the aging method. When facts subsequently become available to indicate that the allowance provided requires an adjustment, a corresponding adjustment is made to the allowance account as a change in estimate.

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

#### Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first in first out (FIFO) method. Market is the lower of replacement cost or net realizable value. The Company carries out physical inventory counts on a monthly basis at each store and warehouse location. Herbs that the Company farms are recorded at its cost, which includes direct cost such as seed selection, fertilizer, labor costs and contract fee that are spent in growing herbs on the leased farmland, and indirect cost which includes amortization of farmland development cost. All the costs are accumulated until the time of harvest and then allocated to harvested herbs cost when they are sold. The Company periodically reviews its inventory and records write-downs to inventories for shrinkage losses and damaged merchandise that are identified. Historically, these amounts have not been material to the consolidated financial statements.

#### Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation or amortization. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets, taking into consideration the assets' estimated residual value. Leasehold improvements are amortized over the shorter of lease term or remaining lease period of the underlying assets. Following are the estimated useful lives of the Company's property and equipment:

|                                | Estimated Useful Life |
|--------------------------------|-----------------------|
| Leasehold improvements         | 3-10 years            |
| Motor vehicles                 | 5 years               |
| Office equipment and furniture | 3-5 years             |
| Buildings                      | 10 years              |

Maintenance, repairs and minor renewals are charged to expense as incurred. Major additions and betterment to property and equipment are capitalized.

#### Impairment of long lived assets

The Company evaluates long lived tangible and intangible assets for impairment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable from its estimated future cash flows. Recoverability is measured by comparing the assets' net book value to the related projected undiscounted cash flows from these assets, considering a number of factors including past operating results, budgets, economic projections, market trends and product development cycles. If the net book value of the asset exceeds the related undiscounted cash flows, the asset is considered impaired, and a second test is performed to measure the amount of impairment loss.

#### Notes payable

During the normal course of business, the Company regularly issues bank acceptance bills as a payment method to settle outstanding accounts payables with various material suppliers. The Company records such bank acceptance bills as notes payables. Such notes payable are generally short term in nature due to their short maturity period of six to nine months.

## Income taxes

The Company records income taxes pursuant to the accounting standards for income taxes. These standards require the recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between income tax basis and financial reporting basis of assets and liabilities. The provision for income taxes consists of taxes currently due and the net change in deferred taxes. A valuation allowance is recognized if it is more likely than not that some portion, or all of, a deferred tax asset will not be realized.

The FASB's accounting standards clarify the accounting and disclosure for uncertain tax positions and prescribe a recognition threshold and measurement attribute for recognition and measurement of a tax position taken or expected to be taken in a tax return. The accounting standards also provide guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. No significant penalties, uncertain tax provisions or interest relating to income taxes have been incurred during the years ended March 31, 2013 and 2012.

All of the tax returns of the Company, since inception, are subject to examination by the tax authorities.

## Value added tax

Sales revenue represents the invoiced value of goods, net of value added tax ("VAT"). All of the Company's products are sold in the PRC and are subject to a VAT on the gross sales price. The VAT rates range up to 17%, depending on the type of products sold. The VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing or acquiring its finished products. The Company recorded a VAT payable and VAT receivable net of payments in the accompanying financial statements.

## Stock based compensation

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with the FASB's accounting standards regarding accounting for stock-based compensation and accounting for equity instruments that are issued to other than employees for acquiring or in conjunction with selling goods or services. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably determinable. The value of equity instruments issued for consideration other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services as defined by these accounting standards. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement.

#### Advertising and promotion costs

Advertising and promotion costs are expensed as incurred, and amounted to \$767,795 and \$929,838 for years ended March 31, 2013 and 2012, respectively. Such costs consist primarily of print and television advertisements, and increased dramatically year over year due to the Company's promotion campaign.

#### Operating leases

The Company leases premises for retail drugstores, offices and wholesale warehouse under non-cancelable operating leases. Operating lease payments are expensed over the term of lease. A majority of the Company's retail drugstore leases have a 3 to 8-year term with a renewal option upon the expiration of the lease, the wholesale warehouse lease has a 10-year term with a renewal option upon the expiration of the lease. The Company has historically been able to renew a majority of its drugstores leases. Under the terms of the lease agreements, the Company has no legal or contractual asset retirement obligations at the end of the lease. Land leased from the government is amortized on a straight-line basis over a 30-year term.

