ACE MARKETING & PROMOTIONS INC
Form 10-Q
October 24, 2011

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2011

COMMISSION FILE NUMBER: 000-51160

ACE MARKETING & PROMOTIONS, INC.
(Exact name of registrant as specified in its charter)

NEW YORK	11-3427886
(State of jurisdiction of Incorporation)	(I.R.S. Employer Identification No.)

457 ROCKAWAY AVE.
VALLEY STREAM, NY 11581
(Address of principal executive offices)

(516) 256-7766
(Registrant's telephone number)

NOT APPLICABLE
(Former name, address and fiscal year, if changed since last report)
[Missing Graphic Reference]

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 x No o

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the 12 preceding months (or such shorter period that the registrant was required to submit and post such file).

Yes x No o

Indicate by checkmark 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 o	Accelerated Filer o
Accelerated Filer o	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 o No x

As of October 20, 2011, the registrant had a total of 23,147,401 shares of Common Stock outstanding.

ACE MARKETING & PROMOTIONS, INC.

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ACE MARKETING &
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Condensed Balance Sheets	September 30, 2011 Unaudited	December 31, 2010 Audited
Assets		
Current Assets:		
Cash and cash equivalents	$1,094,001	$763,581
Accounts receivable, net of allowance for doubtful accounts of $20,000 at September 30, 2011 and December 31, 2010	342,937	298,892
Prepaid expenses and other current assets	486,508	218,336
Total Current Assets	1,923,446	1,280,809
Property and Equipment, net	662,060	249,726
Other Assets	7,745	7,745
Total Assets	$2,593,251	$1,538,280
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$317,082	$243,795
Accrued expenses	139,201	98,270
Total Current Liabilities	456,283	342,065
Commitments and Contingencies		
Stockholders' Equity:		
Preferred Stock, $.0001 par value; 5,000,000 shares authorized, none issued		
Common stock, $.0001 par value; 100,000,000 shares authorized; 23,170,736 and 16,834,260 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	2,316	1,683
Additional paid-in capital	10,825,993	8,300,766
Accumulated deficit	(8,659,840)	(7,074,733)
	2,168,469	1,227,716
Less: Treasury Stock, at cost, 23,334 shares	(31,501)	(31,501)
Total Stockholders' Equity	2,136,968	1,196,215
Total Liabilities and Stockholders' Equity	$2,593,251	$1,538,280

See notes to condensed financial statements.

ACE MARKETING &
PROMOTIONS, INC.

Condensed Statements of Operations

	Three Months Ended September 30, Unaudited		Nine Months Ended September 30, Unaudited	
	2011	2010	2011	2010
Revenues, net	$650,370	$773,830	$2,284,573	$2,447,723
Cost of Revenues	484,032	509,973	1,761,655	1,688,609
Gross Profit	166,338	263,857	522,918	759,114
Operating Expenses:				
Selling, general and administrative expenses	852,186	598,949	2,107,440	2,048,720
Total Operating Expenses	852,186	598,949	2,107,440	2,048,720
Loss from Operations	(685,848)	(335,092)	(1,584,522)	(1,289,606)
Other Income (Expense):				
Interest expense	(151)	(470)	(1,070)	(729)
Interest income	217	181	485	592
Total Other Income (Expense)	66	(289)	(585)	(137)
Net Loss	$(685,782)	$(335,381)	$(1,585,107)	$(1,289,743)
Net Loss Per Common Share:				
Basic	$(0.03)	$(0.03)	$(0.09)	$(0.10)
Diluted	$(0.03)	$(0.03)	$(0.09)	$(0.10)
Weighted Average Common Shares Outstanding:				
Basic	21,025,193	13,221,722	18,074,187	13,028,517
Diluted	21,025,193	13,221,722	18,074,187	13,028,517

See notes to condensed financial statements.

ACE MARKETING & PROMOTIONS, INC.

Statement of Stockholders' Equity
Nine Months Ended September 30, 2011

	Total Stockholders' Equity	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	(Deficit)	Treasury Stock Shares	Treasury Stock Amount
Balance, at December 31, 2010	$ 1,196,215	16,834,260	$1,683	$8,300,766	$(7,074,733)	23,334	$(31,501)
Stock Purchase	448,000	1,166,666	117	447,883			
Stock Warrant	19,153			19,153			
Stock Grant	14,365	150,000	15	14,350			
Stock Compensation	91,005			91,005			
Net Loss	(435,006)				(435,006)		
Balance, at March 31, 2011	$ 1,333,732	18,150,926	$1,815	$8,873,157	$(7,509,739)	23,334	$(31,501)
Stock Purchase	$ 866,250	2,500,000	$250	$866,000			
Stock Warrant	$ 6,369			$6,369			
Stock Grant	14,789	100,000	10	14,779			
Stock Compensation	31,180			31,180			
Net Loss	(464,319)				$(464,319)		
Balance, at June 30, 2011	$ 1,788,001	20,750,926	$2,075	$9,791,485	$(7,974,058)	23,334	$(31,501)
Stock Purchase	$ 950,000	1,950,000	$195	$949,805			
Stock Grant	$ 47,196	335,000	$33	$47,163			
Warrant Exercise		134,810	$13	$(13)			
Stock Compensation	$ 37,553			$37,553			
Net Loss	$ (685,782)				$(685,782)		
Balance, at September 30, 2011	$ 2,136,968	23,170,736	$2,316	$10,825,993	$(8,659,840)	23,334	$(31,501)

See notes to financial statements.

