Biostar Pharmaceuticals, Inc.
Form 10-Q
November 12, 2010

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

FORM 10-Q

(Mark One)
x Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934

For the quarterly period ended: September 30, 2010

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: 001-34708

BIOSTAR PHARMACEUTICALS, INC.
(Exact name of registrant as specified in its charter)

Maryland	20-8747899
(State or other jurisdiction of incorporation of origination)	(I.R.S. Employer Identification Number)
No. 588 Shiji Xi Avenue Xianyang, Shaanxi Province People's Republic of China	712046
(Address of principal executive offices)	(Zip code)

011-86-29-33686638
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each issuer’s classes of common stock, as of the latest practicable date: 26,876,864 shares issued and outstanding as of November 8, 2010.

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TO QUARTERLY REPORT ON FORM 10-Q
FOR QUARTER ENDED SEPTEMBER 30, 2010

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CAUTION REGARDING FORWARD-LOOKING INFORMATION

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

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

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

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

BIOSTAR PHARMACEUTICALS, INC.
CONSOLIDATED BALANCE SHEETS

	September 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$16,554,185	$8,577,704
Accounts receivable	22,033,856	19,803,434
Inventories	750,985	340,078
Prepaid expenses and other receivables	2,594,691	1,500,327
Total Current Assets	41,933,717	30,221,543
Deposits	895,856	1,316,328
Property and equipment, net	5,207,736	4,340,917
Intangible assets, net	11,172,893	11,131,681
Total Assets	$59,210,202	$47,010,469
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts and other payables	$2,993,077	$3,559,281
VAT payable	1,131,979	1,050,051
Income tax payable	1,402,997	1,481,266
Total Current Liabilities	5,528,053	6,090,598
Commitment and Contingencies		
Stockholders' Equity		
Series B, convertible preferred stock, $0.001 par value, 5,000,000 shares authorized, 510,572 and 3,060,000 shares issued and outstanding at September 30, 2010 and December 31, 2009	511	3,060
Common stock, $0.001 par value, 100,000,000 shares authorized, 26,876,864 and 23,374,799 shares issued and outstanding at September 30, 2010 and December 31, 2009	26,877	23,375
Additional paid-in capital	20,545,367	19,801,366
Statutory reserve	4,131,692	2,860,685
Retained earnings	27,570,567	17,548,676
Accumulated other comprehensive income	1,407,135	682,709
Total Stockholders' Equity	53,682,149	40,919,871
Total Liabilities and Stockholders' Equity	$59,210,202	$47,010,469

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

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BIOSTAR PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Sales, net	$20,178,617	$15,556,345	$51,937,483	$36,249,051
Cost of sales	5,464,806	3,585,143	13,310,108	9,753,704
Gross profit	14,713,811	11,971,202	38,627,375	26,495,347
Selling, general and administrative expenses	9,891,406	7,857,258	23,139,574	14,608,550
Income from operations	4,822,405	4,113,944	15,487,801	11,886,797
Other income (expense)				
Interest income	3,001	872	9,681	2,056
Other income	63	-	387	-
Bank charges	(6,031)	(384)	(6,914)	(1,075)
Other expenses	-	-	(193,131)	-
Loss on disposal of property and equipment	-	-	-	(248,730)
Foreign exchange loss	-	-	(5,641)	(10)
Total other income (expense)	(2,967)	488	(195,618)	(247,759)
Income before income taxes	4,819,438	4,114,432	15,292,183	11,639,038
Provision for income taxes	1,385,984	988,286	4,016,359	2,828,683
Net income	$3,433,454	$3,126,146	$11,275,824	$8,810,355
Net income per common share				
Basic	$0.13	$0.13	$0.43	$0.38
Diluted	$0.13	$0.13	$0.41	$0.37
Weighted average common shares outstanding				
Basic	26,866,009	23,240,899	26,099,226	23,240,899
Diluted	27,400,243	23,720,233	27,404,108	23,720,233

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

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BIOSTAR PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$11,275,824	$8,810,355
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	426,708	470,833
Impairment loss on building	-	248,730
Stock-based compensation and other non-cash expenses	520,416	-
Make good shares expense	187,000	-
Changes in operating assets and liabilities:		
Accounts receivable	(2,230,422)	(6,118,030)
Inventories	(410,907)	(389,966)
Deposit	(18,544)	63,363
Prepaid expenses and other receivables	(1,094,364)	(1,505,755)
Accounts payable and accrued expenses	(566,204)	241,181
VAT payable	81,928	472,244
Income tax payable	(78,269)	574,387
Effect of exchange rate changes	563,367	-
Net cash provided by (used in) operating activities	8,656,533	2,867,342
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(607,192)	(9,897)
Acquisition of proprietary technologies	(265,150)	(1,169,529)
Net cash provided by (used in) investing activities	(872,342)	(1,179,426)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of common stock	37,537	-
Net cash provided by (used in) financing activities	37,537	-
Effect of exchange rate changes on cash and cash equivalents	154,753	2,435
Net increase (decrease) in cash and cash equivalents	7,976,481	1,690,351
Cash and cash equivalents, beginning balance	8,577,704	758,316
Cash and cash equivalents, ending balance	$16,554,185	$2,448,667
SUPPLEMENTAL DISCLOSURES:		
Income tax payments	$4,145,012	$1,947,703
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Conversion of preferred stock to common stock	$2,649	$-

Cashless exercise of warrants	$815	$-
Prior year deposit for acquisition of property and equipment	$439,016	$-
Consummation of disposal of building	$-	$2,555,510

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

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BIOSTAR PHARMACEUTICALS, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1 - ORGANIZATION

Biostar Pharmaceuticals, Inc. (“Biostar” or the “Company”) was incorporated in the State of Maryland on March 27, 2007. On June 15, 2007, Biostar formed Shaanxi Biostar Biotech Ltd. (“Shaanxi Biostar”). Shaanxi Biostar is a wholly owned subsidiary of Biostar and a limited liability company organized under the laws of the People's Republic of China (the "PRC").

On November 1, 2007, Shaanxi Biostar entered into a series of agreements including a Management Entrustment Agreement, a Shareholders’ Voting Proxy Agreement, an Exclusive Option Agreement and a Share Pledge Agreement (collectively the “Agreements”) with Shaanxi Aoxing Pharmaceutical Co., Ltd. ("Aoxing Pharmaceutical") and its owners (the “Transaction”). Aoxing Pharmaceutical is a corporation formed under the laws of the PRC. According to these Agreements, Shaanxi Biostar acquired management control of Aoxing Pharmaceutical whereby Shaanxi Biostar is entitled to all of the net profits of Aoxing Pharmaceutical as a management fee and is obligated to fund Aoxing Pharmaceutical’s operations and pay all of the debts. In exchange for entering into the Agreements, on November 1, 2007, the Company issued 19,832,311 shares of its common stock to Aoxing Pharmaceutical’s owners, representing approximately 90% of the Company’s common stock outstanding immediately after the Transaction. Therefore, the Transaction is accounted for as a reverse acquisition, and Aoxing Pharmaceutical is deemed to be the accounting acquirer in the reverse acquisition.

The Agreements provide that Shaanxi Biostar has controlling interest in Aoxing Pharmaceutical as defined by Financial Accounting Standard Board (“FASB”) Interpretation No. 46R “Consolidation of Variable Interest Entities” (“FIN 46R”), included in the FASB Accounting Standards Codification (”Codification”) as Accounting Standards Codification (“ASC”) 810, Consolidation, an Interpretation of Accounting Research Bulletin (“ARB”) No. 51, included in the Codification as ASC 810, Consolidation, which requires Shaanxi Biostar to consolidate the financial statements of Aoxing Pharmaceutical and ultimately consolidate with its parent company, Biostar (see Note 2 “Principles of Consolidation”).

The Company, through its subsidiary and the Agreements with Aoxing Pharmaceutical, is engaged in the business of developing, manufacturing and marketing over-the-counter (“OTC”) and prescription pharmaceutical products in the PRC.

Note 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its subsidiary and variable interest entity (“VIE”) for which the Company is the primary beneficiary. All inter-company accounts and transactions have been eliminated in consolidation. The Company has adopted FIN 46R which requires a VIE to be consolidated by a company if that company is subject to a majority of the risk of loss for the VIE or is entitled to receive a majority of the VIE’s residual returns.

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In determining Aoxing Pharmaceutical is a VIE of Shaanxi Biostar, the Company considered the following indicators, among others:

- Shaanxi Biostar has the full right to control and administer the financial affairs and daily operation of Aoxing Pharmaceutical and has the right to manage and control all assets of Aoxing Pharmaceutical. The equity holders of Aoxing Pharmaceutical as a group have no right to make any decision about Aoxing Pharmaceutical's activities without the consent of Shaanxi Biostar.

- Shaanxi Biostar is assigned all voting rights of Aoxing Pharmaceutical and has the right to appoint all directors and senior management personnel of Aoxing Pharmaceutical. The equity holders of Aoxing Pharmaceutical possess no substantive voting rights.

- Shaanxi Biostar is committed to provide financial support if Aoxing Pharmaceutical requires additional funds to maintain its operations and to repay its debts.

- Shaanxi Biostar is entitled to a management fee equal to Aoxing Pharmaceutical's net profits and is obligated to assume all operation risks and bear all losses of Aoxing Pharmaceutical. Therefore, Shaanxi Biostar is the primary beneficiary of Aoxing Pharmaceutical.

Additional capital provided to Aoxing Pharmaceutical by the Company was recorded as an interest-free loan to Aoxing Pharmaceutical. There was no written note to this loan, the loan was not interest bearing, and the loan was eliminated during consolidation Under the terms of the Agreements, the owners of Aoxing Pharmaceutical are required to transfer their ownership of Aoxing Pharmaceutical to the Company's subsidiary in China when permitted by PRC laws and regulations or to designees of the Company at any time when the Company considers it is necessary to acquire Aoxing Pharmaceutical. In addition, the owners of Aoxing Pharmaceutical have pledged their shares in Aoxing Pharmaceutical as collateral to secure these Agreements.

Unaudited Interim Financial Information

These unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial reporting and the rules and regulations of the Securities and Exchange Commission that permit reduced disclosure for interim periods. Therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. In the opinion of management, all adjustments of a normal recurring nature necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented have been made. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2010.

The consolidated balance sheets and certain comparative information as of December 31, 2009 are derived from the audited consolidated financial statements and related notes for the year ended December 31, 2009 ("2009 Annual Financial Statements"), included in the Company's 2009 Annual Report on Form 10-K. These unaudited interim consolidated financial statements should be read in conjunction with the 2009 Annual Financial Statements.

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Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

Accounts Receivable

The Company maintains allowances for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Terms of sales vary. Allowances are recorded primarily on a specific identification basis. Allowance for doubtful accounts amounted to $136,497 and $133,720 at September 30, 2010 and December 31, 2009, respectively.

Inventories

Inventories are valued at the lower of cost (determined on a weighted average basis) or market. Management compares the cost of inventories with the market value, and allowance is made for writing down the inventories to market value, if lower. Inventories consisted of the following:

	September 30, 2010 (Unaudited)	December 31, 2009
Raw materials	$ 499,139	$ 261,868
Work in process	22,060	41,010
Finished goods	229,786	37,200
	$ 750,985	$ 340,078

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Property and Equipment

Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to earnings as incurred; additions, renewals and betterments are capitalized. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method for substantially all assets with estimated lives of:

Real property	30 years
Leasehold improvements	30 years
Machinery & equipment	5-10 years
Computers & office equipment	5-10 years

Property and equipment consisted of the following:

	September 30, 2010 (Unaudited)	December 31, 2009
Real property	$ 2,423,765	$ 1,528,543
Machinery & equipment	556,001	542,195
Leasehold improvements	1,956,289	1,956,289
Furniture & fixtures	63,420	63,420
Vehicle	91,996	24,970
Construction in progress	1,257,552	1,169,440
	6,349,023	5,284,857
Less: Accumulated depreciation	(1,141,287)	(943,940)
	$ 5,207,736	$ 4,340,917

At September 30, 2010 and December 31, 2009, expenditures incurred for the construction of a raw material processing plant were $1,257,552 and $1,169,440, respectively.

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Intangible Assets

Intangible assets are amortized using the straight-line method over their estimated period of benefit, ranging from ten to fifty years. Management evaluates the recoverability of intangible assets periodically and takes into account events or circumstances that warrant revised estimates of useful lives or that indicate that impairment exists. No impairments of intangible assets have been identified during any of the periods presented. The Company's land use rights will expire between 2056 and 2060. The Company's proprietary technologies were mainly contributed by four owners of the Company and relate to the production of the Company's five state-approved drugs. All of the Company's intangible assets are subject to amortization with estimated useful lives of:

Land use rights	50 years
Proprietary technologies	10 years

The components of finite-lived intangible assets are as follows:

	September 30, 2010 (Unaudited)	December 31, 2009
Land use right	$ 10,571,810	$ 10,571,810
Proprietary technologies	1,782,117	1,511,544
	12,353,927	12,083,354
Less: Accumulated amortization	(1,181,034)	(951,673)
	$ 11,172,893	$ 11,131,681

The estimated future amortization expenses related to intangible assets as of September 30, 2010 are as follows:

Years Ending December 31,	
2010, three months	$ 65,621
2011	340,338
2012	340,338
2013	340,338
2014	340,338
Thereafter	9,745,920

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Advertising

Advertising expense consists primarily of costs of promoting the Company's corporate image and product marketing and costs of direct advertising. The Company expenses all advertising costs as incurred. For the three months ended September 30, 2010 and 2009, the Company incurred advertising expense of approximately $4 million and $3.6 million, respectively. For the nine months ended September 30, 2010 and 2009, the Company incurred advertising expense of approximately $11.6 million and $6.5 million, respectively.