#### Foreign currency translation

The Company uses the United States dollar ("U.S. dollars" or "USD") for financial reporting purposes. The Company's subsidiaries and VIEs maintain their books and records in their functional currency the Renminbi ("RMB"), the currency of the PRC.

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

The balance sheet amounts, with the exception of equity, at March 31, 2013 and 2012 were translated at 1 RMB to \$0.1594 USD and at 1 RMB to \$0.1581 USD, respectively. The average translation rates applied to income and cash flow statement amounts for the years ended March 31, 2013 and 2012 were at 1 RMB to \$0.1586 USD and at 1 RMB to \$0.1561 USD, respectively.

#### Concentrations and credit risk

Certain financial instruments, which subject the Company to concentration of credit risk, consist of cash and restricted cash, accounts receivable, advance to suppliers, accounts payable and other liabilities. The Company has cash balances at financial institutions located in Hong Kong and PRC. Balances at financial institutions in Hong Kong may, from time to time, exceed Hong Kong Deposit Protection Board's insured limits. Balances at financial institutions and state-owned banks within the PRC are not covered by insurance. As of March 31, 2013 and 2012, the Company had deposits totaling \$6,230,011 and \$6,268,508 that were not covered by insurance, respectively. To date, the Company has not experienced any losses in such accounts.

For the fiscal year ended March 31, 2013, one vendor accounted for more than 10% of the Company's total purchases and 33% of advances to suppliers. For the fiscal year ended March 31, 2012, two vendors collectively accounted for 26% of the Company's total purchases and 20% of total advances to suppliers.

For the fiscal year ended March 31, 2013, one customer accounted for 11% of the Company's total sales and two customers collectively accounted for more than 30% of total accounts receivable. For the fiscal year ended March 31, 2012, no customer accounted for 10% or more of the Company's total sales while two customers collectively accounted for 35% of total accounts receivable.

#### Non-controlling interest

As of March 31, 2013, 1% of the equity interest in Shanghai Zhongxing was owned by Shanghai Biayanghong Grand Pharmacy Co., Ltd., and not under the Company's control.

#### Reclassification

Certain prior period amounts have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income or cash flows as previously reported.



## NOTE 4 – TRADE ACCOUNTS RECEIVABLE

Trade accounts receivable consisted of the following:

|                                       | March 31,<br>2013 | March 31,<br>2012 |
|---------------------------------------|-------------------|-------------------|
| Accounts receivable                   | \$ 18,007,051     | \$ 16,817,801     |
| Less: allowance for doubtful accounts | (5,028,243)       | (301,130)         |
| Trade accounts receivable, net        | \$ 12,978,808     | \$ 16,516,671     |

For the years ended March 31, 2013 and 2012, \$846,094 and \$471,334 in accounts receivable were directly written off, respectively.

## Note 5 – OTHER CURRENT ASSETS

Other current assets consisted of the following:

|   | March 31,<br>2013 | March 31,<br>2012 |
|---|-------------------|-------------------|
| Prepaid rental expenses                         | \$ 647,489        | \$ 1,994,280      |
| Lease rights transfer fees, current portion (1) | 247,789           | 402,735           |
| Prepays and other current assets                | 326,221           | 456,286           |
| Total   | \$ 1,221,499      | \$ 2,853,301      |

- (1) Lease rights transfer fees are paid by the Company to secure store rentals in coveted areas. These additional costs of acquiring the right to lease new store locations are capitalized and amortized over the period of the initial lease term.

## Note 6 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

|                                | March 31,<br>2013 | March 31,<br>2012 |
|--------------------------------|-------------------|-------------------|
| Building                       | \$ 1,119,053      | \$ 1,109,926      |
| Leasehold improvements         | 13,956,605        | 11,423,330        |
| Office equipment and furniture | 5,264,996         | 4,808,721         |
| Motor vehicles                 | 424,958           | 420,985           |
| Total                          | 20,765,612        | 17,762,962        |
| Less: Accumulated depreciation | (7,476,960)       | (4,814,490)       |
| Construction-in-progress       | -                 | 2,698,648         |
| Property and equipment, net    | \$ 13,288,652     | \$ 15,647,120     |

Total depreciation expense for property and equipment was \$2,609,717 and \$2,032,786 for the years ended March 31, 2013 and 2012, respectively. For the year ended March 31, 2013, \$2,269,288 of leasehold improvements were written off due to drugstore closings, while no leasehold improvement was written off for the year ended March 31, 2012.