ACE MARKETING &
PROMOTIONS, INC.

Condensed Statements of Cash Flows
Nine Months Ended September 30,

	2011 Unaudited	2010 unaudited
Cash Flows from Operating Activities:		
Net loss	$(1,585,107)	$(1,289,743)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	85,380	39,435
Stock-based compensation	261,610	552,693
Changes in operating assets and liabilities:		
(Increase) decrease in operating assets:		
Accounts receivable	(44,045)	196,306
Prepaid expenses and other assets	(268,173)	(63,925)
Increase (Decrease) in operating liabilities:		
Accounts payable and accrued expenses	114,220	(205,832)
Total adjustments	148,992	518,677
Net Cash Used in Operating Activities	(1,436,115)	(771,066)
Cash Flows from Investing Activities:		
Acquisition of property and equipment	(497,715)	(164,362)
Net Cash (Used) in Provided by Investing Activities	(497,715)	(164,362)
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	2,264,250	600,500
Net Cash Provided by Financing Activities	2,264,250	600,500
Net Increase in Cash and Cash Equivalents	330,420	(334,928)
Cash and Cash Equivalents, beginning of period	763,581	595,611
Cash and Cash Equivalents, end of period	$1,094,001	$260,683

See notes to condensed financial statements.

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ACE MARKETING & PROMOTIONS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

NOTE 1: BASIS OF PRESENTATION:

The accompanying condensed financial statements and footnotes thereto are unaudited.

The Condensed Balance Sheets as of September 30, 2011 and December 31, 2010, the Condensed Statements of Operations for the three months and nine months ended September 30, 2011 and 2010 and the Condensed Statements of Cash Flows for the nine months ended September 30, 2011 and 2010 have been prepared by us without audit, and in accordance with the requirements of Form 10-Q and, therefore, they do not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. In our opinion, the accompanying unaudited condensed financial statements contain all adjustments necessary to present fairly in all material respects our financial position as of September 30, 2011, results of operations for the three months and nine months ended September 30, 2011 and 2010 and cash flows for the nine months ended September 30, 2011 and 2010. All such adjustments are of a normal recurring nature. The results of operations and cash flows for the three months and nine months ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year. We have evaluated subsequent events through the filing of this Form 10-Q with the SEC, and determined there have not been any events that have occurred that would require adjustments to our unaudited Condensed Financial Statements.

The information contained in this report on Form 10-Q should be read in conjunction with our Form 10-K for our fiscal year ended December 31, 2010.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the amounts of assets, liabilities, revenue, costs and expenses. Actual results could differ from these estimates.

NATURE OF OPERATIONS - Ace Marketing & Promotions, Inc. (the "Company" or "Ace") began as promotional products company and has since evolved into an Integrated Marketing Solutions Company. Ace currently focuses on four business verticals; Branding, Interactive, Direct Relationship Marketing and Mobile Marketing. With its newly developed suite of solutions in place, Ace now offer its clients and potential clients the ability to work smarter in addressing their marketing needs by leveraging technology platforms. The services and technology platforms assembled within each business vertical allows Ace to provide its clients with an exceptional mix of solutions for reaching their customers in ways that were previously impossible. Clients have the ability to choose a single solution within a vertical or a complete package of solutions working together seamlessly. By offering the entire suite of solutions, the need for multiple vendors has been eliminated, and Ace can be a single source provider of Branding, Interactive, Direct Relationship Marketing and Mobile Marketing Solutions.

Within the Branding vertical Ace has the ability to create the actual brand, in addition to providing all the branded merchandise. This has been the core of the Ace business model since its inception. The current focus within this vertical is to find new and innovative ways to leverage new technology platforms to drive growth beyond traditional channels.

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ACE MARKETING & PROMOTIONS, INC.
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The Interactive vertical deals with any online marketing & branding initiatives. Utilizing the Ace Place Platform (a proprietary Content Management System); custom websites are created and total control of the site content is given back to the client. Through the Ace Place platform, a client simply chooses from one of the many web-design packages and has the ability to change the content on the site without the need for a programmer and the high hourly fees that go along with them. With this power,
their websites become dynamic and powerful marketing vehicles instead of just an online static ad. For relevant clients, Ace can add an E-Commerce component to their website along with Email Marketing services to assist in marketing the site. As an additional service, each site can be housed on Ace’s servers.

The Direct Relationship Marketing vertical creates 1 to 1 relationship marketing Solutions. Ace’s strategy for delivering successful marketing campaigns utilizes specific databases to personalize messages across a wide array of integrated delivery mechanisms. Ace has expanded its capabilities beyond direct mail to incorporate variable data programming technology into web applications, telephony, email, and print. Ace’s Direct Relationship Marketing solution helps attract new customers and retain exist ones by targeting each identified demographic group through our various tools to get the intended message across with measured results.