Research and Development

Remuneration of research and development staff and material costs incurred for internal research and development activities and payments made to third parties in connection with research and development collaborations prior to regulatory approval are expensed as incurred. Payments made to third parties subsequent to regulatory approval are capitalized and amortized over the shorter of the remaining license period or product patent life. In the nine months ended September 30, 2010 and 2009, the Company incurred research and development expense of $30,049 and $511,614, respectively.

Net Income Per Share

Basic net income per share is computed on the basis of the weighted average number of common stock outstanding during the period.

Diluted net income per share is computed on the basis of the weighted average number of common stock and common stock equivalents outstanding. Dilutive securities having an anti-dilutive effect on diluted net income per share are excluded from the calculation.

Dilution is computed by applying the treasury stock method for options and warrants. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

Dilution is computed by applying the if-converted method for convertible preferred stocks. Under this method, convertible preferred stock is assumed to be converted at the beginning of the period (or at the time of issuance, if later), and preferred dividends (if any) will be added back to determine income applicable to common stock. The shares issuable upon conversion will be added to weighted average number of common stock outstanding. Conversion will be assumed only if it reduces earnings per share (or increases loss per share).

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Recent accounting pronouncements

Effective January 1, 2010, the Company adopted the following Accounting Standards Updates ("ASU") issued by the FASB:

- ASU 2009-05 Fair Value Measurements and Disclosures (Topic 820) – Measuring Liabilities at Fair Value. Amended Topic 820 provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques: (1) the quoted price of the identical liability when traded as an asset, (2) the quoted prices for similar liabilities or similar liabilities when traded as assets, and (3) another valuation technique (e.g., a market approach or income approach) including a technique based on the amount an entity would pay to transfer the identical liability, or a technique based on the amount an entity would receive to enter into an identical liability.

- ASU 2010-06 Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements, add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It amends Topic 820 that a reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers and should present separately information about purchases, sales, issuances, and settlements in the reconciliation for fair value measurements using significant unobservable inputs. It also clarifies the requirements that for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities and should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

- ASU No. 2009-16, Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets. Amended Topic 860 amends the de-recognition accounting and disclosure guidance relating to SFAS 140. Amended Topic 860 eliminates the exemption from consolidation for qualifying special-purpose entity ("QSPE"), it also requires a transferor to evaluate all existing QSPE to determine whether it must be consolidated in accordance with amended Topic 810.

- ASU No. 2009-17, Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities, which amends FASB Interpretation No. 46 (revised December 2003) to address the elimination of the concept of a qualifying special purpose entity. Amended Topic 810 also replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, amended Topic 810 provides more timely and useful information about an enterprise's involvement with a variable interest entity.

- ASU No. 2010-09, Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements. The amendments in the ASU remove the requirement for a SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements.

In April 2010, the FASB issued ASU No. 2010-18, Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset (A consensus of the FASB Emerging Issues Task Force). Amended Topic 310 addresses that modification of loans within a pool under the existing Topic does not result in the removal of such loans from the pool even if modification of such loans would otherwise be considered a troubled debt restructuring. This ASU is effective for modifications of loans accounted for within pools under Subtopic 310-30 occurring in the first interim or annual period ending on or after July 15, 2010 with early adoption

permitted.

The adoption of the foregoing ASU's did not have a material effect on the Company's financial statements.

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In April 2010, the FASB issued ASU No. 2010-13, Compensation – Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades (A consensus of the FASB Emerging Issues Task Force), which provides clarification that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trade should not be considered to contain a condition that is not a market, performance, or service condition. As a result, an entity would not classify such an award as a liability if it otherwise qualifies as equity. This ASU will be effective for periods beginning on or after December 15, 2010. The Company has not elected to early adopt this topic and is evaluating the impact that this ASU will have on the Company's financial statements.

In July, 2010, the FASB issued ASU No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which amends ASC 310 by requiring more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. For public entities, the new and amended disclosures that relate to information as of the end of a reporting period will be effective for the first interim or annual reporting periods ending on or after December 15, 2010. That is, for calendar-year-end public entities, most of the new and amended disclosures in the ASU will be effective for this year-end reporting season. However, the disclosures that include information for activity that occurs during a reporting period will be effective for the first interim or annual periods beginning after December 15, 2010. The Company has not elected to early adopt this ASU and is evaluating the impact that this ASU will have on the Company's financial statements.

Note 3 – PREPAID EXPENSES AND OTHER RECEIVABLES

Prepaid expenses and other receivables include deposits for research and development, prepaid advertising expenses and professional fees, and consisted of the following:

	September 30, 2010 (Unaudited)	December 31, 2009
Research and development expenses	$ 783,730	$ 767,785
Advertising expenses	1,810,961	702,042
Other receivables	-	30,500
Prepaid expenses and other receivables	$ 2,594,691	$ 1,500,327

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Note 4 – DEPOSITS

At September 30, 2010, deposits include a $895,776 refundable deposit for acquiring a medicine packaging manufacturer. At December 31, 2009, deposits include $438,776 for acquiring real properties and proprietary technologies from a medical device manufacturer and $877,552 refundable deposit for acquiring a medicine packaging manufacturer.

Note 5 – STOCKHOLDERS' EQUITY

Series B Convertible Preferred Stock

On November 2, 2009 (the "Closing Date"), the Company entered into and closed on a securities purchase agreement with certain accredited investors (the "Investors") pursuant to which the Investors purchased 2,060,000 shares of the Company's series B convertible preferred stock ("Series B Preferred Stock") with attached warrants to purchase a total of 500,000 shares of its common stock (the "Warrants") for an aggregate purchase price of $3,605,000 ("Purchase Price"). The shares of Series B Preferred Stock purchased by the Investors are convertible into 2,060,000 shares of the Company's common stock.

On November 18, 2009, the Company entered into and closed on a securities purchase agreement with certain accredited investors pursuant to which the investors purchased 1,000,000 shares of the Series B Preferred Stock for an aggregate purchase price of $2,120,000. The shares of Series B Preferred Stock purchased by these investors are convertible into 1,000,000 shares of the Company's common stock.

The Series B Preferred Stock does not pay annual dividends and has no voting rights except as required by law. No dividends will be declared or payable with respect to the Company's common stock while the Series B Preferred Stock is outstanding. The Company will not redeem or purchase any shares of common stock or any other class or series of capital stock that is junior to or on parity with the Series B Preferred Stock while the Series B Preferred Stock is outstanding.

The Series B Preferred Stock is subject to full ratchet anti-dilution adjustment for subsequent lower price issuances by the Company, and both the conversion price of the Series B Preferred Stock and the exercise price of the Warrants are subject to customary adjustments for stock splits, stock dividends, recapitalizations and the like. The full ratchet anti-dilution protection provided to holders of Series B Preferred Stock for subsequent lower price issuances will be null and void and have no further force or effect if EITF 07-5, as such may amended, supplemented or modified by any accounting guidance and/or announcement(s) issued by the FASB, the Emerging Issues Task Force or any other regulatory authority, will adversely effect the Company's financial condition as a result of such provision.

The Company agreed with the Investors that if its common stock is not listed on a national securities exchange within one hundred and forty-five (145) days of the Closing Date, the Company will pay the Investors as liquidated damages and not as a penalty, an amount equal to twelve percent (12%) per annum, based on the lesser of (i) the Purchase Price or (ii) that percentage of the Purchase Price which the shares of common stock issuable upon conversion of the Series B Preferred Stock and issuable upon exercise of the Warrants bears to the number of shares of common stock initially issuable upon conversion of the Series B Preferred Stock; provided, however, such payment of liquidated damages will not accrue until the Company fulfills all of its requirements for listing on a national securities exchange. During the nine months ended September 30, 2010, $6,453 of liquidated damages was recorded because the Company received NASDAQ listing approval after the 145-day deadline.

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As an inducement for the Investors to purchase the Series B Preferred Stock, on November 2, 2009, the Company entered into a Make Good Securities Escrow Agreement with the Investors and Sichenzia Ross Friedman Ference LLP (the "Escrow Agent") whereby the Company has agreed to deliver to the Escrow Agent (i) resolutions executed by the Board of Directors of the Company and (ii) irrevocable instructions of the Company's transfer agent executed by the Company for the issuance of up to an additional 2,000,000 shares of common stock and/or Series B Preferred Stock (the "Make Good Shares"), at the option of the Investors, in the event the Company fails to achieve certain financial performance thresholds for the 12-month periods ended December 31, 2009 and December 31, 2010.

At April 15, 2010, the Company issued 100,000 shares of the Series B Preferred Stock to the Investors because the fiscal 2009 operating income was 15,100,843, which was $799,157 short of the target of $15,900,000 per the make-good provision.

The proceeds of $3,605,000 from the November 2, 2009 private placement were allocated to the Series B Preferred Stock and Warrants based on their relative fair values. The Warrants were valued using the BSM model and recorded in additional paid-in capital.

During the nine months ended September 30, 2010, 2,649,428 shares of Series B Preferred Stock were converted into 2,649,428 shares of common stock.

Warrants

The Company issued warrants to purchase its common stock in connection with its 2007 private placement of series A convertible preferred stock. The warrants are exercisable for three years from the effective date of October 10, 2007 at $1.00 per share. The warrants were later amended to include provisions for cashless exercise.

On February 23, 2010, the holder of one such warrant to purchase up to 1,051,050 shares of common stock elected to make a cashless exercise of the warrant and received 814,859 shares of common stock.

On January 22, 2010, the holder of one such warrant to purchase up to 37,538 shares of common stock exercised the warrant at $1.00 per share and received 37,538 shares of common stock.

The Warrants issued in connection with the November 2, 2009 private placement of Series B Preferred Stock are exercisable for a period of five years from their issuance date at an initial exercise price of $3.00 per share. The Company has the right at any time, on at least forty-five (45) day written notice, to redeem outstanding Warrants at a price of one cent ($0.01) per share provided the market price of the Company's common stock equals to or exceeds $4.50 on each trading day for twenty (20) consecutive trading days ending on the trading day prior to the date that the Company intends to redeem the Warrants.

The Warrants are classified as equity and amounts attributable to the warrants are classified within additional paid-in capital.

On June 1, 2010, the Company issued 55,000 warrants to an investor relations firm. The warrants are exercisable for three years by May 31, 2013 at $2 per share.

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The following table summarizes activities for the Company's warrants for the year ended December 31, 2009 and for the nine months ended September 30, 2010.

	Issued	Exercise Price	Exercised after December 31, 2009	Outstanding as of September 30, 2010	Weighted Average Exercise Price
Issued before January 1, 2009	1,088,588	$ 1	(1,088,588)	-	
Issued on November 2, 2009	500,000	$ 3	-	500,000	
Total, as of December 31, 2009	1,588,588		(1,088,588)	500,000	$ 1.63
Issued on June 1, 2010	55,000	$ 2	-	55,000	
Total, as of September 30, 2010	1,643,588		(1,088,588)	555,000	$ 2.90

Stock Options

The following table summarizes activities for the Company's options for the nine months ended September 30, 2010.

	Granted	Exercise Price	Expiry Date	Vested on December 31, 2009	Vested on September 30, 2010	Exercised	Options Outstanding As of September 30, 2010	Weighted Average Exercise Price
Granted on October 22, 2009	980,000	$ 2.60	October 21, 2014	326,667	228,333	-	980,000	
Granted on December 30, 2009	100,000	$ 4.45	December 29, 2013	-	25,000	-	100,000	
Total	1,080,000			326,667	253,333	-	1,080,000	$ 2.77

Stock Award

During the nine months ended September 30, 2010, the Company awarded 240 shares of common stock to an officer.

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Note 6 - NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted earnings per share of common stock:

	Nine Months Ended September 30,	
	2010	2009
Basic net income per share:		
Net income used in computing basic net income per share	$ 11,275,824	$ 8,810,355
Weighted average number of common stock	26,099,226	23,240,899
Basic net income per share	$ 0.43	$ 0.38
Diluted net income per share:		
Net income used in computing diluted net income per share	$ 11,275,824	$ 8,810,355
Weighted average number of common stock outstanding	26,099,226	23,240,899
Weighted average effect of dilutive securities:		
Convertible preferred stocks	1,085,503	-
Stock warrants	219,379	479,334
Options	-	-
Shares used in computing diluted net income per share	27,404,108	23,720,233
Diluted net income per share	$ 0.41	$ 0.37

Note 7 - INCOME TAXES

The Company was incorporated in the United States of America (“USA”) and has operations in one tax jurisdiction, i.e. the PRC. The Company generated substantially all of its net income from its PRC operations for the nine months ended September 30, 2010 and 2009, and has recorded income tax provision for the periods.

The Company’s subsidiaries and VIE were incorporated in the PRC and are governed by the Income Tax Law of the PRC and various local income tax laws. Effective January 1, 2008, China adopted a uniform tax rate of 25% for all enterprises (including foreign-invested enterprises).

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Uncertain Tax Positions

Interest associated with unrecognized tax benefits are classified as income tax, and penalties are classified in selling, general and administrative expenses in the statements of operations.

For the nine months ended September 30, 2010 and 2009, the Company had no unrecognized tax benefits and related interest and penalties expenses. Currently, the Company is not subject to examination by major tax jurisdictions.