## Note 7 – ADVANCES TO SUPPLIERS

Advances to suppliers consist of deposits with or advances to outside vendors for future inventory purchases. Most of the Company's vendors require a certain amount of money to be deposited with them as a guarantee that the Company will receive purchases on a timely basis. This amount is refundable and bears no interest. As of March 31, 2013 and 2012, advance to suppliers consist of the following:

|                                       | March 31,<br>2013 | March 31,<br>2012 |
|---------------------------------------|-------------------|-------------------|
| Advance to suppliers                  | \$ 19,119,231     | \$ 15,376,970     |
| Less: allowance for doubtful accounts | (3,596,197)       | (1,029,413)       |
| Advance to suppliers, net             | \$ 15,523,034     | \$ 14,347,557     |

#### Note 8 – LONG TERM DEPOSITS, LANDLORDS

Long term deposits are money deposited with or advanced to landlords for securing retail store leases for which the Company does not anticipate applying or being returned within the next twelve months. Most of the Company's landlords require a minimum of six months' rent being paid upfront plus additional deposits.

## Note 9 – OTHER NONCURRENT ASSETS

Other noncurrent assets consisted of the following:

|   | March 31,<br>2013 | March 31,<br>2012 |
|---|-------------------|-------------------|
| Prepayment for lease of land use right – noncurrent (1) | \$ 5,419,600      | \$ 5,533,500      |
| Lease rights transfer fees-noncurrent (2)               | 11,726            | 243,167           |
| Total   | \$ 5,431,326      | \$ 5,776,667      |

- (1) This is a payment made to a local government in connection with entering into a 30-year operating land lease agreement.
- (2) Lease rights transfer fees are paid by the Company to secure store rentals in coveted areas. These additional costs of acquiring the right to lease new store locations are capitalized and amortized over the period of the initial lease term.

## Note 10 – INTANGIBLE ASSETS

Net intangible assets consisted of the following at:

|   | March 31,<br>2013 | March 31,<br>2012 |
|---|-------------------|-------------------|
| Goodwill on acquisition of Jiuxin Medicine    | \$ -              | \$ 1,401,451      |
| Goodwill on acquisition of Shanghai Zhongxing | -                 | 69,549            |
| Licenses and permits                          | 1,104,801         | 1,095,792         |
| Software                                      | 466,071           | 461,820           |
| Total goodwill and other intangible assets    | 1,570,872         | 3,028,612         |
| Less: accumulated amortization                | (368,614)         | (211,667)         |
| Intangible assets, net                        | \$ 1,202,258      | \$ 2,816,945      |

Amortization expense of intangibles for the years ended March 31, 2013 and 2012 amounted to \$154,427 and \$151,993, respectively.

During the year ended March 31, 2013, the Company impaired goodwill that was previously recognized in the acquisitions of Jiuxin Medicine and Shanghai Zhongxing. The impairment to goodwill was made after the Company estimated the fair values of such acquired businesses and determined that each of their implied fair value of goodwill was lower than the carrying value of goodwill. The following table presents the recognition and impairment of the goodwill.

|                                     | For the year<br>ended<br>March 31,<br>2013 | For the year<br>ended<br>March 31,<br>2012 |
|-------------------------------------|--|--|
| Goodwill at the beginning of period | \$ 1,471,000                               | \$ -                                       |
| Acquisition of Jiuxin Medicine      | -  | 1,401,451                                  |
| Acquisition of Shanghai Zhongxing   | -  | 69,549                                     |
| Goodwill impairment                 | (1,473,606)                                | -  |
| Exchange adjustment                 | 2,606                                      | -  |

|                               |    |   |              |
|-------------------------------|----|---|--------------|
| Goodwill at the end of period | \$ | - | \$ 1,471,000 |
|-------------------------------|----|---|--------------|

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## Note 11 – TAXES

## Income tax

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

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

Jo-Jo Drugstores is incorporated in the U.S. and has incurred a net operating loss for income tax purposes for 2013 and 2012. As of March 31, 2013, the estimated net operating loss carry forwards for U.S. income tax purposes amounted to approximately \$1,373,000 which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilized by 2031. Management believes that the realization of the benefits arising from this loss appears to be uncertain due to the Company's limited operating history and continuing losses for U.S. income tax purposes. Accordingly, the Company has provided a 100% deferred tax asset valuation allowance at March 31, 2013 and no deferred tax asset benefit has been recorded. The valuation allowance at March 31, 2013 was \$467,000. The net change in the valuation allowance was an increase of \$56,000. The Company's management reviews this valuation allowance periodically and makes adjustments as necessary.