The Company's fourth business vertical is the Mobile Marketing vertical. The Mobile Marketing advertising medium is set to become the next component of marketing spends as mobile marketing continues to gain more and more momentum. Technology allows advertisers to target and deliver rich media content to specific locations and times where it is most relevant. It gives advertisers the ability to reach consumers with their message as they are ready to make their purchasing decision. Ace Marketing & Promotions subsidiary Mobiquity Networks provides Location-Based Mobile marketing services via Bluetooth and Wi-Fi that requires no GPS tracking and no need to download and application.

Mobiquity Networks is a leading location based mobile marketing network in the US. We utilize a targeted, location-based approach to reach audiences on their personal mobile devices when it matters most. The Company employs a combination of leading-edge mobile technologies to deliver virtually any digital media content including images, videos, audio mp3s, maps, games, applications and coupons to mobile phones within targeted geographic locations. Mobiquity has focused on and built an extensive Location Based Mobile Marketing Mall Network which gives us access to over 90 million mobile customer visits per month while they are shopping. Our network allows brands to engage their potential customers with the right offer at the right place at the right time....when they are about to make a purchasing decision. Mobiquity currently has over 500 zones throughout 67 malls with over 90 million monthly visits. These zones create a cloud of coverage so that visitors do not need to go directly to one of these zone access points. Some of our land mark malls includethe following: Roosevelt Field – NY, the Galleria-Houston, Lenox Square -Atlanta,Northbridge-Chicago , Santa Monica Place-LA and Copley Place –Boston.

We have partnered with Blue Bite LLC. (“Blue Bite”), a premier provider of Proximity Marketing hardware and software solutions, and Eye Corp Pty Ltd., (“EyeCorp”) an out-of-home media company which operates the largest mall advertising display network in the United States, to roll-out an expansive network which comprises of retail, dining, transportation, sporting, music, and other high traffic venues.

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ACE MARKETING & PROMOTIONS, INC.
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Agreement with Simon Property Group, L.P.

In April 2011, we signed an exclusive rights agreement with a Top Mall Developer (the "Simon Property Group") to create a location-based mobile marketing network called Mobiquity Networks. The 50 mall agreement runs through December of 2015 and includes top malls in the Simon Mall portfolio. This new alliance will give advertisers the opportunity to reach millions of mall visitors per month with mobile digital content and offers when they are most receptive to advertising messages.

In connection with Eye Corp., Mobiquity Networks will deliver digital content and offers to shoppers on their mobile devices through Eye Corp's extensive Mall Advertising Network. Eye Corp and Mobiquity Networks have an exclusive agreement to build a location-based mobile marketing network throughout Eye Corp's Mall Advertising network. New properties to be added to the Mobiquity Networks portfolio will include iconic malls in the top DMA's (designated market area) in the US. These prestigious malls further complement Mobiquity Networks' portfolio of prominent malls including Queens Center Mall in New York City, Northbridge in Chicago, and Santa Monica Place in Los Angeles.

Ace's Location-Based Mobile advertising medium is designed to reach on-the-go shoppers via their mobile devices with free rich media content delivered using Bluetooth or Wi-Fi. This advertising medium offers extremely targeted messaging engineered to engage and influence shoppers as they move about the mall environment. Eye Corp, along with Ace Marketing, will jointly create mobile marketing programs for existing clients in conjunction with their already active in mall advertising programs. Mobiquity Networks proximity marketing units will be strategically positioned in shopping malls near entrances, anchor stores, escalators and other high-traffic, and high dwell-time areas. Mobiquity Networks proximity marketing unit placement takes advantage of the opportunity to provide a reminder to consumers and touch them just before making a purchase decision. These units generate high awareness and brand recognition at the right time and place. When combined with the impact of other visual advertising mediums (in mall assets) or as a stand-alone medium, Mobiquity Networks is a great mobile solution to promote a brand on a local or national level.

NOTE 2: ACCOUNTING PRONOUNCEMENTS:

Except for rules and interpretive releases of the SEC under authority of federal securities laws and a limited number of grandfathered standards, the FASB Accounting Standards Codification™ ("ASC") is the sole source of authoritative GAAP literature recognized by the FASB and applicable to the Company. Management has reviewed the aforementioned rules and releases and believes any effect will not have a material impact on the Company's present or future consolidated financial statements.

NOTE 3: SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition - Revenue is recognized when title and risk of loss transfers to the customer and the earnings process is complete. In general, title passes to our customers upon the customer's receipt of the merchandise. The

Company applies the revenue recognition principles which provides for revenue to be recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has been completed, (iii) the customer accepts and verifies receipt, (iv) collectability is reasonably assured. The Company records all shipping and handling fees billed to customers as revenues and related costs as cost of goods sold, when incurred.

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Estimates - The preparation of financial statements in conformity with generally accepted accounting principles 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.

NOTE 4: LOSS PER SHARE

Basic loss per common share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Dilutive loss per share gives effect to stock options and warrants, which are considered to be dilutive common stock equivalents. Basic loss per common share was computed by dividing net loss by the weighted average number of shares of common stock outstanding. The number of common shares potentially issuable upon the exercise of certain options and warrants that were excluded from the diluted loss per common share calculation was approximately 15,900,000 and 6,300,000 because they are anti-dilutive as a result of a net loss for the three and nine months ended September 30, 2011 and 2010, respectively.