Note 8 - STATUTORY RESERVES

The Company's subsidiaries and VIE in the PRC are required to make appropriations to certain non-distributable reserve funds. In accordance with the laws and regulations applicable to China's foreign investment enterprises and with China's Company Laws, an enterprise's income, after the payment of PRC income taxes, must be allocated to the statutory surplus reserves. The proportion of allocation for reserves is 10 percent of the profit after tax to the surplus reserve fund, not to exceed 50 percent of registered capital.

Use of the statutory reserve fund is restricted to set offs against losses, expansion of production and operation or increase in the registered capital of a company. Use of the statutory public welfare fund is restricted to the capital expenditures for the collective welfare of employees. These reserves are not transferable to the Company in the form of cash dividends, loans or advances. These reserves are therefore not available for distribution except in liquidation. As of September 30, 2010 and December 31, 2009, the Company's VIE had allocated $4,131,692 and $2,860,685, respectively, to these non-distributable reserve funds.

Note 9 - OTHER COMPREHENSIVE INCOME

The following table summarizes comprehensive income for the nine months ended September 30, 2010 and 2009:

	Nine Months Ended September 30, 2010	2009
Net income	$ 11,275,824	$ 8,810,355
Change in foreign currency translation adjustment	724,426	449,453
Comprehensive income	$ 12,000,250	$ 9,259,808

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Note 10 – ACQUISITION

In March 2010, the Company entered into an agreement to acquire the assets of Xi'an Meipude Bio-Technology Co., Ltd. ("Meipude"), a medical equipment and nutrients manufacturer in Xi'an, PRC, and took control of Meipude's assets. This transaction was accounted for as a purchase of assets. The purchase price of $1,148,316 was allocated to the assets acquired based on the estimated fair values on the date of acquisition.

The following table summarizes the allocation of the purchase price for Meipude:

Inventories	$5,902
Property and equipment	877,264
Intangible assets	265,150
	$1,148,316

Note 11 - COMMITMENT

Research and Development ("R&D") Agreement

On November 15, 2009 and December 19, 2009, the Company entered into three agreements with Fourth Military Medical University Xijing Hospital State Drug Clinical Research Center ("Fourth Military") to conduct clinical trial for two new drugs. Pursuant to these agreements, the Company paid Fourth Military $767,785 in the fourth quarter of 2009 as a deposit for clinical trial expenses and is obligated to pay Fourth Military an additional $613,681 upon completion of the clinical trial.

Construction Contracts

The Company is committed to various construction contracts for a raw material processing plant with a total contract price of approximately $1,418,313. As of September 30, 2010, the cash commitment remaining for these contracts was approximately $223,944.

Note 12 - SEGMENT INFORMATION

During the nine months ended September 30, 2010 and 2009, revenues of the Company represented net sales of pharmaceutical products. No financial information by business segment is presented. Furthermore, as all revenues are derived from the PRC, no geographic information by geographical segment is presented. In addition, all tangible and intangible assets are located in the PRC.

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Note 13- CURRENT VULNERABILITY DUE TO CERTAIN RISK FACTORS

All of the Company's operations are carried out in the PRC; therefore the Company is subject to the risks not typically associated with entities operating in the USA. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, and by the general state of the PRC's economy. All of the following risks may impair the Company's business operations. If any of the following risks actually occurs, the Company's business, financial condition or results of operations could be materially adversely affected. In such case, an investor in the Company may lose all or part of the investment. Such risks include:

- The Company may not be able to adequately protect and maintain its intellectual property.
- The Company may not be able to obtain regulatory approvals for its products.
- The Company may have difficulty competing with larger and better financed companies in the same sector.
- New legislative or regulatory requirements may adversely affect the Company's business and operations.
- The Company is dependent on certain key existing and future personnel.
- Changes in the laws and regulations in the PRC may adversely affect the Company's ability to conduct its business.
- The Company may experience barriers to conducting business due to governmental policy.
- Capital outflow policies in the PRC may hamper the Company's ability to remit income to the USA.
- Fluctuation of the Renminbi could materially affect the Company's financial condition and results of operations.
- The Company may face obstacles from the communist system in the PRC.
- The Company may have difficulty establishing adequate management, legal and financial controls in the PRC.
- The Company's growth is dependent on its ability to successfully develop, market, or acquire new drugs. The Company may be subject to product liability claims in future.
- Trade barriers and taxes may have an adverse affect on the Company's business and operations. There may not be sufficient liquidity in the market for the Company's securities in order for investors to sell their securities.

Note 14 – SUBSEQUENT EVENT

On October 27, 2010, the Company held its annual general shareholder meeting. The meeting elected five directors including Ronghua Wang, Qinghua Liu, Zibing Pan, Zhongyang Shang, and Haipeng Wu. The meeting ratified the appointment of Mazars CPA Limited as the independent accounting firm for the fiscal year ending on December 31, 2010. The meeting also approved The Biostar Pharmaceuticals Inc. 2009 Incentive Stock Plan.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our financial statements and the notes thereto which appear elsewhere in this report. The results shown herein are not necessarily indicative of the results to be expected in any future periods. This discussion contains forward-looking statements based on current expectations, which involve uncertainties. In some cases, you can identify forward-looking statements by terminology such as "anticipate," "estimate," "plan," "project," "predict," "potential," "continue," "ongoing," "expect," "believe," "intend," "may," "will," "should," "could," or the negative of these terms or other comparable terminology. All forward-looking statements included in this document are based on information available to the management on the date hereof. Actual results and the timing of events could differ materially from the forward-looking statements as a result of a number of factors. Readers should also carefully review factors set forth in other reports or documents that we file from time to time with the Securities and Exchange Commission.

Overview

Biostar Pharmaceuticals, Inc. ("we", the "Company" or "Biostar") was incorporated on March 27, 2007 in the State of Maryland. Our business operation is conducted in China primarily through our variable interest entity ("VIE"), Shaanxi Aoxing Pharmaceutical Co., Ltd. ("Aoxing Pharmaceutical"), which we control through contractual arrangements between Aoxing Pharmaceutical and our wholly owned subsidiary, Shaanxi Biostar Biotech Ltd. ("Shaanxi Biostar").

On March 28, 2010, we, through Shaanxi Biostar, entered into an agreement to acquire the assets of Xi'an Meipude Bio-Technology Co., Ltd., a Xi'an-based medical equipment manufacturer ("Meipude"), for RMB7.85 million ($1.1million), including certain assets registered to a family member of an original Meipude shareholder. We took control over the assets of Meipude on March 29, 2010. To facilitate the transfer of some of the assets, however, we were required to acquire all of the outstanding equity interests of Meipude, which we subsequently transferred to two unrelated third parties on June 23, 2010.

Our products include three over-the-counter ("OTC") medicines and two prescription-based pharmaceuticals, which are sold and distributed in over 22 provinces and provincial-level cities throughout China. We also produced and sold one medical device and four health products during the nine months ended September 30, 2010. Our best-selling product, Xin Ao Xing Oleanolic Acid Capsule ("Xin Ao Xing Capsule"), is a state-approved OTC drug for treatment of Hepatitis B.

Liquidity and Capital Resources

As of September 30, 2010, we had cash and cash equivalents of approximately $16.6 million. We believe our existing cash and cash equivalents will be sufficient to maintain our operations at present level for at least the next twelve months.

Net cash provided by operating activities for the nine months ended September 30, 2010 was $8.7 million. This was primarily due to our net income of $11.3 million, adjusted by non-cash related expenses including depreciation and amortization of $0.4 million, stock-based compensation of $0.5 million, make-good share expense of $0.2 million and exchange rate effect of $0.6 million, offset by a net increase in working capital items of $4.3 million. The net increase in working capital items was mainly due to increase in accounts receivable and inventories resulting from increase in sales.

Net cash used in investing activities for the nine months ended September 30, 2010 was $0.9 million, primarily due to the acquisition of properties and intangible assets resulting from the Meipude acquisition.

Net cash provided by financing activities for the nine months ended September 30, 2010 was $37,537, primarily due to the exercise of warrants.

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Results of Operations

Net Sales

For the three and nine months ended September 30, 2010, total net sales increased by approximately $4.6 million or 30%, and $15.7 million or 43%, respectively, compared to the same periods in 2009. This was primarily due to our diversified product portfolio and marketing efforts in existing and new sales regions. Domestic Chinese customers still accounted for 100% of total sales.

Net Sales		Three Months Ended September 30,					
		2010			2009		
Drugs							
	Xin Aoxing Oleanolic Acid Capsule	$ 12,914,126	64.0	%	$ 11,963,899	76.9	%
	Gan Wang Compound Paracetamol Capsule	1,528,470	7.6	%	995,691	6.4	%
	Tianqi Dysmenorrhea Capsule	1,599,570	7.9	%	1,079,217	6.9	%
	Danshen Granule	1,099,998	5.5	%	623,681	4.0	%
	Taohuasan Pediatrics Medicine	977,986	4.8	%	893,857	5.8	%
	Subtotal	18,120,150	89.8	%	15,556,345	100.0	%
Health products							
	Tangning Capsule	436,104	2.2	%	-	0.0	%
	Yizi Capsule	1,291,237	6.4	%	-	0.0	%
	Shengjing Capsule	189,790	0.9	%	-	0.0	%
	Aoxing Ointment	95,904	0.5	%	-	0.0	%
	Other	-	0.0	%	-	0.0	%
	Subtotal	2,013,035	10.0	%	-	0.0	%
Medical device							
	Hernia belt	45,432	0.2	%	-	0.0	%
	Subtotal	45,432	0.2	%	-	0.0	%
	Total revenue	$ 20,178,617	100.0	%	$ 15,556,345	100.0	%

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		Nine Months Ended September 30,					
		2010			2009		
Drugs							
	Xin Aoxing Oleanolic Acid Capsule	$ 34,791,887	67.0	%	$ 24,771,067	68.3	%
	Gan Wang Compound Paracetamol Capsule	3,701,964	7.1	%	2,785,964	7.7	%
	Tianqi Dysmenorrhea Capsule	3,974,654	7.7	%	3,563,274	9.8	%
	Danshen Granule	2,575,754	5.0	%	2,280,522	6.3	%
	Taohuasan Pediatrics Medicine	3,024,029	5.8	%	2,848,224	7.9	%
	Subtotal	48,068,288	92.6	%	36,249,051	100.0	%
Health products							
	Tangning Capsule	839,548	1.6	%	-	0.0	%
	Yizi Capsule	2,430,564	4.7	%	-	0.0	%
	Shengjing Capsule	372,701	0.7	%	-	0.0	%
	Aoxing Ointment	161,344	0.3	%	-	0.0	%
	Other	-	0.0	%	-	0.0	%
	Subtotal	3,804,157	7.3	%	-	0.0	%
Medical device							
	Hernia belt	65,038	0.1	%	-	0.0	%
	Subtotal	65,038	0.1	%	-	0.0	%
	Total revenue	$ 51,937,483	100.0	%	$ 36,249,051	100.0	%

Revenue from rural market were $4.2 million and $1 million, and accounted for 21% and 7% of the total net sales for the three months ended September 30, 2010 and 2009, respectively, representing a 313% increase. Revenue from rural market were $9.2 million and $6.3 million, and accounted for 18% and 17% of the total net sales for the nine months ended September 30, 2010 and 2009, respectively, representing a 45% increase.

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Cost of sales

Compared to the same periods of 2009, cost of sales increased by about $1.9 million or 52%, and $3.6 million or 36%, for the three and nine months ended September 30, 2010, respectively. The increase in the cost of sales was primarily due to the increase in sales volume, especially Xin Aoxing Oleanolic Acid Capsule.

Cost of Sales		Three Months Ended September 30,					
		2010			2009		
Drugs							
	Xin Aoxing Oleanolic Acid Capsule	$ 2,021,621	37.0	%	$ 1,897,787	52.9	%
	Gan Wang Compound Paracetamol Capsule	791,969	14.5	%	517,869	14.4	%
	Tianqi Dysmenorrhea Capsule	596,809	10.9	%	385,865	10.8	%
	Danshen Granule	831,308	15.2	%	471,933	13.2	%
	Taohuasan Pediatrics Medicine	344,219	6.3	%	311,689	8.7	%
	Subtotal	4,585,926	83.9	%	3,585,143	100.0	%
Health products							
	Tangning Capsule	140,616	2.6	%	-	0.0	%
	Yizi Capsule	502,043	9.2	%	-	0.0	%
	Shengjing Capsule	148,986	2.7	%	-	0.0	%
	Aoxing Ointment	65,676	1.2	%	-	0.0	%
	Other	-	0.0	%	-	0.0	%
	Subtotal	857,321	15.7	%	-	0.0	%
Medical device							
	Hernia belt	21,559	0.4	%	-	0.0	%
	Subtotal	21,559	0.4	%	-	0.0	%
	Total cost	$ 5,464,806	100.0	%	$ 3,585,143	100.0	%

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		Nine Months Ended September 30,					
		2010			2009		
Drugs							
	Xin Aoxing Oleanolic Acid Capsule	$ 5,287,416	39.7	%	$ 4,217,293	43.2	%
	Gan Wang Compound Paracetamol Capsule	1,915,296	14.4	%	1,491,498	15.3	%
	Tianqi Dysmenorrhea Capsule	1,471,292	11.1	%	1,273,970	13.1	%
	Danshen Granule	1,941,412	14.6	%	1,776,601	18.2	%
	Taohuasan Pediatrics Medicine	1,052,344	7.9	%	994,342	10.2	%
	Subtotal	11,667,760	87.7	%	9,753,704	100.0	%
Health products							
	Tangning Capsule	269,155	2.0	%	-	0.0	%
	Yizi Capsule	938,001	7.1	%	-	0.0	%
	Shengjing Capsule	290,713	2.2	%	-	0.0	%
	Aoxing Ointment	111,769	0.8	%	-	0.0	%
	Other	-	0.0	%	-	0.0	%
	Subtotal	1,609,638	12.1	%	-	0.0	%
Medical device							
	Hernia belt	32,710	0.2	%	-	0.0	%
	Subtotal	32,710	0.2	%	-	0.0	%
	Total cost	$ 13,310,108	100.0	%	$ 9,753,704	100.0	%