Significant components of the income tax provision were as follows for the year ended March 31, 2013 and 2012:

|                          | For the years ended<br>March 31, |              |
|--------------------------|----------------------------------|--------------|
|                          | 2013                             | 2012         |
| Current tax provision    |                                  |              |
| Federal                  | \$ -                             | \$ -         |
| State                    | -                                | -            |
| Foreign                  | 58,380                           | 2,939,131    |
|                          | 58,380                           | 2,939,131    |
| Deferred tax provision   |                                  |              |
| Federal                  | \$ -                             | \$ -         |
| State                    | -                                | -            |
| Foreign                  | 295,422                          | (290,766)    |
|                          | 295,422                          | (290,766)    |
| Income tax provision (a) | \$ 353,802                       | \$ 2,648,365 |

(a) The current income tax provision for the year ended March 31, 2013, represents prepaid tax expenses incurred by the Company which were not refundable.

Income from continuing operations before income taxes were allocated between the United States and foreign components for the year ended March 31, 2013 and 2012 as follows:

|               | For the years ended March<br>31, |              |
|---------------|----------------------------------|--------------|
|               | 2013                             | 2012         |
| United States | \$ (303,442)                     | \$ (490,726) |

|         |                 |               |
|---------|-----------------|---------------|
| Foreign | (13,677,281)    | 11,279,570    |
|         | \$ (13,980,723) | \$ 10,788,844 |

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The Company files U.S. federal and state income tax returns. With few exceptions, the Company was subject to the U.S. federal and state income tax examinations by tax authorities for years on or after 2007.

The Company's subsidiaries and VIEs in China file income tax returns with both the state and local tax bureaus in the PRC. Such income tax returns are subject to examinations by these foreign tax authorities and have passed all examinations since each subsidiary's and VIE's inception date.

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

|   | 2013   | 2012   |
|---|--------|--------|
| U.S. Statutory rates                      | 34.0%  | 34.0%  |
| Foreign income not recognized in the U.S. | (34.0) | (34.0) |
| China income taxes                        | 25.0   | 25.0   |
| Change in valuation allowance (a)         | (22.4) | -      |
| Others (b)                                | (0.1)  | (0.5)  |
| Effective tax rate                        | 2.5%   | 24.5%  |

(a) The Company incurred operating loss in its fiscal year 2013.

(b) The (0.1)% for the year ended March 31, 2013 and the (0.5)% for the year ended March 31, 2012 represent the combined effect of expenses incurred by the Company that were not deductible for PRC income tax and PRC income tax exemptions.

The Company's subsidiaries and VIEs in China recognized deferred tax asset in the amount of \$0 and \$ 294,490 at March 31, 2013 and 2012, respectively. The temporary differences and carryforwards gave rise to the following deferred tax asset at March 31, 2013 and 2012:

|                                   | March 31,<br>2013 | March 31,<br>2012 |
|-----------------------------------|-------------------|-------------------|
| Current deferred tax assets:      |                   |                   |
| Allowance for doubtful accounts   | \$ 1,911,450      | \$ 166,049        |
| Payroll accrual                   | 62,346            | 28,817            |
| Valuation allowance               | (1,973,796)       | -                 |
| Total current deferred tax assets | \$ -              | \$ 194,866        |
| Long-term deferred tax assets:    |                   |                   |
| Goodwill impairment               | \$ 370,774        | \$ -              |
| Depreciation and amortization     | 261,960           | 99,624            |
| Net operating loss carryforward   | 47,418            | -                 |
| Valuation allowance               | (680,152)         | -                 |
| Total current deferred tax assets | \$ -              | \$ 99,624         |
| Total                             | \$ -              | \$ 294,490        |

Management believe that the realization of the benefits arising from these temporary differences and carryforwards appears to be uncertain due to the Company's significant operating loss in 2013, the Company has made a full valuation allowance against its net deferred tax assets at March 31, 2013. Management reviews this valuation

allowance periodically and makes adjustments as necessary. Future reversal of the valuation allowance will be recognized either when the benefit is realized or when it has been determined that it is more likely than not that the benefit will be realized through future earnings.