NOTE 5: STOCK COMPENSATION

Compensation costs related to share-based payment transactions, including employee stock options, are recognized in the financial statements utilizing the straight line method for the cost of these awards.

The Company's results for the three month periods ended September 30, 2011 and 2010 include employee share-based compensation expense totaling approximately $85,000 and $56,000, respectively. The Company's results for the nine month periods ended September 30, 2011 and 2010 include employee share-based compensation expense totaling approximately $262,000 and $553,000, respectively. Such amounts have been included in the Condensed Consolidated Statements of Operations within selling, general and administrative expenses. No income tax benefit has been recognized in the statement of operations for share-based compensation arrangements due to a history of operating losses.

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The following table summarizes stock-based compensation expense for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Employee stock-based compensation - option grants	$ 47,197	$ -	$ 89,963	$ 267,180
Employee stock-based compensation - stock grants	-	-	14,789	
Non-Employee stock-based compensation - option grants	31,180	40,322	104,232	134,799
Non-Employee stock-based compensation - stock grants	-	15,250	14,365	135,650
Non-Employee stock-based compensation-stock warrant	6,372	-	38,261	15,064
Total	$ 84,749	$ 55,572	$ 261,610	$ 552,693

NOTE 6: STOCK OPTION PLAN

During Fiscal 2005, the Company established, and the stockholders approved, an Employee Benefit and Consulting Services Compensation Plan (the "2005 Plan") for the granting of up to 2,000,000 non-statutory and incentive stock options and stock awards to directors, officers, consultants and key employees of the Company. On June 9, 2005, the Board of Directors amended the Plan to increase the number of stock options and awards to be granted under the Plan to 4,000,000. In October 2009, the Company established and the stockholders approved a 2009 Employee Benefit and Consulting Services Compensation Plan (the "2009 Plan") for granting up to 4,000,000 non-statutory and incentive stock options and awards to directors, officers, consultants and employees of the Company. (The 2005 Plan and the 2005 Plan are collectively referred to as the "Plans".)

All stock options under the Plans are granted at or above the fair market value of the common stock at the grant date. Employee and non-employee stock options vest over varying periods and generally expire either 5 or 10 years from the grant date.

The fair value of options at the date of grant was estimated using the Black-Scholes option pricing model. The fair values of these restricted stock awards are equal to the market value of the Company’s stock on the date of grant, after taking into certain discounts. The expected volatility is based upon historical volatility of our stock and other contributing factors. The expected term is based upon observation of actual time elapsed between date of grant and exercise of options for all employees. Previously, such assumptions were determined based on historical data.

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The weighted average assumptions made in calculating the fair values of options granted during the three months and nine months ended September 30, 2011 and 2010 are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
Expected volatility	187.04%	123.48%	108.97%	123.48%
Expected dividend yield	-	-	-	-
Risk-free interest rate	92.00%	3.01%	2.36%	3.01%
Expected term (in years)	5	7.73	7.29	7.73

	Share	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, January 1, 2011	3,120,000	.97	5.23	6,500
Granted	315,000	.33	7.48	
Exercised	-			
Cancelled & Expired	(130,000)	2.50	5.00	
Outstanding, September 30, 2011	3,305,000	.85	5.09	
Options exercisable, September 30, 2011	3,155,000	.84	5.11	$ 1,426,350

The weighted-average grant-date fair value of options granted during the nine months ended September 30, 2011 and 2010 was $0.33 and $0.26, respectively.

The aggregate intrinsic value of options outstanding and options exercisable at September 30, 2011 is calculated as the difference between the exercise price of the underlying options and the market price of the Company's common stock for the shares that had exercise prices, that were lower than the $1.25 closing price of the Company's common stock on September 30, 2011.

As of September 30, 2011, the fair value of unamortized compensation cost related to unvested stock option awards was approximately $62,000. Unamortized compensation cost as of September 30, 2011 is expected to be recognized over a remaining weighted-average vesting period of 0.5 years.

ACE MARKETING & PROMOTIONS, INC.
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The weighted average assumptions made in calculating the fair value of warrants granted during the three and nine months ended September 30, 2011 and 2010 are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
Expected volatility	56.83%	132.18%	56.83%	132.18%
Expected dividend yield	-	-	-	-
Risk-free interest rate	1.07%	2.65%	1.07%	1.15%
Expected term (in years)	3	5	3	3

	Share	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, January 1, 2011	6,243,965	$ 0.54	2.26	$ 6,500
Granted	7,021,666	$ 0.45	2.39	
Exercised	(395,000)	-		
Cancelled	(299,989)	-		
Outstanding, September 30, 2011	12,570,642	$ 0.50	2.09	
Warrants exercisable, September 30, 2011	12,570,642	$ 0.50	2.09	$ 9,369,726

NOTE 7: CONSULTING AGREEMENTS

In January 2010, the Company entered into an agreement with a consulting firm to provide services over the next twelve months. The agreement provides for the issuance of 100,000 restricted common shares of Common Stock.

In January 2010, the Company also entered into an agreement with a two individuals to provide services over the next twelve months. The agreement provides for the issuance of 57,500 shares and 52,500 restricted common shares of Common Stock which vest immediately.