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Gross Profit		Three Months Ended September 30,					
		2010			2009		
Drugs							
	Xin Aoxing Oleanolic Acid Capsule	$ 10,892,505	84.3	%	$ 10,066,112	84.1	%
	Gan Wang Compound Paracetamol Capsule	736,501	48.2	%	477,822	48.0	%
	Tianqi Dysmenorrhea Capsule	1,002,761	62.7	%	693,352	64.2	%
	Danshen Granule	268,690	24.4	%	151,748	24.3	%
	Taohuasan Pediatrics Medicine	633,767	64.8	%	582,168	65.1	%
	Subtotal	13,534,224	74.7	%	11,971,202	77.0	%
Health products							
	Tangning Capsule	295,488	67.8	%	-	0.0	%
	Yizi Capsule	789,194	61.1	%	-	0.0	%
	Shengjing Capsule	40,804	21.5	%	-	0.0	%
	Aoxing Ointment	30,228	31.5	%	-	0.0	%
	Other	-	0.0	%	-	0.0	%
	Subtotal	1,155,714	57.4	%	-	0.0	%
Medical device							
	Hernia belt	23,873	52.5	%	-	0.0	%
	Subtotal	23,873	52.5	%	-	0.0	%
	Total gross profit	$ 14,713,811	72.9	%	$ 11,971,202	77.0	%

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		Nine Months Ended September 30,					
		2010			2009		
Drugs							
	Xin Aoxing Oleanolic Acid Capsule	$ 29,504,471	84.8	%	$ 20,553,774	83.0	%
	Gan Wang Compound Paracetamol Capsule	1,786,668	48.3	%	1,294,466	46.5	%
	Tianqi Dysmenorrhea Capsule	2,503,362	63.0	%	2,289,304	64.2	%
	Danshen Granule	634,342	24.6	%	503,921	22.1	%
	Taohuasan Pediatrics Medicine	1,971,685	65.2	%	1,853,882	65.1	%
	Subtotal	36,400,528	75.7	%	26,495,347	73.1	%
Health products							
	Tangning Capsule	570,393	67.9	%	-	0.0	%
	Yizi Capsule	1,492,563	61.4	%	-	0.0	%
	Shengjing Capsule	81,988	22.0	%	-	0.0	%
	Aoxing Ointment	49,575	30.7	%	-	0.0	%
	Other	-	0.0	%	-	0.0	%
	Subtotal	2,194,519	57.7	%	-	0.0	%
Medical device							
	Hernia belt	32,328	49.7	%	-	0.0	%
	Subtotal	32,328	49.7	%	-	0.0	%
	Total gross profit	$ 38,627,375	74.4	%	$ 26,495,347	73.1	%

Gross profit increased $2.7 million or 23%, and $12.1 million or 46%, for the three and nine months ended September 30, 2010, respectively, compared to the same periods in 2009. The increase in gross profit was due primarily to the increase in sales volume.

The overall gross profit margin decreased in the third quarter of 2010 by 4% compared to the same period in 2009 mainly because the health products that we began to distribute this year carried lower gross margins than those typical of our drug products historically. However, the overall gross profit margin increased by 1% for the nine months ended September 30, 2010 compared to the same period in 2009 due primarily to the increase in sales of Xin Aoxing Oleanolic Acid Capsule which had a gross profit margin of 85% for the nine months ended September 30, 2010.

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Selling, General and Administrative Expenses

	Three Months Ended September 30,							
	2010			2009				
	Amount	% of Net Sales		Amount	% of Net Sales		% of Change	
Selling expenses	$ 8,673,251	43	%	$ 6,778,046	44	%	28	%
General & administrative expenses	$ 1,218,155	6	%	$ 1,079,212	7	%	13	%

	Nine Months Ended September 30,							
	2010			2009				
	Amount	% of Net Sales		Amount	% of Net Sales		% of Change	
Selling expenses	$ 20,334,068	39	%	$ 12,392,090	34	%	64	%
General & administrative expenses	$ 2,805,506	5	%	$ 2,216,460	6	%	27	%

The period-over-period increase in selling expenses in dollar amount for the three and nine months ended September 30, 2010 were mainly due to the increase in both business volume and advertising expenditures. Advertising expense accounted for 46% and 53% of the total selling expenses for the three months ended September 30, 2010 and 2009, respectively, and 57% and 52% of the total selling expenses for the nine months ended September 30, 2010 and 2009, respectively. However, general and administrative expenses as a percentage of total net sales decreased for both the three and nine months ended September 30, 2010 due to better efficiency achieved by economy of scale as our operational size increased.

Stock-based compensation

Our board of directors adopted a stock option incentive plan in August 2009. The values of options granted under the plan are expensed over the term of their respective vesting periods. Stock awards are valued using the market price on or around the date the shares were awarded and included as a period compensation expense. Consequently, we incurred $127,865 and $520,416 in stock-based compensation for the three and nine months ended September 30, 2010, respectively.

Interest Expense

We did not incur interest expense for the three months and nine months ended September 30, 2010 and 2009.

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Provision for Income Taxes

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Provision for income taxes	$ 1,385,984	$ 988,286	$ 4,016,359	$ 2,828,683
Effective tax rate	29%	24%	26%	24%

For the three and nine months ended September 30, 2010, provision for income taxes increased by $397,698 and $1,187,676, respectively, compared to the same periods in 2009, driven by higher taxable income year over year. The applicable tax rate for the three and nine months ended September 30, 2010 was 25%, being the uniform corporate income tax rate in China.

Critical Accounting Policies

We believe the following critical accounting policies, among others, affect management's more significant judgments and estimates used in the preparation of the financial statements:

Allowance for Doubtful Accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance for doubtful accounts is based on specific identification of customer accounts and management's best estimate of the likelihood of potential loss, taking into account such factors as the financial condition and payment history of major customers. Management evaluates the collectability of the receivables at least quarterly. If the financial condition of a customer was to deteriorate further, resulting in an impairment of their ability to make payments, additional allowances may be required. Such differences could be material and could significantly impact cash flows from operating activities.

The following table sets out the aging of our accounts receivable for each balance sheet periods presented.

Accounts Receivable Aging	Total	1-30 days	31-60 days	61-90 days	91-120 days	121-365 days	> 365 days
As of September 30, 2010	$22,170,353	$8,768,228	$7,346,451	$6,009,848	$2,181	$36,906	$6,739
As of December 31, 2009	$19,937,154	$7,238,448	$6,598,953	$6,093,151	$-	$6,602	$-

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The following table presents the days sales outstanding calculated based on sales and accounts receivables for the nine months ended September 30, 2010 and 2009.

	Nine Months Ended September 30,	
	2010	2009
Days sales outstanding	116	134

The number of days that sales were outstanding decreased to 116 days for the nine months ended September 30, 2010 from 134 days for the same period in 2009.

The following are steps the Company takes in collecting accounts receivable:

Step 1: After the payment term has been exceeded, the Company stops taking orders from the delinquent customer and allows the responsible sales person three to six months to collect the accounts receivable. Most of the accounts receivable will be collected in this step because the sales person's compensation is tied to sales receipts.

Step 2: If the sales person's collection efforts are not successful, the Company hires a collection agent and allows the agent another three to six months to collect the accounts receivable.

Step 3: If the collection agent's efforts are not successful, the Company will commence legal action to collect the accounts receivable.

Our policies for writing off the accounts receivable are as follows:

1. If after taking legal action, it appears that an accounts receivable is not likely to become collectible, such accounts receivable will be written off if it is more than two years old.

2. If during the collection period, the customer provides bankruptcy or other insolvency documentation, the corresponding accounts receivable will be written off.

3. If we are no longer able to locate a particular customer in order for us to take any collection or legal actions, the accounts receivable for such customer will be written off if it is more than two years old.

Inventory

We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand, future pricing and market conditions. If actual future demands, future pricing or market conditions are less favorable than those projected by management, additional inventory write-downs may be required and the differences could be material. Such differences might significantly impact cash flows from operating activities.

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Property and Equipment

Property and equipment are stated at historical cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Judgment is required to determine the estimated useful lives of assets, especially for computer equipment, including determining how long existing equipment can function and when new technologies will be introduced at cost-effective price points to replace existing equipment. Changes in these estimates and assumptions could materially impact the financial position and results of operations.

Stock-Based Compensation

Our stock-based compensation expense is estimated at the grant date based on the award's fair value as calculated by the Black-Scholes-Merton (BSM) option-pricing model and is recognized as expense over the requisite service period. The BSM model requires various highly judgmental assumptions including expected volatility and option life. Changes in these assumptions could materially impact the financial position and results of operations.

Valuation of Intangibles

From time to time, we acquire intangible assets that are beneficial to our product development processes. Management periodically evaluates the carrying value of intangibles, including the related amortization periods. In evaluating acquired intangible assets, management determines whether there has been impairment by comparing the anticipated undiscounted cash flows from the operation and eventual disposition of the product line with its carrying value. If the undiscounted cash flows are less than the carrying value, the amount of the impairment, if any, will be determined by comparing the carrying value of each intangible asset with its fair value. Fair value is generally based on either a discounted cash flows analysis or market analysis. Future operating income is based on various assumptions, including regulatory approvals, patents being granted, and the type and nature of competing products. If regulatory approvals or patents are not obtained or are substantially delayed, or other competing technologies are developed and obtain general market acceptance or market conditions otherwise change, our intangibles may have a substantially reduced value, which could be material.

Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and for operating losses and tax credit carry-forwards. Management must make assumptions, judgments and estimates to determine the current provision for income taxes and the deferred tax assets and liabilities and any valuation allowance to be recorded against a deferred tax asset. Management's judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, management's interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax law or management's interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in the financial statements. Management's assumptions, judgments and estimates relative to the value of a deferred tax asset take into account predictions of the amount and category of future taxable income, such as income from operations. Actual operating results and the underlying amount and category of income in future years could render management's current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate. Any of the assumptions, judgments and estimates mentioned above could cause our actual income tax obligations to differ from the estimates, thus materially impact the financial position and results of operations.

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Foreign Currency

Our functional currency is the U.S. dollar, and our subsidiary and our VIE in China use their respective local currencies as their functional currencies, i.e. the RMB. An entity's functional currency is the currency of the primary economic environment in which the entity operates. Management must use judgment in determining an entity's functional currency, assessing economic factors including cash flow, sales price, sales market, expense, financing and inter-company transactions and arrangements. The impact from exchange rate changes related to transactions denominated in currencies other than the functional currency is recorded as a gain and loss in the statements of operations, while the impact from exchange rate changes related to translating a foreign entity's financial statements from the functional currency to its reporting currency, the U.S. dollar, is disclosed and accumulated in a separate component under the equity section of the balance sheets. Different judgments or assumptions resulting in a change of functional currency may materially impact our financial position and results of operations.

Contractual Obligations

The following table sets forth our contractual obligations as of September 30, 2010:

		Payments due by period			
	Total	Within 1 year	1-3 years	3-5 years	>5 years
Construction contract	$223,944	$223,944	-	-	-
Research and development expense	613,681	613,681	-	-	-
Total contractual obligations	$837,625	$837,625	-	-	-

Inflation

Management believes that inflation has not had a material effect on our results of operations.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements, as defined in Regulation S-K Section 303(a)(4).

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are a "smaller reporting company" as defined by Regulations S-K and as such, are not required to provide this information.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this quarterly report on Form 10-Q, our principal executive officer and principal financial officer have evaluated the effectiveness of our “disclosure controls and procedures” (“Disclosure Controls”). Disclosure Controls, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Our management, including the CEO and CFO, does not expect that our Disclosure Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based upon their controls evaluation, our CEO and CFO have concluded that our Disclosure Controls, as of the end of the period covered by this Quarterly Report, were effective at a reasonable assurance level.

Changes in Internal Control over Financial Reporting

No changes in our internal control over financial reporting have come to management's attention during our last fiscal quarter that have materially affected, or are likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None

Item 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

Our operating history may not serve as an adequate basis to judge our future prospects and results of operations.

Aoxing Pharmaceutical commenced its current line of business operations in 1997 and received its Good Manufacturing Practices ("GMP") certification in January 2006, which must be renewed every five years for Aoxing Pharmaceutical to stay in business. Aoxing Pharmaceutical's operating history may not provide a meaningful basis on which to evaluate its business. We cannot assure you that we will maintain our profitability or that we will not incur net losses in the future. We expect that our operating expenses will increase as we expand. Any significant failure to realize anticipated revenue growth could result in significant operating losses. We will continue to encounter risks and difficulties frequently experienced by companies at a similar stage of development, including our potential failure to:

- raise adequate capital for expansion and operations;
- implement our business model and strategy and adapt and modify them as needed;
- increase awareness of our brand name, protect our reputation and develop customer loyalty;
- manage our expanding operations and service offerings, including the integration of any future acquisitions;
- maintain adequate control of our expenses; or
- anticipate and adapt to changing conditions in the medical over the counter, pharmaceutical and nutritional supplement markets in which we operate as well as the impact of any changes in government regulations, mergers and acquisitions involving our competitors, technological developments and other significant competitive and market dynamics.

If we are not successful in addressing any or all of these risks, our business may be materially and adversely affected.

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The loss of Aoxing Pharmaceutical as our operating business would have a material adverse effect on our business and the price of our common stock.