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## Value added tax

VAT on sales and on purchases amounted to \$19,189,325 and \$18,441,552 for the year ended March 31, 2013, and \$17,778,942 and \$14,285,240 for the year ended March 31, 2012, respectively.

Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

Taxes payable at March 31, 2013 and 2012 consisted of the following:

|                     | March 31,<br>2013 | March 31,<br>2012 |
|---------------------|-------------------|-------------------|
| VAT                 | \$ 334,833        | \$ 435,390        |
| Income tax          | 7,628             | 7,240             |
| Others              | 29,172            | 26,976            |
| Total taxes payable | \$ 371,633        | \$ 469,606        |

## Note 12 – POSTRETIREMENT BENEFITS

Regulations in the PRC require the Company to contribute to a defined contribution retirement plan for all permanent employees. The contribution for each employee is based on a percentage of the employee's current compensation as required by the local government. The Company contributed \$634,453 and \$540,226 in employment benefits and pension for the years ended March 31, 2013 and 2012, respectively.

## Note 13 – RELATED PARTY TRANSACTIONS AND ARRANGEMENTS

Amounts payable to related parties are summarized as follows:

|                        | March 31,<br>2013 | March 31,<br>2012 |
|------------------------|-------------------|-------------------|
| Due to cofounders (1): | \$ 576,818        | \$ 880,058        |
| Due to director (2):   | 647,599           | 578,383           |
| Total                  | \$ 1,224,417      | \$ 1,458,441      |

- (1) As of March 31, 2013 and 2012, amount due to cofounders represents loans from the Owners to Jiuxin Management to enable Jiuxin Management to meet its approved PRC registered capital requirements.
- (2) Mr. Lei Liu personally lent U.S. dollars to the Company to facilitate its payments of expenses in the United States.

As of March 31, 2013 and 2012, notes payable totaling \$7,186,453 and \$4,208,928 were secured by the personal properties of certain of the Company's shareholders, respectively.

The Company leases from Mr. Lei Liu a retail space which expires in August 2014, and its corporate office which expires in December 2013. Rent expense amounted to \$163,851 and \$187,320 for the years ended March 31, 2013 and 2012, respectively. \$0 and \$187,320 was paid to Mr. Liu for the years ended March 31, 2013 and 2012, respectively.



## Note 14 – PURCHASE OPTION DERIVATIVE LIABILITY

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

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

On April 22, 2010, the issue date of the option, the Company classified the fair value of this option as a liability resulting in a decrease of additional paid-in capital of \$402,451 and the establishment of a \$402,451 in liability to recognize the option's fair value. The Company recognized a gain of \$18,810 from the change in fair value of the option liability for year ended March 31, 2013.

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

|                         | March 31,<br>2013 (1) |
|-------------------------|-----------------------|
| Stock price             | \$ 1.07               |
| Exercise price          | \$ 6.25               |
| Annual dividend yield   | 0%                    |
| Expected term (years)   | 2.05                  |
| Risk-free interest rate | 0.25%                 |
| Expected volatility     | 97.07%                |

(1) As of March 31, 2013, the option to purchase 105,000 shares of common stock had not been exercised.

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

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

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

sheets at fair value.

#### Note 15 – STOCKHOLDERS' EQUITY

##### Common stock

On April 9, 2010, the Company affected a 1-for-2 reverse split of its issued and outstanding shares of common stock and a proportional reduction of its authorized shares of common stock. All share and per share amounts used in the Company's consolidated financial statements and accompanying notes have been retroactively restated to reflect the 1-for-2 reverse stock split.

On April 28, 2010, the Company closed a public offering of 3.5 million shares of common stock at \$5.00 per share with gross proceeds of approximately \$17.5 million.

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### Stock-based compensation

On March 15, 2011, the Company agreed to issue 11,268 shares of restricted common stock to Mr. Marc Serrio, a non-executive director, for his annual service. The terms of the service agreement was continued on March 15, 2012, and 33,058 shares of restricted common stock were issued accordingly. Mr. Serrio resigned from the Company's board of directors on November 30, 2012. The trading value of the Company's common stock on March 15, 2012 and 2011 was \$1.21 and \$3.55, respectively. Accordingly, \$22,099 and \$40,000 were charged to general and administrative expense year ended March 31, 2013 and 2012, respectively.