In January 2011, the Company entered into an agreement with a consulting firm to provide business development services. The agreement provides for the issuance of 100,000 shares of restricted Common Stock and Warrants to purchase 200,000 shares of restricted Common Stock.

Pursuant to an agreement dated as of November 15, 2010, the Company entered into a three year contract with a consulting firm to provide certain financial and public relation services on a non-exclusive basis. Pursuant to the agreement, an initial retainer of $12,500 was paid. The agreement provides for the possible issuance of up to 250,000 common shares and up to $100,000 in cash compensation based upon referrals of credible and synergistic corporate partners and/or acquisitions, which acquisitions or partnerships must be approved by Ace. In January 2011 and August 2011, the Company approved the issuance of 50,000 shares and 175,000 shares of common stock, respectively, for consulting services rendered by this consultant.

In June 2011, we entered into a one-year Investor Relation, Public Awareness Agreement with Legend Securities, Inc. at a cost of $10,000 per month and 75,000 shares of restricted Common Stock per quarter.

ACE MARKETING & PROMOTIONS, INC.
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Ace has retained an outside contractor to build its website development program at a cost of $120,000, $80,000 of which has been paid and the remaining $40,000 was accrued in the quarter ended September 30, 2011. At its option, Ace will make the final $40,000 payment to the contractor in cash or through the issuance of up to 66,000 shares of its common stock.

NOTE 8: PRIVATE PLACEMENT

On December 8, 2009, Ace Marketing & Promotions, Inc. entered into an Introducing Agent Agreement with Legend Securities, Inc., a FINRA registered broker-dealer ("Legend"), to attempt to raise additional financing through the sale of its Common Stock and Warrants. Between December 8, 2009 and March 15, 2010, the Company closed on gross proceeds of $1,025,000 before commissions of $117,000. The planned use of proceeds is to primarily expand the Company's mobile and interactive divisions. The Company issued pursuant to the terms of the offering an aggregate of 2,050,000 shares of Common Stock at a per share price of $.50 per share and 1,025,000 Warrants exercisable at $1.00 per share to investors in the offering and placement agent warrants to purchase an amount equal to 10% of the number of shares and the number of warrants sold in the offering. All securities were issued pursuant to Rule 506 of Regulation D promulgated under Section 4(2) of the Securities Act of 1933, as amended.

In August 2010, the Company raised $175,000 in gross proceeds from the sale of 437,500 shares and a like number of Warrants expiring in August 2013. The investor paid $0.40 per Share and received Warrants exercisable at $0.60 per Share. In November 2010, the Company commenced a plan of financing and raised an additional $800,500 in financing from the sale of 2,934,999 Shares of its restricted Common Stock at $0.30 per Share and Class E Common Stock Purchase Warrants to purchase a like number of Shares, exercisable at $0.30 per Share through August 31, 2013. Subsequent to the completion of the second financing, the Company agreed to adjust the terms of the August 2010 transaction and issue to the August 2010 investor Shares and Class E Warrants on the same terms as those sold in November - December 2010. Accordingly, an additional 145,833 Shares and a like number of Warrants were issued to the August 2010 investor, with the exercise price of the Warrants being lowered from $0.60 per Share to $0.30 per Share.

In March 2011, the Company commenced a private placement offering. Pursuant to said offering which terminated on April 19, 2011, the Company raised $755,000 in gross proceeds from the sale of 2,516,667 shares of common stock and a like number of warrants, exercisable at $.30 per share through August 31, 2013. Exemption is claimed for the sale of securities pursuant to Rule 506 and/or Section 4(2) of the Securities Act of 1933, as amended.

Between May 25, 2011 and June 3, 2011, the Company received gross proceeds of $461,250 from the sale of 1,025,000 shares of Common Stock at a purchase price of $.45 per share. The sale of stock was also accompanied by Warrants expiring on May 31, 2014. Exemption is claimed for the sale of securities pursuant to Rule 506 and/or Section 4(2) of the Securities Act of 1933, as amended.

In July 2011, the Company commenced a private placement offering. Pursuant to said offering between July14, 2011 and August 1, 2011, the Company raised $975,000 in gross proceeds from the sale of 1,950,000 shares of common stock and a like number of warrants, exercisable at $.60 per share through July 31, 2014. Exemption is claimed for the sale of securities pursuant to Rule 506 and/or Section 4(2) of the Securities Act of 1933, as amended.

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(UNAUDITED)

NOTE 9: OPTIONS OUTSIDE COMPENSATION PLAN

On March 25, 2010, the Company granted Non-Statutory Stock Options to purchase 10,000 shares of the Company's Common Stock to an attorney for services rendered. at an exercise price of $.54 per share, with 100% of the options vesting immediately and expiring on March 25, 2020.

On March 25, 2010, the Company issued a total of 100,000 Non-Statutory Stock Options to two key employees in accordance with their employment agreement. The Options have an exercise price of $.54 per share, with 100% of the options vesting immediately and expiring on March 25, 2020.

On April 9, 2009, the Company hired a firm as an independent sales organization to promote its proximity marketing units in the sports and entertainment industry. The firm was granted options to purchase 100,000 shares at $.90 per share outside of Ace's compensation plan which generates approximately a non-cash $3,000 expense on a monthly basis.