We have no equity ownership interest in Aoxing Pharmaceutical. Our ability to control Aoxing Pharmaceutical and consolidate its financial results is through a series of contractual arrangements between it and our wholly owned subsidiary Shaanxi Biostar. Management of Aoxing Pharmaceutical is an affiliate of us and of Shaanxi Biostar, and the stockholders of Aoxing Pharmaceutical are also our stockholders. Thus, the contractual arrangements were not entered into as a result of arms' length negotiations because the parties to such agreements are under common control. Mr. Wang, our Chairman of the Board and Chief Executive Officer, holds approximately 45.31% of the shares of Aoxing Pharmaceutical and 33.39% of our common stock. While we have been advised by our PRC counsel that the contractual arrangements are legal and enforceable under PRC law, these affiliates control the parties to the contractual arrangements, and it could be possible for them to cause Aoxing Pharmaceutical and its shareholders to breach the contractual arrangements, in which event our unaffiliated investors would have little or no recourse because of the inherent difficulties in enforcing their rights since all our assets are located in the PRC. (See, Risk Factor "The PRC laws and regulations governing our current business operations are sometimes vague and uncertain. Any changes in such PRC laws and regulations may harm our business.") In the event that management of Aoxing Pharmaceutical decides to cause a breach of the contractual arrangements, the risk of loss for the affiliated shareholders of Aoxing Pharmaceutical could be lower than that for the unaffiliated investors, and the interests of the management and shareholders of Aoxing Pharmaceutical would be in conflict with the interest of our other stockholders.

As we currently depend on Xin Ao Xing Oleanolic Acid Capsule for a substantial majority of our revenues, any adverse developments relating to that product will materially and adversely affect our results of operations.

We currently rely on Xin Ao Xing Oleanolic Acid Capsule for a substantial majority of our revenues. 67% and 69% of our revenues were derived from sales of this product for the nine months ended September 30, 2010 and for the year ended December 31, 2009, respectively. Accordingly, any of the following could materially and adversely affect our business, financial condition and results of operations:

- any decrease in its market acceptance or popularity in the market due to competing products or other factors; or
- loss of our ability to manufacture and/or distribute this product due to compliance or other regulatory issues.

Our failure to compete effectively may adversely affect our ability to generate revenue.

We compete with other companies, many of which are developing or can be expected to develop products similar to ours. Many of our competitors are also more established than we are, and have significantly greater financial, technical, marketing and other resources than we presently possess. Some of our competitors have greater name recognition and a larger customer base. These competitors may be able to respond more quickly to new or changing opportunities and customer requirements and may be able to undertake more extensive promotional activities, offer more attractive terms to customers, and adopt more aggressive pricing policies. We cannot assure you that we will be able to compete effectively with current or future competitors or that the competitive pressures we face will not harm our business.

We may not be able to effectively control and manage our growth.

If our business and markets grow and develop, it will be necessary for us to finance and manage expansion in an orderly fashion. An expansion would increase demands on existing management, workforce and facilities. Failure to satisfy such increased demands could interrupt or adversely affect our operations, cause delay in production and delivery of our products, and increase administrative inefficiencies.

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We may require additional financing in the future and a failure to obtain such required financing will inhibit our ability to grow.

The continued growth of our business may require additional funding from time to time, which we expect to raise in private placements of our equity or debt securities with accredited investors or by offering our securities for sale pursuant to an effective registration statement on a market where our common stock is traded. The proceeds of these fundings will be forwarded to Aoxing Pharmaceutical and accounted for as a loan to Aoxing Pharmaceutical and eliminated during consolidation. The proceeds would be used for general corporate purposes of Aoxing Pharmaceutical, which could include acquisitions, investments, repayment of debt and capital expenditures among other things. We may also use the proceeds to repurchase our capital stock or for our corporate overhead expenses. If we borrow funds we expect to be the primary obligor on any debt. Obtaining additional funding would be subject to a number of factors including market conditions, operating performance and investor sentiment, many of which are outside of our control. These factors could make the timing, amount, terms and conditions of additional funding unattractive or unavailable to us. Our management believes that we currently have sufficient funds from working capital to meet our current operating costs over the next 12 months.

The terms of any future financing may adversely affect your interest as stockholders.

If we require additional financing in the future, we may be required to incur indebtedness or issue equity securities, the terms of which may adversely affect your interests in us. For example, the issuance of additional indebtedness may be senior in right of payment to your shares upon our liquidation. In addition, indebtedness may be under terms that make the operation of Aoxing Pharmaceutical's business more difficult because the lender's consent could be required before we take certain actions. Similarly the terms of any equity securities we issue may be senior in right of payment of dividends to your common stock and may contain superior rights and other rights as compared to your common stock. Further, any such issuance of equity securities may dilute your interest in us.

We may engage in future acquisitions that could dilute the ownership interests of our stockholders, cause us to incur debt and assume contingent liabilities.

We may review acquisition and strategic investment prospects that we believe would complement our current product offerings, augment our market coverage or enhance our technical capabilities, or otherwise offer growth opportunities. From time to time we review investment opportunities in new businesses and we expect to make investments in, and to acquire, businesses, products, or technologies in the future. We expect that when we raise funds from investors for any of these purposes we will be either the issuer or the primary obligor while the proceeds will be forwarded to Aoxing Pharmaceutical and accounted for as a loan to Aoxing Pharmaceutical and eliminated during consolidation. In the event of any future acquisitions, we could:

- issue equity securities which would dilute current stockholders’ percentage ownership;
- incur substantial debt;
- assume contingent liabilities; or
- expend significant cash.

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These actions could have a material adverse effect on our operating results or the price of our common stock. Moreover, even if we do obtain benefits in the form of increased sales and earnings, there may be a lag between the time when the expenses associated with an acquisition are incurred and the time when we recognize such benefits. Acquisitions and investment activities also entail numerous risks, including:

- difficulties in the assimilation of acquired operations, technologies and/or products;
- unanticipated costs associated with the acquisition or investment transaction;
- the diversion of management's attention from other business concerns;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which Aoxing Pharmaceutical has no or limited prior experience;
- the potential loss of key employees of acquired organizations; and
- substantial charges for the amortization of certain purchased intangible assets, deferred stock compensation or similar items.

We cannot assure you that we will be able to successfully integrate any businesses, products, technology, or personnel that we might acquire in the future, and our failure to do so could have a material adverse effect on our business, operating results and financial condition.

We do not hold any indemnification insurance for our officers and directors.

Our certificate of incorporation provides for the indemnification and/or exculpation of our directors, officers, employees and agents the maximum extent provided, and under the terms provided, by the laws and decisions of the courts of the state of Maryland. Since we do not carry indemnification insurance, these indemnification provisions could result in substantial expenditures, which we may be unable to recoup and which could adversely affect our business and financial conditions.

We may not have adequate internal accounting controls. While we have certain internal procedures in our budgeting, forecasting and in the management and allocation of funds, our internal controls may not be adequate.

We are constantly striving to improve our internal accounting controls. We expect to continue to improve our internal accounting control for budgeting, forecasting, managing and allocating our funds and to better account for them as we grow. There is no guarantee that such improvements will be adequate or successful or that such improvements will be carried out on a timely basis. If we do not have adequate internal accounting controls, we may not be able to appropriately budget, forecast and manage our funds, we may also be unable to prepare accurate accounts on a timely basis to meet our continuing financial reporting obligations and we may not be able to satisfy our obligations under U.S. securities laws.

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Rules adopted by the SEC pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require 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. The standards that must be met for management to assess the internal control over financial reporting as effective require significant documentation, testing and possible remediation to meet the detailed standards. Some members of our management team have limited or no experience operating a public company or little or no familiarity with SEC rules and requirements, including SEC reporting practices and requirements applicable to public companies. While we are in the process of engaging a consulting firm to evaluate and assist us with implementing a viable internal control system, our lack of great familiarity with Section 404 may nevertheless unduly divert management's time and resources in executing the business plan. 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. So far, our external auditors have not reported to our board of directors any significant weakness on our internal control and provided recommendations accordingly. Nevertheless, 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 stock. Furthermore, we anticipate that we will incur considerable costs and use significant management time and other resources in our efforts to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

We are dependent on certain key personnel and loss of these key personnel could have a material adverse effect on our business, financial condition and results of operations.

Our success is, to a certain extent, attributable to the management, sales and marketing, and pharmaceutical factory operational expertise of key personnel. We are dependent upon the services of Mr. Wang, our Chairman and CEO, for the continued growth and operation of our Company because of his experience in the industry and his personal and business contacts in the PRC. Mr. Wang currently has a five year employment contract with Aoxing Pharmaceutical that expires in June 2015. Although we have no reason to believe that Mr. Wang will discontinue his services with us or Aoxing Pharmaceutical or not renew his employment contract with Aoxing Pharmaceutical, the interruption or loss of his services would adversely affect our ability to effectively run our business and pursue our business strategy as well as our results of operations.

Additionally, Deyin Chen, our Chief Financial Officer, Amei Zhang, our Chief Operating Officer, Shuang Gong, our Corporate Secretary, and Yuan Jian, general manager and chief engineer of Aoxing Pharmaceutical, perform key functions in the operation of our business. There can be no assurance that we will be able to retain these officers after the term of their employment contracts expire. The loss of these officers could have a material adverse effect upon our business, financial condition, and results of operations. We do not carry key man life insurance for any of our key personnel nor do we foresee purchasing such insurance to protect against a loss of key personnel.

We may not be able to hire and retain qualified personnel to support our growth, and if we are unable to retain or hire these personnel in the future, our ability to improve our products and implement our business objectives could be adversely affected.

We must attract, recruit and retain a sizeable workforce of technically competent employees. Competition for senior management and senior personnel in the PRC is intense, the pool of qualified candidates in the PRC is very limited, and we may not be able to retain the services of our senior executives or senior personnel, or attract and retain high-quality senior executives or senior personnel in the future. This failure could materially and adversely affect our future growth and financial condition. We expect to hire additional sales and plant personnel throughout fiscal year 2010 in order to accommodate our growth.

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If we fail to increase our brand recognition, we may face difficulty in obtaining new customers and business partners.

We believe that establishing, maintaining and enhancing our brand in a cost-effective manner is critical to achieving widespread acceptance of our current and future products and services and is an important element in our effort to increase our customer base and obtain new business partners. We believe that the importance of brand recognition will increase as competition in our market develops. Some of our potential competitors already have well-established brands in the pharmaceutical promotion and distribution industry. Successful promotion of our brand will depend largely on our ability to maintain a sizeable and active customer base, our marketing efforts and ability to provide reliable and useful products and services at competitive prices. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we will incur in building our brand. If we fail to successfully promote and maintain our brand, or if we incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, in which case our business, operating results and financial condition would be materially adversely affected.

Our operating results may fluctuate as a result of factors beyond our control.

Our operating results may fluctuate significantly in the future as a result of a variety of factors, many of which are beyond our control. These factors include:

- the costs of pharmaceutical products and development;
- the relative speed and success with which we can obtain and maintain customers, merchants and vendors for our products;
- capital expenditures for equipment;
- marketing and promotional activities and other costs;
- changes in our pricing policies, suppliers and competitors;
- the ability of our suppliers to provide products in a timely manner to their customers;
- changes in operating expenses;
- increased competition in the pharmaceutical markets; and
- other general economic and seasonal factors.

We face risks related to product liability claims.

We presently do not maintain product liability insurance. We face the risk of loss because of adverse publicity associated with product liability lawsuits, whether or not such claims are valid. We may not be able to avoid such claims. Although product liability lawsuits in the PRC are rare, and we have not, to date, experienced significant failure of our products, there is no guarantee that we will not face such liability in the future. This liability could be substantial and the occurrence of such loss or liability may have a material adverse effect on our business, financial condition and prospects.

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There are many safety risks involved in our products that could expose us to liability or inhibit our ability to secure insurance.

Our products involve direct or indirect impact on human health and life. The drugs and products we manufacture and sell may be flawed and cause dangerous side effects and even fatality in certain cases, and lead to major business losses and legal and other liabilities and damages to our Company. In the event that any of our products are alleged to have adverse side effects, we could be subject to product liability claims. Some distributors may refuse to sell our products in certain provinces if they perceive such products to have a high risk.

We face marketing risks.

Newly developed drugs and technology may not be compatible with market needs. Because markets for drugs differentiate geographically inside the PRC, we must develop and manufacture our products to accurately target specific markets to ensure product sales. If we fail to invest in extensive market research to understand the health needs of consumers in different geographic areas, we may face limited market acceptance of our products, which could have a material adverse effect on our sales and earnings.

We face risks relating to difficulty in defending intellectual property rights from infringement.

Our success depends on the protection of our current and future technology and products and our ability to defend our intellectual property rights. We filed for trademark protection for various names and brands of our products sold in the PRC. We also filed for patent protection on three of our products, one of which has been approved. However, it is possible for our competitors to develop similar competitive products even though we have taken steps to protect our intellectual property. If we fail to protect our intellectual property adequately, competitors may manufacture and market products similar to ours. We expect to file patent applications seeking to protect newly developed technology and products in various countries, including the PRC. Some patent applications in the PRC are maintained in secrecy until the patent is issued. Because the publication of discoveries tends to follow their actual discovery by many months, we may not be the first to invent, or file patent applications on any of our discoveries. Patents may not be issued with respect to any of our patent applications and existing or future patents issued to or licensed by us may not provide competitive advantages for our products. Patents that are issued may be challenged, invalidated or circumvented by our competitors. Furthermore, our patent rights may not prevent our competitors from developing, using or commercializing products that are similar or functionally equivalent to our products.

