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China Sky's Reported First Quarter Earnings Only Raise More Questions.

China Sky One Medical, Inc. (NASDAQ: CSKI) released first quarter earnings on May 14. The disclosures made in China Sky's earnings announcement and Form 10-Q for the first quarter continue to underscore the issues raised previously by asensio.com, concerning margins and inventory levels. China Sky's disclosures also raise new questions.

China Sky competes in a mature and highly competitive industry. China Sky's claimed results are not comparable with those of the established industry leaders, which do not have China Sky's serious governance and accounting issues.

China Sky continues reporting questionable margins. Gross margin for the first quarter was 76%, compared to gross margin of 77% in the first quarter of last year. However, China Sky claimed to discontinue its "contract sales" entirely, meaning sales of products manufactured by other companies. These contract sales should have lower margins than products manufactured by China Sky directly. According to China Sky's Form 10-Q, contract sales decreased from 24% of sales in the first quarter of 2008 to 0% in the first quarter of 2009. Despite the sharp change in contract sales, gross margins remained remarkably constant, decreasing only 1%. An asensio.com report issued on April 20 analyzes CSKI's margin reporting.

A report issued by asensio.com on May 5 questioned the low level of China Sky's reported inventory relative to sales. At year-end 2008, China Sky reported having only \$55,614 in finished goods inventory, representing less than one day's worth of sales. At the end of the first quarter, reported finished goods inventory was \$498,095. This represents only 7.5 days of sales. By comparison, American Oriental Bioengineering, Inc. (NYSE: AOB), a company very similar to CSKI, reported having more than \$8 million in finished goods inventory at the end of the first quarter, representing more than 43 days of sales.

China Sky continues reporting unexplained growth, which is the subject of an ongoing asensio.com review. In the first quarter, China Sky's revenues increased 100% from prior-year period, going from \$12.4 million in 2008 to \$24.8 million in 2009. According to disclosures made in China Sky's SEC filings, this purported growth must be organic. China Sky did complete three acquisitions in 2008, but none of these could have been a major source of revenue growth. One of the acquired companies, Peng Lai Jin Chuang, had "dormant operations" until after the acquisition, according to CSKI's 10-Q. Another, Haina Pharmaceutical, was only acquired for a distribution license for \$437,375. CSKI's 10-Q actually discloses that the acquired company "does not have an established sales network." The third acquired company only had \$2 million in sales the prior year. Therefore, none of these acquisitions could be driving the more than \$37 million, or 40%, increase in revenues China Sky is projecting for 2009.

Investors should carefully question how a company can increase its sales without substantial increases in working capital and property, plant, and equipment. China Sky states that it only has \$20.9 million in net property and equipment, which reportedly generated \$24.8 million in revenue in the first quarter. In contrast, AOB had \$245.5 million in property, plant, equipment, and land-use rights to generate \$46.1 million of revenue in the first quarter. That is, China Sky in one quarter generated revenue comprising 118% of its total PP&E, while AOB generated revenue

representing only 19% of its PP&E.