NOTE 10: SHARED BASED COMPENSATION

On January 4, 2010, the Company issued 6,000 Warrants to purchase Common Stock to an independent consultant to manage sales relationships. The services were recorded equal to the value of the shares at the date of grant and an expense of $3,051 is included in the operating expenses for the year ended December 31, 2010

On August 17, 2010, the Company issued 145,600 Warrants to purchase Common Stock to franchisee owners of a chain store for the purpose of placing proximity marketing units in their business locations.

RESTRICTED STOCK GRANTS - In January 2010, the Company entered into an agreement with a consulting firm to provide services over the next twelve months. The agreement provides for the issuance of 100,000 restricted Common Stock.

In January 2010, the Company also entered into an agreement with two individuals to provide services over the next twelve months. The agreement provides for the issuance of 57,500 shares and 52,500 restricted common shares of Common Stock which vest immediately.

Pursuant to an agreement dated as of November 15, 2010, the Company entered into a three year contract with a consulting firm to provide certain financial and public relation services on a non-exclusive basis. Pursuant to the agreement, an initial retainer of $12,500 was paid. The agreement provides for the possible issuance of up to 250,000 common shares and up to $100,000 in cash compensation based upon referrals of credible and synergistic corporate partners and/or acquisitions, which acquisitions or partnerships must be approved by Ace. In January 2011, the Company approved the issuance of 50,000 shares of common stock for consulting services rendered by this consultant. In August 2011, the Company issued an additional 175,000 shares of Common Stock for consulting services rendered by the consultant.

During the past three years, the Company has granted under our 2005 Plan certain employees and consultants restricted stock awards for services for the prior year with vesting to occur after the passage of an additional 12 months. These awards totaled 45,000 Shares for 2008, subject to continued services with the Company through December 31, 2009. These awards totaled 51,000 Shares for 2009 subject to continued services with the Company through December 31, 2010. These awards totaled 105,000 Shares for 2010 subject to continued services with the Company through December 31, 2011.

ACE MARKETING & PROMOTIONS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

The Company's results for the three months ended September 30, 2011 and 2010 include employee share-based compensation expense totaling approximately $85,000 and $56,000, respectively. The Company's results for the nine months ended September 30, 2011 and 2010 include employee share-based compensation expense totaling approximately $262,000 and $553,000, respectively. Such amounts have been included in the Statements of Operations within selling, general and administrative expenses. No income tax benefit has been recognized in the statement of operations for share-based compensation arrangements due to a history of operating losses.

NOTE 11. EMPLOYMENT CONTRACTS/DIRECTOR COMPENSATION

On April 7, 2010, the Board of Directors approved a five-year extension of the employment contracts of Dean L. Julia and Michael D. Trepeta to expire on March 1, 2015. The Board approved the continuation of each officer's annual salary and scheduled salary increases on March 1 of each year of $2,000 per month. The Board also approved a signing bonus of stock options to purchase 200,000 shares granted to each officer which is fully vested at the date of grant and exercisable at $.50 per share through April 7, 2020; ten-year stock options to purchase 100,000 shares of Common Stock to be granted to each officer at fair market value on each anniversary date of the contract and extension thereof commencing March 1, 2011; and termination pay of one year base salary based upon the scheduled annual salary of each executive officer for the next contract year plus the amount of bonuses paid or entitled to be paid to the executive for the current fiscal year or the preceding fiscal year, whichever is higher. In the event of termination, the executives will continue to receive all benefits included in the employment agreement through the scheduled expiration date of said employment agreement prior to the acceleration of the termination date thereof.

On April 7, 2010, the Board of Directors approved the grant of options to purchase 150,000 shares of Common Stock to a director, exercisable at $.50 per share at any time from the date of grant through April 7, 2020. The Board also approved commencing March 1, 2011, and every March 1st thereafter, the grant of 50,000 ten-year stock options to purchase shares at the fair market value at the date of grant to each director who is not an executive officer of the Company.

On March 1, 2011, Messrs. Julia and Trepeta each received 10-year options to purchase 100,000 shares, exercisable at $.26 per share. On the same date, a director also received 10-year options to purchase 50,000 shares exercisable at $.26 per share.

NOTE 12. WARRANT EXERCISE

In September 2011, Warrants to purchase 395,000 shares of the Company’s Common Stock were exercised on a cashless basis at exercises prices ranging from $.30 per share to $.90 per share resulting in the issuance of 134,810 shares of restricted Common Stock.

NOTE 13. SUBSEQUENT EVENTS

The Company has evaluated all subsequent events through the filing date of this Form 10-Q for appropriate accounting and disclosures.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The information contained in this Form 10-Q and documents incorporated herein by reference are intended to update the information contained in the Company's Form 10-K for its fiscal year ended December 31, 2010 which includes our audited financial statements for the year ended December 31, 2010 and such information presumes that readers have access to, and will have read, the "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Risk Factors" and other information contained in such Form 10-K and other Company filings with the Securities and Exchange Commission (“SEC”).