We require those of our employees who have access to proprietary information to enter into confidentiality agreements with us. These agreements may be breached, and there may not be adequate remedies in the event of a breach. Disputes may arise concerning the ownership of intellectual property or the applicability of confidentiality agreements. Moreover, our trade secrets and proprietary technology may otherwise become known or be independently developed by our competitors. If patents are not issued with respect to products arising from research, we may not be able to maintain the confidentiality of information relating to these products.

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We face risks relating to third parties that may claim that we infringe on their proprietary rights and may prevent us from manufacturing and selling certain of our products.

There has been substantial litigation in the pharmaceutical industry with respect to the manufacturing, use and sale of new products. These lawsuits relate to the validity and infringement of patents or proprietary rights of third parties. We may be required to commence or defend against charges relating to the infringement of patent or proprietary rights. Any such litigation could:

- require us to incur substantial expense, even if covered by insurance or even if we are successful in the litigation;
- require us to divert significant time and effort of our technical and management personnel;
- result in the loss of our rights to develop or make certain products; and
- require us to pay substantial monetary damages or royalties in order to license proprietary rights from third parties.

Although patent and intellectual property disputes within the pharmaceutical industry have often been settled through licensing or similar arrangements, costs associated with these arrangements may be substantial and could include the long-term payment of royalties. These arrangements may be investigated by regulatory agencies and, if improper, may be invalidated. Furthermore, the required licenses may not be made available to us on acceptable terms. Accordingly, an adverse determination in a judicial or administrative proceeding or a failure to obtain necessary licenses could prevent us from manufacturing and selling some of our products or increase our costs to market these products.

In addition, when seeking regulatory approval for some of our products, we may be required to certify to regulatory authorities, including the SFDA, that such products do not infringe upon third party patent rights. Filing a certification against a patent gives the patent holder the right to bring a patent infringement lawsuit against us. Any lawsuit would delay the receipt of regulatory approvals. A claim of infringement and the resulting delay could result in substantial expenses and even prevent us from manufacturing and selling certain of our products.

Our launch of a product prior to a final court decision or the expiration of a patent held by a third party may result in substantial damages to us. If we are found to infringe a patent held by a third party and become subject to such damages, these damages could have a material adverse effect on the results of our operations and financial condition.

We face risks related to research and the ability to develop new drugs.

Our growth and survival depends on our ability to consistently discover, develop and commercialize new products and find new, and improve on existing, technology and platforms. As such, if we fail to make sufficient investments in research, be attentive to consumer needs or do not focus on the most advanced technology, our current and future products could be surpassed by more effective or advanced products of other companies.

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The commercial success of our products depends upon the degree of market acceptance among the medical community and a failure to attain market acceptance among the medical community may have an adverse impact on our operations and profitability.

The commercial success of our products depends upon the degree of market acceptance by the PRC medical community, such as hospitals and physicians. Even if our products are approved by the SFDA, there is no assurance that physicians will prescribe or recommend our products to patients. Furthermore, a product's prevalence and use at hospitals may be contingent upon its relationship with the medical community. Currently, Danshen Granule and Taohausan are only available by medical prescription. The acceptance of our products by the PRC medical community may depend upon several factors, including but not limited to, the product's acceptance by physicians and patients as a safe and effective treatment, cost effectiveness, potential advantages over alternative treatments, and the prevalence and severity of side effects. Failure to attain market acceptance among the medical community may have an adverse impact on our operations and profitability.

If all or a significant portion of our customers with accounts receivable fail to pay all or part of the trade receivables or delay the repayment, our net income will decrease, and our profitability will be adversely affected.

We had accounts receivable, net of allowance for doubtful accounts, of approximately $22,033,856 (unaudited) as of September 30, 2010. The standard credit period for most of our customers is around 90 days. Within the medical industry in China, the collection period is generally longer than for other industries. Our average collection period for the nine months ended September 30, 2010 was 116 days. There is no assurance that our accounts receivable will be fully repaid on a timely basis. If all or a significant portion of our customers with accounts receivable fail to pay all or part of the accounts receivable or delay the payment due to us for whatever reason, our net profit will decrease and our profitability will be adversely affected.

Risks Relating To the Pharmaceutical Industry

Our certificates, permits, and licenses related to our pharmaceutical operations are subject to governmental control and renewal, and failure to obtain renewal will cause all or part of our operations to be terminated.

Aoxing Pharmaceutical is subject to various PRC laws and regulations pertaining to the pharmaceutical industry. Aoxing Pharmaceutical has attained certificates, permits, and licenses required for the operation of a pharmaceutical enterprise and the manufacturing of pharmaceutical products in the PRC.

Pursuant to the Good Manufacturing Practices (GMP) for Pharmaceutical Products and the Authentication Regulations for Drug GMP, both promulgated by the SFDA in order to promote quality and safety of pharmaceutical production, we and our competitors are required to meet GMP standards in order to manufacture pharmaceutical products. The GMP certificate is valid for a term of five years, and must be renewed before its expiration. Aoxing Pharmaceutical originally obtained its GMP certificate for the manufacture of drugs in capsule, granule and powder-forms in January 2006, which is valid until January 23, 2011.

According to the Medicine Administration Law of the PRC and its implementation rules, a drug manufacturer must also obtain a pharmaceutical manufacturing permit from the relevant provincial branch of the SFDA, who must verify that the manufacturer’s production processes and products meet the standards by onsite inspections and review of test results. The permit is valid for a term of five years and is renewable upon application prior to its expiration. Aoxing Pharmaceutical’s permit for the manufacture of drugs in capsule, granule and powder-forms was originally issued on January 1, 2006 and is valid until December 31, 2010.

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Also according to the Drug Administration Law of the PRC and its implementation rules, as well as the Admnistration Regulations for Drug Registration, every pharmaceutical manufacturer must register and obtain a drug approval number for each medicine that it manufactures from the SFDA, which drug approval number is valid for five years and is renewable upon application thereafter. The drug approval numbers for our five drug products are currently expired, although the renewal applications have been submitted to and accepted by the Shaanxi branch of the SFDA, and we expect to obtain renewed approval documents for the drug approval numbers by October 2010. According to the Circular Concerning Relevant Issues of Drug Re-registration Acceptance issued by the SFDA, our drug approval numbers will remain valid during the review of the renewal applications. Further, the review process must be completed before September 30, 2010, according to the Circular of Improsing the Approving Work of Drug Re-registration issued by SFDA.

Aoxing Pharmaceutical also holds production permits for eight health products (including three products for which Aoxing Pharmaceutical is the manufacturing agent for the actual manufacturer), which are valid for three years and renewable thereafter prior to their expiration. Currently, the permit for one of our own health products (Aoxing Ganbao) is expired, and permits for three of our other health products (Ao Xing No. 1, Baitongning and Aoxing Ointment) will expire later this year. We submitted renewal application for the expired permit, which renewal we are expect sometime in the fourth quarter of 2010. We intend to apply for renewal of the permits of the other four products prior to their respective expiration dates.

During the renewal process, Aoxing Pharmaceutical will be re-evaluated by the appropriate governmental authorities and must comply with the then prevailing standards and regulations which may change from time to time. In the event that it is not able to renew any of the foregoing certificates, permits and licenses, all or part of its operations may be terminated, which will adversely affect our business. Furthermore, if escalating compliance costs associated with governmental standards and regulations restrict or prohibit any part of Aoxing Pharmaceutical's operations, it may adversely affect its operation and our profitability.

Under the Drug Administration Law of the PRC and its implementing rules, the SFDA approvals, including our pharmaceutical manufacturing permit and drug approval numbers, may be suspended or revoked prior to their expiration dates under circumstances that include:

- producing counterfeit medicine;
- producing inferior quality products;
- failing to meet the drug GMP standards;
- purchasing medical ingredients used in the manufacturing of products that are not covered by a valid pharmaceutical manufacturing permit or pharmaceutical trade permit;
- fraudulent reporting of results or product samples in the application process;
- failing to meet drug labeling and direction standards;
- bribing doctors or hospital personnel to entice them to use products;
- producing pharmaceuticals for use or resale by companies that are not approved by the SFDA; or
- the approved drug has a serious side effect.

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If our pharmaceutical products fail to receive regulatory approval or are severely limited in these products' scope of use, we may be unable to recoup considerable research and development expenditures.

Our research and development of pharmaceutical products is subject to the regulatory approval of the SFDA. The regulatory approval procedure for pharmaceuticals can be quite lengthy, costly, and uncertain. Depending upon the discretion of the SFDA, the approval process may be significantly delayed by additional clinical testing and require the expenditure of resources not currently available; in such an event, it may be necessary for us to abandon our application. Even where approval of the product is granted, it may contain significant limitations in the form of narrow indications, warnings, precautions, or contra-indications with respect to conditions of use. If approval of our product is denied, abandoned, or severely limited in terms of the scope of product use, it may result in the inability to recoup considerable research and development expenditures. Currently, we have two products, Gansukang and Azithromycin, pending before the SFDA, and one product, Zushima, pending before the PRC Military SFDA. If we do not receive timely approval for any of these drugs, then production will be delayed and sales of these products cannot be planned for.

Adverse publicity associated with our products, ingredients or network marketing program, or those of similar companies, could harm our financial condition and operating results. Additionally, anti-corruption measures taken by the government to correct corruptive practices in the pharmaceutical industry could adversely affect our sales and reputation.

The results of our operations may be significantly affected by the public's perception of our products and similar companies. This perception is dependent upon opinions concerning:

- the safety and quality of our products and ingredients;
- the safety and quality of similar products and ingredients distributed by other companies; and
- our sales force.

Adverse publicity concerning any actual or purported failure to comply with applicable laws and regulations regarding product claims and advertising, good manufacturing practices, or other aspects of our business, whether or not resulting in enforcement actions or the imposition of penalties, could have an adverse affect on our goodwill and could negatively affect our sales and ability to generate revenue.

In addition, our consumers' perception of the safety and quality of products and ingredients as well as similar products and ingredients distributed by other companies can be significantly influenced by media attention, publicized scientific research or findings, widespread product liability claims and other publicity concerning our products or ingredients or similar products and ingredients distributed by other companies. Adverse publicity, whether or not accurate or resulting from consumers' use or misuse of our products, that associates consumption of our products or ingredients or any similar products or ingredients with illness or other adverse effects, questions the benefits of our or similar products or claims that any such products are ineffective, inappropriately labeled or have inaccurate instructions as to their use, could negatively impact our reputation or the market demand for our products.

The Chinese government has implemented anti-corruption measures to correct corrupt practices. In the pharmaceutical industry, such practices include, among others, acceptance of kickbacks, bribery or other illegal gains or benefits by the hospitals and medical practitioners from pharmaceutical distributors in connection with the prescription of a certain drug. Some of our sales to our ultimate customers are conducted through third-party distributors. We have no control over our third-party distributors, who may engage in corrupt practices to promote our products. If any of our third-party distributors engage in such practices and the government takes enforcement action, our products may be seized and our own practices, and involvement in the distributors’ practices may be investigated. If this occurs, our sales and reputation may be materially and adversely affected.

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If we fail to develop new products with high profit margins, and our high profit margin products are substituted by competitor's products, our gross and net profit margins will be adversely affected.

There is no assurance that we will be able to sustain our profit margins in the future. The pharmaceutical industry in the PRC is very competitive, and there may be pressure to reduce sale prices of products without a corresponding decrease in the price of raw materials. In addition, new products are constantly being introduced to the market. In order to increase our sales and expand our market share, we may be forced to reduce prices in the future, leading to a decrease in gross profit margin. The research and development of new products and technology is costly and time consuming, and there are no assurances that our research and development of new products will either be successful or completed within the anticipated timeframe, if at all. There is no assurance that our competitors' new products, technology, and processes will not render our existing products obsolete or non-competitive. To the extent that we fail to develop new products with high profit margins and our high profit margin products are substituted by competitors' products, our gross profit margins will be adversely affected.

We are subject to market and channel risks.

We sell our products to retail distributors either directly or through our distributors. Because of this, we are dependent to a large degree upon the success of specific retailers in our distribution channels. Our success is dependent, to a large degree, on the growth and success of these retailers, which may be outside our control. There can be no assurance that the retail distribution channels will be able to grow or prosper as they face price and service pressure from other channels. There can be no assurance that these retailers, in the aggregate, will respond or continue to respond to our marketing commitment in these channels.

Risks Relating To Doing Business In The PRC

Changes in the policies of the PRC government could have a significant impact upon the business we may be able to conduct in the PRC and the profitability of such business.

Our business operations may be adversely affected by the current and future political environment in the PRC. The PRC has operated as a socialist state since the mid-1900s and is controlled by the PRC’s Communist Party. The Chinese government exerts substantial influence and control over the manner in which we must conduct our business activities. The PRC has only permitted provincial and local economic autonomy and private economic activities since 1988. The government of the PRC has exercised and continues to exercise substantial control over virtually every sector of the Chinese economy, particularly the pharmaceutical industry, through regulation and state ownership. Our ability to operate in the PRC may be adversely affected by changes in Chinese laws and regulations, including those relating to taxation, import and export tariffs, raw materials, environmental regulations, land use rights, property and other matters. Under current leadership, the government of the PRC has been pursuing economic reform policies that encourage private economic activity and greater economic decentralization. There is no assurance, however, that the government of the PRC will continue to pursue these policies, or that it will not significantly alter these policies from time to time without notice.

