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## ***China Sky's Reported Inventory Belies Its Stated Earnings and Sales.***

An analysis of China Sky One Medical, Inc.'s (NASDAQ: CSKI) inventory reporting, as well as certain customer and supplier disclosures, raises serious questions about the accuracy of its reported sales and earnings. See attached [Exhibits 1 - 4](http://www.asensio.com/CSKI/CSKI_Inventory.pdf).

Reports previously issued by asensio.com revealed discrepancies in China Sky's stated EPS, gross margins and average sales prices, along with concerns about its corporate governance and auditors.

The inventory analysis was performed for each year that China Sky has been a public company and filed financial disclosures. The analysis compares the inventory levels each year and against other comparable Chinese companies.

China Sky is claiming that its annual sales have increased more than twenty-fold since 2004, but its finished goods inventory has declined in absolute terms by 75%. China Sky's finished goods inventory was four times greater in 2004 than in 2008, while its sales were more than 20 times greater in 2008 than in 2004. China Sky's finished goods inventory level implies that it turned over finished goods more than 365 times in 2008, and only 4.5 times in 2004.

In 2008, China Sky reported \$91 million in sales, but the company reported just \$55,614 in finished goods inventory at year-end. In 2004\*, China Sky reported \$4.2 million in sales, while it reported \$229,136 in finished goods inventory at year-end.

The \$55,614 in finished goods inventory China Sky reports having at the end of 2008 implies that it had less than one day's worth of sales in finished goods inventory, using the average daily sales in the fourth quarter. This is also the case for 2007. In 2004, however, the company had 81 days of sales in finished goods inventory. See Exhibit 2.

There are other irregularities in China Sky's reported inventory. Exhibit 4 shows the questionable reductions in the company's disclosed finished goods inventory that have occurred during the fourth quarter the past two years. In 2008, finished goods inventory declined 92% in the fourth quarter. In 2007 there was nearly a 93% decline. In 2006, the decline was 41%.

China Sky's inventory claims appear irregular when compared to other public companies selling so-called traditional-Chinese-medicine products in China. As shown in Exhibit 3, in 2008 China Sky had an inventory turnover ratio that was nearly ten times greater than the average inventory turnover of three other comparable companies. While comparable companies report as much as 184 days of inventory on hand, China Sky only had 7 days of total inventory on hand at the end of 2008.

An analysis of China Sky's procurement and distribution is contained in Exhibit 1. This exhibit compares customer and supplier relationships in 2006 versus 2008. The company claimed to have customers covering the same geographic area in 2006 and in 2008. While reported revenues increased from \$19.9 million in 2006 to \$91.8 million, China Sky's number of customers actually decreased from 900 to 233 over the same period, according to China Sky's

10-Ks.

Exhibit 1 also notes the discrepancies in China Sky's disclosures of supplier and customer relationships between the 2007 and 2006 10-Ks. For example, in its 2006 10-K the company stated, "No one supplier accounts for more than 20% of our total raw material purchases." However, the 2007 10-K apparently contradicts this by stating that the supplier Harbin Yongheng Printing Ltd. accounted for 27% of inventory purchases in 2006. The nature of these supplier and customer relationships and the conflicting disclosures about those relationships only add to questions about the seemingly unbelievable reported inventory figures.

China Sky claims in its 2007 10-K that it "has a small inventory on hand primarily due to the enhanced productivity of newly purchased equipment and machinery, and the popularity of Company products in the market." This is the only basis China Sky gives to explain its irregular inventory level.

Perhaps China Sky is referring to its newly acquired transportation equipment as an explanation for its inventory. China Sky reports \$885,880 in transportation equipment at year-end 2008, up from \$318,779 at year-end 2007. China Sky does not disclose how it distributes \$91 million worth of product throughout 22 provinces of China. However, it is telling to note that its \$885,880 worth of transportation equipment is nearly 16 times the value of its finished goods inventory at year end.

\* 2004 financial information is taken from audited statements for the Chinese operating company that became CSKI through a reverse merger in 2006: Harbin Tian Di Ren Medical Science and Technology Company. The audited statements can be found in CSKI's 8-K filed May 15, 2006.