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, and actual results could be significantly different than those discussed in this Form 10-Q. Certain statements contained in Management's Discussion and Analysis, particularly in "Liquidity and Capital Resources," and elsewhere in this Form 10-Q are forward-looking statements. These statements discuss, among other things, expected growth, future revenues and future performance. Although we believe the expectations expressed in such forward-looking statements are based on reasonable assumptions within the bounds of our knowledge of our business, a number of factors could cause actual results to differ materially from those expressed in any forward-looking statements, whether oral or written, made by us or on our behalf. The forward-looking statements are subject to risks and uncertainties including, without limitation, the following: (a) changes in levels of competition from current competitors and potential new competition, (b) possible loss of customers, and (c) the company's ability to attract and retain key personnel, (d) The Company's ability to manage other risks, uncertainties and factors inherent in the business and otherwise discussed in this 10-Q and in the Company's other filings with the SEC. The foregoing should not be construed as an exhaustive list of all factors that could cause actual results to differ materially from those expressed in forward-looking statements made by us. All forward-looking statements included in this document are made as of the date hereof, based on information available to the Company on the date thereof, and the Company assumes no obligation to update any forward-looking statements.

NATURE OF OPERATIONS

Ace Marketing & Promotions, Inc. (the "Company" or "Ace") began as promotional products company and has since evolved into an Integrated Marketing Solutions Company. Ace currently focuses on four business verticals; Branding, Interactive, Direct Relationship Marketing and Mobile Marketing. With its newly developed suite of solutions in place, Ace now offer its clients and potential clients the ability to work smarter in addressing their marketing needs by leveraging technology platforms. The services and technology platforms assembled within each business vertical allows Ace to provide its clients with an exceptional mix of solutions for reaching their customers in ways that were previously impossible. Clients have the ability to choose a single solution within a vertical or a complete package of solutions working together seamlessly. By offering the entire suite of solutions, the need for multiple vendors has been eliminated, and Ace can be a single source provider of Branding, Interactive, Direct Relationship Marketing and Mobile Marketing Solutions.

Within the Branding vertical Ace has the ability to create the actual brand, in addition to providing all the branded merchandise. This has been the core of the Ace business model since its inception. The current focus within this vertical is to find new and innovative ways to leverage new technology platforms to drive growth beyond traditional channels.

The Interactive vertical deals with any online marketing & branding initiatives. Utilizing the Ace Place Platform (a proprietary Content Management System); custom websites are created and total control of the site content is given back to the client. Through the Ace Place platform, a client simply chooses from one of the many web-design packages and has the ability to change the content on the site without the need for a programmer and the high hourly fees that go along with them. With this power, their websites become dynamic and powerful marketing vehicles instead of just an online static ad. For relevant clients, Ace can add an E-Commerce component to their website along with Email Marketing services to assist in marketing the site. As an additional service, each site can be housed on Ace's servers.

The Direct Relationship Marketing vertical creates 1 to 1 relationship marketing Solutions. Ace's strategy for delivering successful marketing campaigns utilizes specific databases to personalize messages across a wide array of integrated delivery mechanisms. Ace has expanded its capabilities beyond direct mail to incorporate variable data programming technology into web applications, telephony, email, and print. Ace's Direct Relationship Marketing solution helps attract new customers and retain exist ones by targeting each identified demographic group through our various tools to get the intended message across with measured results.

The Company's fourth business vertical is the Mobile Marketing vertical. The Mobile Marketing advertising medium is set to become the next component of marketing spends as mobile marketing continues to gain more and more momentum. Technology allows advertisers to target and deliver rich media content to specific locations and times where it is most relevant. It gives advertisers the ability to reach consumers with their message as they are ready to make their purchasing decision.

Ace Marketing & Promotions subsidiary Mobiquity Networks provides Location-Based Mobile marketing services via Bluetooth and Wi-Fi that requires no GPS tracking and no need to download and application. Mobiquity Networks is a leading location based mobile marketing network in the US. We utilize a targeted, location-based approach to reach audiences on their personal mobile devices when it matters most. The Company employs a combination of leading-edge mobile technologies to deliver virtually any digital media content including images, videos, audio mp3s, maps, games, applications and coupons to mobile phones within targeted geographic locations. Mobiquity has focused on and built an extensive Location Based Mobile Marketing Mall Network which gives us access to over 90 million mobile customer visits per month while they are shopping. Our network allows brands to engage their potential customers with the right offer at the right place at the right time....when they are about to make a purchasing decision. Mobiquity currently has over 500 zones throughout 67 malls with over 90 million monthly visits. These zones create a cloud of coverage so that visitors do not need to go directly to one of these zone access points. Some of our land mark malls include:

- Roosevelt Field - NY
- The Galleria – Houston
- Lenox Square – Atlanta
- Northbridge – Chicago
- Santa Monica Place – LA
- Copley Place – Boston

Business Partners

We have partnered with Blue Bite LLC. ("Blue Bite"), a premier provider of Proximity Marketing hardware and software solutions, and Eye Corp Pty Ltd., ("EyeCorp") an out-of-home media company which operates the largest mall advertising display network in the United States, to roll-out an expansive network which comprises of retail, dining, transportation, sporting, music, and other high traffic venues.

Agreement with Simon Property Group, L.P.