The PRC's economy is in a transition from a planned economy to a market oriented economy subject to five-year and annual plans adopted by the government that set national economic development goals. Policies of the PRC government can have significant effects on the economic conditions of the PRC. The PRC government has confirmed that economic development will follow the model of a market economy. Under this direction, we believe that the PRC will continue to strengthen its economic and trading relationships with foreign countries and business development in the PRC will follow market forces. While we believe that this trend will continue, there can be no assurance that this will be the case.

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A change in policies by the PRC government could adversely affect our interests by, among other factors: changes in laws, regulations or the interpretation thereof, confiscatory taxation, restrictions on currency conversion, imports or sources of supplies, or the expropriation or nationalization of private enterprises. Although the PRC government has been pursuing economic reform policies for more than two decades, there is no assurance that the government will continue to pursue such policies or that such policies will not be significantly altered, especially in the event of a change in leadership, social or political disruption, or other circumstances affecting the PRC's political, economic and social life.

PRC laws and regulations governing our current business operations are sometimes vague and uncertain. Any changes in such PRC laws and regulations may harm our business.

PRC laws and regulations governing our current business operations are sometimes vague and uncertain. The PRC's legal system is a civil law system based on written statutes, where legal cases have little value as precedent unlike the common law system of the United States. There are substantial uncertainties regarding the interpretation and application of PRC laws and regulations, including but not limited to the laws and regulations governing our business, or the enforcement and performance of our arrangements with customers in the event of the imposition of statutory liens, death, bankruptcy and criminal proceedings. The Chinese government has been developing a comprehensive system of commercial laws, and considerable progress has been made in introducing laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. However, because these laws and regulations are relatively new, and because of the limited volume of published cases and judicial interpretation and their lack of force as precedent, interpretation and enforcement of these laws and regulations involve significant uncertainties. New laws and regulations that affect existing and proposed future businesses may also be applied retroactively. We are considered a foreign person or foreign funded enterprise under PRC laws, and as a result, we are required to comply with PRC laws and regulations. We cannot predict what effect the interpretation of existing or new PRC laws or regulations may have on our business. If the relevant authorities find that we are in violation of PRC laws or regulations, they would have broad discretion in dealing with such a violation, including, without limitation:

- levying fines;
- revoking Aoxing Pharmaceutical's business and other licenses;
- requiring that we restructure our ownership or operations; and
- requiring that we discontinue any portion or all of our business.

Among the material laws of the PRC that we are subject to are (i) the Medicine Administration Law, governing the management of pharmaceutical companies, medicine production procedure and packaging, and prices, and the Medicine Registration Administration Regulation, governing the registration of new medicine and Drug Approval Numbers, (ii) the Advertisement Law, the Regulation of Drug Advertisements Censoring implemented by the State Administration for Industry and Commerce and SFDA, governing rules on advertising of medicine advertisement, (iii) the Standardization of the Management on the Quality of Medicine Production issued by the SFDA, providing standards for staff, plants, equipment, materials, environment and production management, (iv) the Price Law, (v) the Measurement Law, (vi) the Enterprise Income Tax Law, the Value Added Tax Interim Regulation and the Law of Tax Collection Administration, (vii) the Environmental Protection Law, (viii) the Contract Law, (ix) the Patent Law, (x) the Accounting Laws, (xi) the Labor Law and the Labor Contract Law, and (xii) the Food Safety Law, which regulates activities involving every aspect of food in China.

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A slowdown, inflation or other adverse development in the PRC economy may harm our customers, and demand for our services and products may decline significantly.

All of our operations are conducted in the PRC, and all of our revenue is generated from sales in the PRC. Although the PRC economy has grown significantly in recent years, we cannot assure you that this growth will continue. A slowdown in overall economic growth, an economic downturn, a recession or other adverse economic developments in the PRC could significantly reduce the demand for our products and harm our business.

While the PRC economy has experienced rapid growth, such growth has been uneven among various sectors of the economy and in different geographical areas of the country. Rapid economic growth could lead to growth in the money supply and rising inflation. If prices for our products rise at a rate that is insufficient to compensate for the rise in the costs of supplies, it may harm our profitability. In order to control inflation in the past, the PRC government has imposed controls on bank credit, limits on loans for fixed assets and restrictions on state bank lending. Such an austere policy can lead to a slowing of economic growth. In October 2004, the People's Bank of China, the PRC's central bank, raised interest rates for the first time in nearly a decade and indicated in a statement that the measure was prompted by inflationary concerns in the Chinese economy. Repeated rises in interest rates by the central bank would likely slow economic activity in the PRC which could, in turn, materially increase our costs and also reduce demand for our products.

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

The PRC government imposes controls on the convertibility of the Chinese currency, the Renminbi (“RMB”), into foreign currencies and, in certain cases, the remittance of currency out of the PRC. We receive substantially all of our revenue in RMB, which is currently not a freely convertible currency. Shortages in the availability of foreign currency may restrict our ability to remit sufficient foreign currency to pay dividends, or otherwise satisfy foreign currency dominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from the transaction, can be made in foreign currencies without prior approval from the PRC State Administration of Foreign Exchange by complying with certain procedural requirements. However, approval from appropriate governmental authorities is required where RMB is to be converted into foreign currency and remitted out of the PRC to pay capital expenses such as the repayment of bank loans denominated in foreign currencies.

The PRC government may also in the future restrict access 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 certain of our expenses as they come due.

The fluctuation of the Renminbi may harm an investment in our securities.

The value of the RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in the PRC's political and economic conditions. According to the website www.xe.com, as of September 30, 2010, $1 was equal to RMB 6. 69275. As we rely entirely on revenue earned in the PRC, any significant revaluation of the RMB may materially and adversely affect our cash flows, revenue and financial condition. For example, to the extent that we need to convert U.S. dollars we receive from an offering of our securities into RMB for Aoxing Pharmaceutical’s operations, appreciation of the RMB against the U.S. dollar would diminish the value of the proceeds of the offering and this could harm Aoxing Pharmaceutical’s business, financial condition and results of operations because it would reduce the proceeds available to us for capital investment in proportion to the appreciation of the RMB. Thus, if we raise $1,000,000 and the RMB appreciates against the U.S. dollar by 15%, then the proceeds will be worth only RMB 5,688,837 as opposed to RMB 6,692,750 prior to the appreciation. Conversely, if we decide to convert our RMB into U.S. dollars for the purpose of making payments for dividends on our common

shares or for other business purposes and the U.S. dollar appreciates against the RMB, the U.S. dollar equivalent of the RMB we convert would be reduced in proportion to the amount the U.S. dollar appreciates. In addition, the depreciation of significant RMB denominated assets could result in a charge to our income statement and a reduction in the dollar value of these assets. Thus, if Aoxing Pharmaceutical has RMB 1,000,000 in assets and RMB is depreciated against the U.S. dollar by 15%, then the assets will be valued at $127,003 as opposed to $149,415 prior to the depreciation.

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On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in an approximately 19.13% appreciation of the RMB against the U.S. dollar as of September 30, 2010. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the RMB against the U.S. dollar.

Current regulations relating to offshore investment activities by PRC residents may limit our ability to acquire PRC companies and could adversely affect us.

In October 2005, SAFE issued a public notice effective from November 1, 2005, the Notice on Relevant Issues in the Foreign Exchange Control over Financing and Return Investment Through Special Purpose Companies by Residents Inside China, or the SAFE notice or SAFE #75, which requires PRC residents, including both legal persons and natural persons, to register with the competent local SAFE branch before establishing or controlling any company outside of the PRC, referred to as an "offshore special purpose company," for the purpose of overseas equity financing involving onshore assets or equity interests held by them. In addition, any PRC resident that is the shareholder of an offshore special purpose company is required to amend its SAFE registration with the local SAFE branch with respect to that offshore special purpose company in connection with any increase or decrease of capital, transfer of shares, merger, division, equity investment or creation of any security interest over any assets located in the PRC. Moreover, if the offshore special purpose company was established and owned the onshore assets or equity interests before the implementation date of the SAFE notice, a retroactive SAFE registration is required to have been completed before March 31, 2006. If any PRC shareholder of any offshore special purpose company fails to make the required SAFE registration and amendment, the PRC subsidiaries of that offshore special purpose company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to the offshore special purpose company. Moreover, failure to comply with the SAFE registration and amendment requirements described above could result in liability under PRC laws for evasion of applicable foreign exchange restrictions.

Our CEO, Ronghua Wang, who is a PRC resident, has submitted his application to register with the local SAFE branch as required by SAFE #75. The 13 other shareholders of Aoxing Pharmaceutical, who along with Mr. Wang hold in the aggregate 100% of Aoxing Pharmaceutical’s outstanding equity interests, have also duly authorized Mr. Wang to submit their applications to the local SAFE branch on their behalf. We had previously expected the local SAFE branch to issue separate registration for each of the 14 shareholders of Aoxing Pharmaceutical. We were informed by the local SAFE branch, however, that while it has acknowledged the receipt of the 14 applications, it will only issue one registration for all the shareholders rather than separate registrations, which we believe it has the discretionary power to do. As a result, we and/or the shareholders of Aoxing Pharmaceutical may be deemed not in full compliance with SAFE #75’s registration requirement for each shareholder of the domestic company, despite our efforts to comply.

We believe that the abovementioned risk may be mitigated by the fact that while the Aoxing Pharmaceutical shareholders do not have their individual registrations, the local SAFE branch deems them registered under the single registration that it will issue. Nevertheless, there is no guarantee that the single registration will be deemed sufficient for compliance purpose. Failure by any of our shareholders who is a PRC resident, or controlled by a PRC resident, to comply with relevant requirements under this regulation could subject us to fines or sanctions imposed by the PRC government, including restrictions on Shaanxi Biostar’s ability to pay dividends or make distributions to us and our ability to increase our investment in Shaanxi Biostar.

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The PRC's legal and judicial system may not adequately protect our business and operations and the rights of foreign investors.

The PRC legal and judicial system may negatively impact foreign investors. In 1982, the National People's Congress amended the Constitution of the PRC to authorize foreign investment and guarantee the "lawful rights and interests" of foreign investors in the PRC. However, the PRC's system of laws is not yet comprehensive. The legal and judicial systems in the PRC are still rudimentary, and enforcement of existing laws is inconsistent. Many judges in the PRC lack the depth of legal training and experience that would be expected of a judge in a more developed country. Because the PRC judiciary is relatively inexperienced in enforcing the laws that do exist, anticipation of judicial decision-making is more uncertain than would be expected in a more developed country. It may be impossible to obtain swift and equitable enforcement of laws that do exist, or to obtain enforcement of the judgment of one court by a court of another jurisdiction. The PRC's legal system is based on the civil law regime, that is, it is based on written statutes; a decision by one judge does not set a legal precedent that is required to be followed by judges in other cases. In addition, the interpretation of Chinese laws may be varied to reflect domestic political changes.

The promulgation of new laws, changes to existing laws and the pre-emption of local regulations by national laws may adversely affect foreign investors. However, the trend of legislation over the last 20 years has significantly enhanced the protection of foreign investment and allowed for more control by foreign parties of their investments in Chinese enterprises. There can be no assurance that a change in leadership, social or political disruption, or unforeseen circumstances affecting the PRC's political, economic or social life, will not affect the PRC government's ability to continue to support and pursue these reforms. Such a shift could have a material adverse effect on our business and prospects.

The practical effect of the PRC legal system on our business operations in the PRC can be viewed from two separate but intertwined considerations. First, as a matter of substantive law, the Foreign Invested Enterprise laws provide significant protection from government interference. In addition, these laws guarantee the full enjoyment of the benefits of corporate Articles and contracts to Foreign Invested Enterprise participants. These laws, however, do impose standards concerning corporate formation and governance, which are qualitatively different from the general corporation laws of the United States. Similarly, the PRC accounting laws mandate accounting practices that are not consistent with U.S. generally accepted accounting principles. PRC's accounting laws require that an annual "statutory audit" be performed in accordance with PRC accounting standards and that the books of account of Foreign Invested Enterprises are maintained in accordance with Chinese accounting laws. Article 14 of the People's Republic of China Wholly Foreign-Owned Enterprise Law requires a wholly foreign-owned enterprise to set up account books and submit certain periodic fiscal reports and statements to designated financial and tax authorities, at the risk of business license revocation. While the enforcement of substantive rights may appear less clear than United States procedures, the Foreign Invested Enterprises and Wholly Foreign-Owned Enterprises are Chinese registered companies, which enjoy the same status as other Chinese registered companies in business-to-business dispute resolution. Any award rendered by an arbitration tribunal is enforceable in accordance with the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958). Therefore, as a practical matter, although no assurances can be given, the Chinese legal infrastructure, while different in operation from its United States counterpart, should not present any significant impediment to the operation of Foreign Invested Enterprises

Any recurrence of severe acute respiratory syndrome, or SARS, or another widespread public health problem, could harm our operations.

A renewed outbreak of SARS or another widespread public health problem (such as bird flu) in the PRC, where all of our revenue is derived, could significantly harm our operations. Our operations may be impacted by a number of health-related factors, including quarantines or closures of some of our offices that would adversely disrupt our operations. Any of the foregoing events or other unforeseen consequences of public health problems could

significantly harm our operations.

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Because our principal assets are located outside of the United States and all of our directors and officers reside outside of the United States, it may be difficult for our investors to enforce their rights based on U.S. federal securities laws against us and our officers or to enforce judgments of U.S. courts against us or them in the PRC.

All of our current directors and officers reside outside of the United States. In addition, our operating company is located in the PRC and substantially all of our assets are located outside of the United States. It may therefore be difficult for investors in the United States to enforce their legal rights based on the civil liability provisions of the U.S. federal securities laws against us in the courts of either the U.S. or the PRC and, even if civil judgments are obtained in U.S. courts, to enforce such judgments in PRC courts. Further, it is unclear if extradition treaties now in effect between the United States and the PRC would permit effective enforcement against us or our officers and directors of criminal penalties, under the U.S. federal securities laws or otherwise.

