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## *China Sky, Takasima, and Massage Chairs: A Tangled Web of Coincidences or Related Parties?*

China Sky One Medical, Inc. (NASDAQ: CSKI) reported in its 2006 10-K that in March 2007 it entered into an agreement with a Malaysian company called Takasima Industries for the distribution in Malaysia of China Sky's Slim Patch product. Under the terms of the agreement, Takasima was required to generate sales revenue of US\$1 million per month. The 2006 10-K also states, "Management anticipates that this strategic agreement could result in up to US\$12 million in additional annual sales revenue in 2007, with a net profit margin of 20%." This was an amount equal to 60% of CSKI's 2006 revenue.

There is an apparent conflict on the date of the agreement in China Sky's disclosures. The 10-K states that the agreement was entered into March 2007. A [press release](http://www.asensio.com/CSKI/Takasima/CSKI_Takasima_Release.pdf) dated February 20, 2007, states that the agreement with Takasima was made "early this year." Neither the press release nor the 10-K refers to the full legal name of Takasima Industries.

Neither the 2008 10-K nor the 2007 10-K provides any new disclosures concerning the term of the Takasima agreement, and for what period Takasima agreed to have minimum sales of \$1 million per month.

The Takasima story was instrumental in China Sky claiming to have revenues grow from \$19 million in 2006 to \$49 million in 2007. China Sky's reported revenues from Malaysia in 2007 were more than \$13 million. In 2008, however, China Sky's Malaysia sales were only \$8.8 million.

Information was gained by asensio.com that puts into question the nature of the relationship between China Sky and Takasima, and implies the transactions between the two might have been done at much less than arm's-length.

California corporate registration records show an entity called [Takasima Sporting Goods, Inc.](http://www.asensio.com/CSKI/Takasima/Takasima_CA.pdf) at an address in City of Industry, California. A company called [Lailai Capital Corporation](http://www.asensio.com/CSKI/Takasima/Lailai_CA.pdf) has the same address under California records. What makes this interesting is a connection with the principal of American Eastern Securities, Inc., the group that arranged China Sky's reverse merger and first subsequent PIPE offering, and that was a major shareholder as of April 2008.

Charles Trang Chong Hung is American Eastern's principal. Hung is listed as Registered Principal in a [FINRA sanction](http://www.asensio.com/CSKI/Takasima/Hung_AWC.pdf) against himself and American Eastern. Hung is also listed as the secretary of Lailai Capital Corporation in a lawsuit filed against Lailai by Union Oil BREA Federal Credit Union. See attached ["Complaint for Money, Fraud, Constructive Trust and for Conspiracy."](http://www.asensio.com/CSKI/Takasima/Lailai_Hung_Complaint.pdf)

Hung was issued stock in CSKI as part of CSKI's reverse merger in 2006. In CSKI's 8-K filed May 15, 2006, Hung appears as having 87,685 shares. American Eastern Group, Inc. appears owning the same number of shares, and another entity, American Eastern Securities, Inc. appears owning 54,803 shares. EIC Investments, LLC, whose principal is Hung's son, Charles Hung, Jr., also received 54,803 shares in the reverse merger. China Sky's Form S-1 filed April 11, 2008 shows American Eastern Group also having warrants to purchase 500,000 shares at \$2 per share, expiring July 2009.

California records for Lilai Capital also show Kirk G. Downing as a former registered agent. Downing is an attorney based in City of Industry, CA who sits on the board of American Dairy, Inc. (NYSE: ADY). American Dairy was another Chinese reverse merger arranged by Hung and American Eastern Securities. In 2007, American Dairy was the subject of [an informal SEC probe](http://www.asensio.com/CSKI/Takasima/ADY_Barrons.pdf) due to the practices of its auditor Murrell Hall McIntosh, an Oklahoma-based firm that also served as auditor to China Sky.