On August 1, 2011, the Company appointed Mr. Ming Zhao as its chief financial officer, and in connection therewith, entered into an agreement pursuant to which the Company agreed to issue him 40,000 shares of restricted common stock under the Company's stock incentive plan (the "Plan"), to be vested in eight equal quarterly installments over two years. Mr. Zhao agreed to waive the remaining shares awards from November 1, 2012. The trading values of the Company's common stock on May 1, 2010 and August 1, 2011 were \$4.80 and \$1.70, respectively. Accordingly, \$19,864 and \$25,036 was charged to general and administrative expense for the years ended December 31, 2013 and 2012.

On August 1, 2011, the Company entered into an agreement pursuant to which the Company agreed to issue 4,613 shares of restricted common stock under the Plan in connection with Mr. Bennet P. Tchaikovsky's services as chief financial officer from April 28, 2011 to August 1, 2011. On August 1, 2011, the Company appointed Mr. Tchaikovsky to its board of directors, and in connection therewith, entered into an agreement pursuant to which the Company agreed to issue to Mr. Tchaikovsky 5,883 shares of its restricted common stock under the Plan. The trading values of the Company's common stock on May 14, 2010, April 28, 2011, and August 1, 2011 were \$4.66, \$2.71, and \$1.70, respectively. Accordingly, \$3,344 was charged to general and administrative expense for the year ended March 31, 2013. Mr. Tchaikovsky resigned from the Company's board of directors on January 1, 2013.

The Company agreed to issue 2,340 shares of common stock every six month to its legal counsel as partial payment for legal services. On November 1, 2011 and May 1, 2012, the Company agreed to issue additional 2,340 shares of common stock to its legal counsel as partial payment for two consecutive six months of legal services. The terms of the service agreement was continued on November 1, 2012, with 2,340 shares of restricted common stock to be issued accordingly. The trading value of the Company's common stock on November 1, 2011, May 1, 2012, and November 1, 2012 was \$1.66, \$1.07 and \$0.72, respectively. \$4,546 was recorded as service compensation expense for the year ended March 31, 2013.

On January 16, 2012, the Company granted a total of 297,000 shares of restricted common stock under the Plan to a group of 46 employees. These restricted shares will vest on January 16, 2015, provided that the employees are still employed by the Company on such date. \$78,235 and \$30,578 was charged to general and administrative expense and selling expense for the year ended March 31, 2013, respectively. \$15,988 and \$6,541 were charged to general and administrative expense and selling expense respectively for the year ended March 31, 2012.

#### Statutory reserve

Statutory reserves represent restricted retained earnings. Based on their legal formation, the Company is required to set aside 10% of the net income of each VIE and subsidiary in the PRC as reported in its statutory account on an annual basis to the Statutory Surplus Reserve Fund (the "Reserve Fund"). Once the total amount set aside in the Reserve Fund reaches 50% of the entity's registered capital, further appropriations become discretionary. The Reserve Fund can be used to increase the entity's registered capital upon approval by relevant government authorities or eliminate its future losses under PRC GAAP upon a resolution by its board of directors. The Reserve Fund is not distributable to shareholders, as cash dividend or otherwise, except in the event of liquidation.

Appropriations to the Reserve Fund are accounted for as a transfer from unrestricted earnings to statutory reserves. During the years ended March 31, 2013 and 2012, the Company did not make appropriations to the statutory reserves.

There are no legal requirements in the PRC to fund the Reserve Fund by transfer of cash to any restricted accounts, and the Company does not do so.