The relative lack of public company experience of our management team may put us at a competitive disadvantage.

Our management team lacks public company experience, which could impair our ability to comply with legal and regulatory requirements such as those imposed by the Sarbanes-Oxley Act of 2002. The individuals who now constitute our senior management have never had responsibility for managing a publicly traded company. Such responsibilities include complying with federal securities laws and making required disclosures on a timely basis. Our senior management may not be able to implement programs and policies in an effective and timely manner that adequately responds to such increased legal, regulatory compliance and reporting requirements. Our failure to comply with all applicable requirements could lead to the imposition of fines and penalties and distract our management from tending to the growth of our business.

Failure to comply with the United States Foreign Corrupt Practices Act could subject us to penalties and other adverse consequences.

As a Maryland corporation, we are subject to the United States Foreign Corrupt Practices Act, which generally prohibits United States companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Foreign and local Chinese companies, including some that may compete with our company, are not subject to these prohibitions. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices may occur from time-to-time in the PRC. We can make no assurance, however, that our employees or other agents will not engage in such conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties and other consequences that may have a material adverse effect on our business, financial condition and results of operations.

Because our funds are held in banks in the PRC that do not provide insurance, the failure of any bank in which we deposit our funds could affect our ability to continue in business.

Banks and other financial institutions in the PRC do not provide insurance for funds held on deposit. A significant portion of our assets are in the form of cash deposited with banks in the PRC, and in the event of a bank failure, we may not have access to our funds on deposit. Depending upon the amount of money we maintain in a bank that fails, our inability to have access to our cash could impair our operations, and, if we are not able to access funds to pay our suppliers, employees and other creditors, we may be unable to continue in business.

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We may not possess all of the licenses required to operate our business, or we may fail to maintain the licenses we currently hold. This could subject us to fines and other penalties, which may have a material adverse effect on our business, financial condition and results of operations.

We are required to hold a variety of permits and licenses to operate our business in China. We may not possess all of the permits and licenses required for all of our business activities. In addition, there may be circumstances under which an approval, permit or license granted by a governmental agency is subject to change without substantial advance notice, and it is possible that we could fail to obtain an approval, permit or license that is required to expand our business as we intend. If we fail to obtain or to maintain such permits or licenses, or renewals are granted with onerous conditions, we could be subject to fines and other penalties and be limited in the number or the quality of the products that we would be able to offer. As a result, our business, financial condition and results of operations could be materially and adversely affected.

Risks Relating to our Common Stock

Our officers and directors control us through their positions and stock ownership, and their interests may differ from other stockholders.

As of September 30, 2010, there were 26,876,864 shares of our common stock issued and outstanding. Our officers and directors own approximately 34.12% of our common stock. Mr. Ronghua Wang, our Chairman of the Board and CEO, owns approximately 33.39% of our common stock. As a result, he is able to influence the outcome of stockholder votes on various matters, including the election of directors and extraordinary corporate transactions including business combinations. Yet Mr. Wang's interests may differ from those of other stockholders. Furthermore, ownership of 34.12% of our common stock by our officers and directors reduces the public float and liquidity, and may affect the market price, of our common stock.

The full conversion and exercise of certain outstanding series B convertible preferred stock and related warrants could result in substantial dilution of the Company in terms of a particular percentage ownership in our Company as well as the book value of the common shares. The sale of a large amount of common shares received upon exercise of the warrants on the public market to finance the exercise price or to pay associated income taxes, or the perception that such sales could occur, could substantially depress the prevailing market prices for our shares.

As of September 30, 2010, there are a total of 510,572 shares of series B convertible preferred stock, and 555,000 warrants outstanding with a weighted average exercise price of $2.90. In the event of conversion or exercise of these securities, a stockholder could suffer substantial dilution of his, her or its investment in terms of the percentage ownership in us as well as the book value of the common shares held. Full conversion and exercise of the outstanding series B convertible preferred stock and warrants would increase the outstanding common shares as of September 30, 2010 by approximately 3.3% to approximately 27.8 million shares. Additionally, there are 2,000,000 shares of common stock and/or series B convertible preferred stock (the “Make Good Shares”) issuable in connection with a Make Good Escrow Agreement that we entered into with the investors of the series B convertible preferred stock, which shares are issuable to these investors if we do not reach certain financial milestones. Because we were unable to satisfy our fiscal 2009 financial milestones, we have issued to these investors 100,000 shares of our series B convertible preferred stock. If we are also unable to meet our fiscal 2010 financial milestones, we may be obligated to issue up to the balance of the Make Good Shares, depending on the extent of our shortfall, thereby causing further dilution of the Company.

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We are not likely to pay cash dividends in the foreseeable future.

We intend to retain any future earnings for use in the operation and expansion of our business. We do not expect to pay any cash dividends in the foreseeable future but will review this policy as circumstances dictate. Should we decide in the future to do so, as a holding company, our ability to pay dividends and meet other obligations depends upon the receipt of dividends or other payments from our operating subsidiaries. In addition, our operating subsidiaries, from time to time, may be subject to restrictions on their ability to make distributions to us, including restrictions on the conversion of local currency into U.S. dollars or other hard currency and other regulatory restrictions.

Our common shares have historically been thinly traded, and you may be unable to sell at or near ask prices or at all if you desire to liquidate your shares.

We cannot predict the extent to which an active public market for our common stock will develop or be sustained. Our common stock commenced trading on The NASDAQ Global Market on April 23, 2010.

Our common stock was previously quoted on the OTC Bulletin Board, where they have historically been sporadically or “thinly traded”, meaning that the number of persons interested in purchasing our common shares at or near bid prices at any given time may be relatively small or non-existent. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. We cannot give you any assurance that a broader or more active public trading market for our common stock will develop or be sustained, or that current trading levels will be sustained.

The market price for our common stock is particularly volatile given our status as a relatively small company with a small and thinly traded “float” that could lead to wide fluctuations in our share price. The price at which you purchase our common stock may not be indicative of the price that will prevail in the trading market. You may be unable to sell your common stock at or above your purchase price if at all, which may result in substantial losses to you.

The market for our common shares is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. The volatility in our share price is attributable to a number of factors. First, as noted above, our common shares are sporadically and/or thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our stockholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large number of our common shares are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without adverse impact on its share price. Secondly, we are a speculative or “risky” investment due to our fluctuating level of revenues or profits to date and uncertainty of future market acceptance for our current and potential products. As a consequence of this enhanced risk, more risk-averse investors may, under the fear of losing all or most of their investment in the event of negative news or lack of progress, be more inclined to sell their shares on the market more quickly and at greater discounts than would be the case with the stock of a seasoned issuer. The following factors may add to the volatility in the price of our common shares: actual or anticipated variations in our quarterly or annual operating results; adverse outcomes; the termination of our contractual arrangements with Aoxing Pharmaceutical; and additions or departures of our key personnel, as well as other items discussed under this “Risk Factors” section, as well as elsewhere in this report. Many of these factors are beyond our control and may decrease the

market price of our common shares, regardless of our operating performance. We cannot make any predictions or projections as to what the prevailing market price for our common shares will be at any time, including as to whether our common shares will sustain their current market prices, or as to what effect that the sale of shares or the availability of common shares for sale at any time will have on the prevailing market price.

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Stockholders should be aware that the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include (1) control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer; (2) manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases; (3) boiler room practices involving high-pressure sales tactics and unrealistic price projections by inexperienced sales persons; (4) excessive and undisclosed bid-ask differential and markups by selling broker-dealers; and (5) the wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the resulting inevitable collapse of those prices and with consequent investor losses. Our management is aware of the abuses that have occurred historically in the penny stock market. Although we do not expect to be in a position to dictate the behavior of the market or of broker-dealers who participate in the market, management will strive within the confines of practical limitations to prevent the described patterns from being established with respect to our securities. The occurrence of these patterns or practices could increase the volatility of our share price.

Volatility in our common share price may subject us to securities litigation.

The market for our common stock is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. 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.

Investors may have difficulty liquidating their investment because our common stock is subject to the “penny stock" rules, which require delivery of a schedule explaining the penny stock market and the associated risks before any sale.

Our common stock may be subject to regulations prescribed by the SEC relating to "penny stocks." The SEC has adopted regulations that generally define a penny stock to be any equity security that has a market price (as defined in such regulations) of less than $5 per share, subject to certain exceptions. These regulations impose additional sales practice requirements on broker-dealers who sell penny stocks to persons other than established customers and accredited investors (generally institutions with assets in excess of $5,000,000 and individuals with a net worth in excess of $1,000,000 or annual income exceeding $200,000 (individually) or $300,000 (jointly with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of these securities and have received the purchaser's prior written consent to the transaction. Additionally, for any transaction, other than exempt transactions, involving a penny stock, the rules require the delivery, prior to the transaction, of a risk disclosure document mandated by the SEC relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market-maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

Legal remedies, which may be available to the investor, are as follows:

- If penny stocks are sold in violation of the investor's rights listed above, or other federal or state securities laws, the investor may be able to cancel his purchase and get his money back;
- If the stocks are sold in a fraudulent manner, the investor may be able to sue the persons and firms that caused the fraud for damages;
- If the investor has signed an arbitration agreement, however, s/he may have to pursue a claim through arbitration.

If the person purchasing the securities is someone other than an accredited investor or an established customer of the broker-dealer, the broker-dealer must also approve the potential customer's account by obtaining information concerning the customer's financial situation, investment experience and investment objectives. The broker-dealer must also make a determination whether the transaction is suitable for the customer and whether the customer has sufficient knowledge and experience in financial matters to be reasonably expected to be capable of evaluating the risk of transactions in such securities. Accordingly, the SEC's rules may limit the number of potential purchasers of the shares of our common stock and stockholders may have difficulty selling their securities.

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A large number of shares will be eligible for future sale and may depress our stock price.

We may be required, under terms of future financing arrangements, to offer a large number of common shares to the public, or to register for sale by future private investors a large number of shares sold in private sales to them.

Sales of substantial amounts of common stock, or a perception that such sales could occur, and the existence of options or warrants to purchase shares of common stock at prices that may be below the then-current market price of our common stock, could adversely affect the market price of our common stock and could impair our ability to raise capital through the sale of our equity securities, either of which would decrease the value of any earlier investment in our common stock.

We are authorized to issue "blank check" preferred stock, which, if issued without stockholders approval, may adversely affect the rights of holders of our common stock.

We are authorized to issue 10,000,000 shares of preferred stock, of which 5,000,000 shares have been designated as series A preferred stock, and 5,000,000 as series B preferred stock. As of September 30, 2010, there were no shares of series A preferred stock, and 510,572 shares of series B preferred stock, issued and outstanding. Our board of directors is authorized under our Articles of Incorporation, as amended, to provide for the issuance of additional shares of preferred stock by resolution, and to fix the designation, powers, preferences and rights of the shares of each such series and the qualifications, limitations or restrictions thereof without any further vote or action by the stockholders. Any shares of preferred stock so issued are likely to have priority over the common stock with respect to dividend or liquidation rights. In the event of issuance, the preferred stock could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change in control, which could have the effect of discouraging bids for our company and thereby prevent stockholders from receiving the maximum value for their shares. We have no present intention to issue any shares of our preferred stock in order to discourage or delay a change of control. However, there can be no assurance that preferred stock will not be issued at some time in the future.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None during the three months ended September 30, 2010.

Item 3. Defaults upon Senior Securities.

None

Item 4. (Removed and Reserved).

Item 5. Other Information.

None

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Item 6. Exhibits.

Exhibit Number	Description
3.1	Articles of Incorporation filed with the corporate secretary of State of the State of Maryland on March 27, 2007 (1)
3.2	Articles of Amendment filed with the corporate secretary of State of the State of Maryland on August 1, 2007 (1)
3.3	Articles of Amendment filed with the corporate secretary of State of the State of Maryland on September 14, 2007 (1)
3.4	Certificate of Designation for the Series B Convertible Preferred Stock as filed with the corporate secretary of State of Maryland on November 2, 2009 (2)
3.4	Bylaws (1)
10.1	Employment Agreement with Deyin Chen dated June 30, 2010 (3)
10.2	Clinical Research Agreement by and between Shaanxi Aoxing Pharmaceutical Co., Ltd. and the 4th Military District University Beijing Hospital State Pharmaceutical Clinical Research Center dated November 15, 2009 *
10.3	Clinical Research Agreement by and between Shaanxi Aoxing Pharmaceutical Co., Ltd. and the 4th Military District University Beijing Hospital State Pharmaceutical Clinical Research Center dated December 19, 2009 *
10.4	Labor Contract between Shaanxi Aoxing Pharmaceutical Co., Ltd. and Ronghua Wang dated June 30, 2010 *
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
32.1	Certification of the Principal Executive Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *
32.2	Certification of the Principal Financial Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *

* Filed herewith.

(1) Previously filed as an exhibit to the Company's Registration Statement on Form SB-2 (File No. 333-147363) filed with the SEC on November 13, 2007.
(2) Previously filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on November 3, 2009.
(3) Previously filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on July 2, 2010.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIOSTAR PHARMACEUTICALS, INC.
(Registrant)

Date: November 12, 2010 By: /s/ Ronghua Wang
Ronghua Wang
Chief Executive Officer and President
(Principal Executive Officer)

Date: November 12, 2010 By: /s/ Deyin Chen
Deyin Chen
Chief Financial Officer
(Principal Financial and Accounting Officer)

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