An internet search shows Downing's office in City of Industry, CA is located in a building where Hung's American Eastern Group and e-Fang Accountancy Corp. also have offices. E-Fang Accountancy was China Sky's first auditor following the reverse merger in 2006. After e-Fang audited CSKI's 2006 10-K, the 10-K had to be amended twice, and the earnings had to be restated. Net income went from \$4.3 million to \$624,415 following the restatement.

The connection between China Sky, Hung of American Eastern, Takasima Sporting Goods, and Lilai Capital may seem tentative at first glance. But there are some facts that make the connection look rather too coincidental.

The China Sky fourth quarter 2008 earnings conference call transcript states, "...we've now expanded sales of Slim Patch into South Korea and Sudan after engaging PAX-Medicare and Lai Li Investment Company as exclusive sales agents." Lai Li Investment Company, of course, sounds very similar to Lilai Capital Corporation. (Why any company would be marketing a weight-loss product in the war-torn Sudan, where there have been recent reports of extreme famine, is another discussion entirely.)

If you visit the physical address in California where Lilai Capital and Takasima Sporting Goods have been registered, you will find that the building is now occupied by a business called [Sunpentown](http://www.asensio.com/CSKI/Takasima/Sunpentown.JPG).

Going to the [Sunpentown website](http://www.sunpentown.com/index.html) reveals that the company sells massage chairs, among other items. Searching for ["Sunpentown Takasima"](http://www.asensio.com/CSKI/Takasima/Sunpentown_Takasima.mht) reveals massage chairs marketed under both the Sunpentown and Takasima brand names. Going to the website of the Malaysian [Takasima Industries](http://www.takasima.com.my/main.htm), the company touted as selling China Sky products, shows that the company lists fitness equipment as its products, but has advertisements offering [massage chairs](http://www.asensio.com/CSKI/Takasima/Takasima_promotion.jpg).

It seems there may be a more than coincidental link between Takasima Industries, the Malaysian company claimed to be distributing China Sky products, and Takasima Sporting Goods, the California business. Given Takasima Sporting Good's connection with Hung, and Hung's deep involvement with China Sky, there is reason to suspect that China Sky's reported sales agent in Malaysia may actually be a related party. If China Sky's agreement with Takasima was not made at arm's-length, it would be cause to doubt the reliability of China Sky's reported sales made through Takasima.

Furthermore, there is reason to suspect that China Sky's new sales agent for the Sudan, Lai Li Investment Company, may be a related party as well, given Hung's involvement with Lilai Capital Corporation.

Beyond the issue of potentially related parties, there may be reason to doubt whether the Malaysian company that CSKI refers to as Takasima Industries could support the level of sales claimed. In 2007, CSKI reported that Takasima's sales of the Slim Patch were at least \$1 million per month, and more than \$12 million for the year, though the agreement was only signed in March of 2007 (according to the 10-K), or in February of 2007 or before (according to the press release).

[Financial statements](http://www.asensio.com/CSKI/Takasima/Takasima_Industries.pdf) filed with the Malaysian government for Takasima Industries (M) SDN BHD show that for the twelve months ended May 31, 2007,

Takasima's revenues were approximately US\$4.0 million and current assets were only \$1.8 million (converted from Malaysian ringgits at 3.40 MYR / USD, current at May 31, 2007).

If Takasima had been meeting the terms of the reported sales agreement with China Sky, then Takasima should have had at least US\$3 million in sales from March, April, and May of 2007 alone.

Additionally, China Sky's press release from February 2007 states that Takasima has "sister companies," operating under the names "Takasima Health-Mar, Blueway International and Osiwa (M) Sdn. Bhd. of Pinway Industries." [Financial statements](http://www.asensio.com/CSKI/Takasima/Takasima_Others.pdf) filed with the Malaysian government indicate that these "sister" companies were all dormant in 2007, except Takasima Health-Mar.

In the case of a legitimate company with legitimate auditors, related party transactions are vetted during the audit. Given CSKI's revolving-door audit style ([see previous asensio.com report](http://www.asensio.com/Reports/ReportView.aspx?ReportId=932&CompanyId=165&CompanyName=Report)), it is entirely possible that such vetting was never accomplished or initiated.