#### Note 16 – EARNINGS PER SHARE

The Company reports earnings per share in accordance with the provisions of the FASB's related accounting standard. This standard requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution, but includes vested restricted stocks and is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

The following is a reconciliation of the basic and diluted earnings per share computation:

|   | Years ended<br>March 31, |              |
|---|--------------------------|--------------|
|   | 2013                     | 2012         |
| Net (loss) income attributable to controlling interest  | \$ (14,333,731)          | \$ 8,141,626 |
| Weighted average shares used in basic computation       | 13,580,731               | 13,568,481   |
| Diluted effect of restricted shares                     | -                        | 1,514        |
| Weighted average shares used in diluted computation     | 13,580,731               | 13,569,995   |
| Earnings per share – Basic:                             |                          |              |
| Net (loss) income before noncontrolling interest        | \$ (1.06)                | \$ 0.60      |
| Add: Net (loss) attributable to noncontrolling interest | \$ (0.00)                | \$ (0.00)    |
| Net (loss) income attributable to controlling interest  | \$ (1.06)                | \$ 0.60      |
| Earnings per share – Diluted:                           |                          |              |
| Net (loss) income before noncontrolling interest        | \$ (1.06)                | \$ 0.60      |
| Add: Net (loss) attributable to noncontrolling interest | \$ (0.00)                | \$ (0.00)    |
| Net (loss) income attributable to controlling interest  | \$ (1.06)                | \$ 0.60      |

For the year ended March 31, 2013 and 2012, 105,000 shares underlying outstanding purchase options were excluded from the calculation of diluted earnings per share as the options were anti-dilutive.

#### Note 17 – SEGMENTS

The Company operates within three main reportable segments: retail drugstores, drug wholesale and herbs farming. The retail drugstores segment sells prescription and OTC medicines, TCM, dietary supplement, medical devices, and sundry items to retail customers. The drug wholesale segment supplies the retail drugstores and sells prescription and OTC medicines, TCM, dietary supplement, medical devices and sundry items in batch to other drug vendors and hospitals. The Company's herbs farming segment cultivates selected herbs for sale to other drug vendors. The Company is also involved in online sales and clinic services that do not meet the quantitative thresholds for reportable segments and are included in the retail drugstores segment.

The Company evaluates performance based on profit or loss from operations before interest and income taxes not including nonrecurring gains and losses.

The Company's reportable business segments are strategic business units that offer different products and services. Each segment is managed separately because they require different operation and markets to distinct classes of customers.

The following table presents summarized information by segment of the continuing operation for the year ended March 31, 2013:

|                                     | Retail<br>drugstores | Drug<br>wholesale | Herb<br>farming (a) | Total         |
|-------------------------------------|----------------------|-------------------|---------------------|---------------|
| Revenue                             | \$ 40,726,080        | \$ 46,235,086     | \$ 2,534,380        | \$ 89,495,546 |
| Cost of goods                       | \$ 30,791,464        | \$ 43,846,081     | \$ 223,008          | \$ 74,860,553 |
| Gross profit                        | \$ 9,934,616         | \$ 2,389,005      | \$ 2,311,372        | \$ 14,634,993 |
| Selling expenses                    | \$ 11,666,876        | \$ 550,108        | \$ -                | \$ 12,216,984 |
| General and administrative expenses | \$ 6,584,185         | \$ 8,022,317      | \$ 393,862          | \$ 15,000,364 |
| Goodwill impairment loss            | \$ 69,673            | \$ 1,403,933      | \$ -                | \$ 1,473,606  |

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|                               |    |             |                |              |    |              |
|-------------------------------|----|-------------|----------------|--------------|----|--------------|
| Income from operations        | \$ | (8,386,118) | \$ (7,587,353) | \$ 1,917,510 | \$ | (14,055,961) |
| Depreciation and amortization | \$ | 2,469,723   | \$ 55,980      | \$ 238,441   | \$ | 2,764,144    |
| Total capital expenditures    | \$ | 406,824     | \$ 8,328       | \$ -         | \$ | 415,152      |

(a) Due to the nature of herb farming, harvested herbs were sold to a local vendor, with no promotional activities conducted or selling expenses incurred.

The following table presents summarized information by segment of the continuing operation for the year ended March 31, 2012:

|                                     | Retail<br>drugstores | Drug<br>wholesale | Herb<br>farming | Total         |
|-------------------------------------|----------------------|-------------------|-----------------|---------------|
| Revenue                             | \$ 66,074,348        | \$ 24,060,963     | \$ 4,217,574    | \$ 94,352,885 |
| Cost of goods                       | \$ 44,289,323        | \$ 22,283,976     | \$ 216,785      | \$ 66,790,084 |
| Gross profit                        | \$ 21,785,025        | \$ 1,776,987      | \$ 4,000,789    | \$ 27,562,801 |
| Selling expenses                    | \$ 8,417,445         | \$ 80,795         | \$ -            | \$ 8,498,240  |
| General and administrative expenses | \$ 5,391,659         | \$ 3,005,576      | \$ 185,154      | \$ 8,582,389  |
| Income from operations              | \$ 7,975,921         | \$ (1,309,384)    | \$ 3,815,635    | \$ 10,482,172 |
| Depreciation and amortization       | \$ 2,057,166         | \$ 126,341        | \$ 157,358      | \$ 2,340,865  |
| Total capital expenditures          | \$ 4,782,988         | \$ 132,253        | \$ -            | \$ 4,915,241  |



The Company does not have long-lived assets located outside the PRC. In accordance with the enterprise-wide disclosure requirements of FASB's accounting standard, the Company's net revenue from external customers through its retail stores by main product categories for the years ended March 31, 2013 and 2012 is as follows:

|                         | Years ended<br>March 31, |               |
|-------------------------|--------------------------|---------------|
|                         | 2013                     | 2012          |
| Prescription drugs      | \$ 16,489,103            | \$ 28,424,237 |
| OTC drugs               | 14,032,854               | 19,487,835    |
| Nutritional supplements | 4,263,849                | 7,060,574     |
| TCM                     | 3,679,689                | 8,738,394     |
| Sundry products         | 1,101,934                | 1,039,234     |
| Medical devices         | 1,158,651                | 1,324,074     |
| Total                   | \$ 40,726,080            | \$ 66,074,348 |

The Company's net revenue from external customers through wholesale by main product categories for the years ended March 31, 2013 and 2012 is as follows:

|                         | Years ended<br>March 31, |               |
|-------------------------|--------------------------|---------------|
|                         | 2013                     | 2012          |
| Prescription drugs      | \$ 27,156,460            | \$ 14,262,802 |
| OTC drugs               | 9,049,439                | 5,917,032     |
| Nutritional supplements | 8,455,686                | 3,074,101     |
| TCM                     | 215,505                  | 4,923,672     |
| Sundry products         | 1,268,723                | 36,510        |
| Medical devices         | 89,273                   | 64,420        |
| Total                   | \$ 46,235,086            | \$ 28,278,537 |

The Company's net revenue from external customers through Chinese herbs farming by main products is as follows:

|                         | Years ended<br>March 31, |              |
|-------------------------|--------------------------|--------------|
|                         | 2013                     | 2012         |
| Prescription drugs      | \$ -                     | \$ -         |
| OTC drugs               | -                        | -            |
| Nutritional supplements | -                        | -            |
| TCM                     | 2,534,380                | 4,481,274    |
| Sundry products         | -                        | -            |
| Medical devices         | -                        | -            |
| Total                   | \$ 2,534,380             | \$ 4,481,274 |

#### Note 18 – COMMITMENTS AND CONTINGENCIES

##### Operating lease commitments

The Company recognizes lease expense on a straight line basis over the term of its leases in accordance with the relevant accounting standards. The Company has entered into various tenancy agreements for its store premises and for the land leased from a local government to farm herbs.

The Company's commitments for minimum rental payments under its leases for the next five years and thereafter are as follows:

| Years ending March 31, | Retail<br>drugstores | Drug<br>wholesale | Herb<br>farming | Total<br>amount |
|------------------------|----------------------|-------------------|-----------------|-----------------|
| 2014                   | \$ 3,078,343         | \$ 222,955        | \$ -            | \$ 3,301,298    |
| 2015                   | 1,346,835            | 251,881           | -               | 1,598,716       |
| 2016                   | 259,358              | 277,588           | -               | 536,946         |
| 2017                   | 214,565              | 283,253           | -               | 497,818         |
| 2018                   | 66,853               | 283,253           | -               | 350,106         |
| Thereafter             | 20,920               | 481,398           | -               | 502,318         |

Total rent expense amounted to \$4,861,835 and \$4,351,671 for years ended March 31, 2013 and 2012, respectively.

#### Note 19 – Subsequent Events

Since May, 2013, the Company has been applying to open a branch clinic of Jiuzhou Service in Xiasha, a sub-district of Hangzhou. The Company also plans to relocate a Jiuzhou Grand Pharmacy store from Gongcheng to a location adjacent to the new branch clinic. No significant investment is required in connection therewith. As of the report date, the application has not been approved but is expected to be approved in the near future.