In April 2011, we signed an exclusive rights agreement with a Top Mall Developer (the "Simon Property Group") to create a location-based mobile marketing network called Mobiquity Networks. The 50 mall agreement runs through December of 2015 and includes top malls in the Simon Mall portfolio. This new alliance will give advertisers the opportunity to reach millions of mall visitors per month with mobile digital content and offers when they are most receptive to advertising messages.

In connection with Eye Corp., Mobiquity Networks will deliver digital content and offers to shoppers on their mobile devices through Eye Corp's extensive Mall Advertising Network. Eye Corp and Mobiquity Networks have an exclusive agreement to build a location-based mobile marketing network throughout Eye Corp's Mall Advertising network. New properties to be added to the Mobiquity Networks portfolio will include iconic malls in the top DMA's (designated market area) in the US. These prestigious malls further complement Mobiquity Networks' portfolio of prominent malls including Queens Center Mall in New York City, Northbridge in Chicago, and Santa Monica Place in Los Angeles.

Ace's Location-Based Mobile advertising medium is designed to reach on-the-go shoppers via their mobile devices with free rich media content delivered using Bluetooth or Wi-Fi. This advertising medium offers extremely targeted messaging engineered to engage and influence shoppers as they move about the mall environment. Eye Corp, along with Ace Marketing, will jointly create mobile marketing programs for existing clients in conjunction with their already active in mall advertising programs. Mobiquity Networks proximity marketing units will be strategically positioned in shopping malls near entrances, anchor stores, escalators and other high-traffic, and high dwell-time areas. Mobiquity Networks proximity marketing unit placement takes advantage of the opportunity to provide a reminder to consumers and touch them just before making a purchase decision. These units generate high awareness and brand recognition at the right time and place. When combined with the impact of other visual advertising mediums (in mall assets) or as a stand-alone medium, Mobiquity Networks is a great mobile solution to promote a brand on a local or national level.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of financial statements requires management to make estimates and disclosures on the date of the financial statements. On an on-going basis, we evaluate our estimates including, but not limited to, those related to revenue recognition. We use authoritative pronouncements, historical experience and other assumptions as the basis for making judgments. Actual results could differ from those estimates. We believe that the following critical accounting policies affect our more significant judgments and estimates in the preparation of our financial statements.

REVENUE RECOGNITION. Revenues are recognized when title and risk of loss transfers to the customer and the earnings process is complete. In general, title passes to our customers upon the customer's receipt of the merchandise. Revenue is accounted by reporting revenue gross as a principal versus net as an agent. Revenue is recognized on a gross basis since our company has the risks and rewards of ownership, latitude in selection of vendors and pricing, and bears all credit risk. Our company records all shipping and handling fees billed to customers as revenues, and related costs as cost of goods sold, when incurred.

ALLOWANCE FOR DOUBTFUL ACCOUNTS. We are required to make judgments based on historical experience and future expectations, as to the realizability of our accounts receivable. We make these assessments based on the following factors: (a) historical experience, (b) customer concentrations, (c) customer credit worthiness, (d) current economic conditions, and (e) changes in customer payment terms.

STOCK BASED COMPENSATION. The Company records compensation expense associated with stock options and other equity-based compensation. Share-based compensation expense is determined based on the grant-date fair value estimated using the Black Scholes method. The Company recognizes compensation expense on a straight-line basis over the requisite service period of the award.

RESULTS OF OPERATIONS

The following table sets forth certain selected unaudited condensed statement of operations data for the periods indicated in dollars and as a percentage of total net revenues. The following discussion relates to our results of operations for the periods noted and is not necessarily indicative of the results expected for any other interim period or any future fiscal year. In addition, we note that the period-to-period comparison may not be indicative of future performance.

	Three Months Ended September 30,	
	2011	2010
Revenue	$ 650,370	$ 773,830
Cost of Revenues	484,032	509,973
Gross Profit	166,338	263,857
Selling, General and Administrative Expenses	852,186	598,949
(Loss) from Operations	$ (685,848)	$ (335,092)

We generated revenues of $650,370 in the third quarter of 2011 compared to $773,830 in the same three month period ended September 30, 2010. The decrease in revenues of $123,460 in 2011 compared to 2010 was due to the downturn in the overall economy.

Cost of revenues was $484,032 or 74.4% of revenues in the third quarter of 2011 compared to $509,973 or 65.9% of revenues in the same three months of 2010. Cost of revenues includes purchases and freight costs associated with the shipping of merchandise to our customers. CN-RIGHT: 0pt" align="left">

	Carrying Value at March 31, 2011	Fair Value Measurements at March 31, 2011, Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Investments	$ 46,094	$ 46,094	$ -	$ -
Conversion feature on the $3.5M Convertible Debt (November 2007)	-	-	-	-
Conversion feature on the $13.9M Convertible Debt (May 2008)	4,218	-	-	4,218
1,875,000 warrants issued in May 2008	1,214,398	-	-	1,214,398
Total	$ 1,264,710	$ 46,094	$ -	$ 1,218,616

Level 3 Valuation Reconciliations:

	March 31, 2011 (Unaudited)	June 30, 2010
Beginning Balance	$ 18,497,227	$ 39,912,733
Reclassification to APIC due to conversion of notes	(2,200,370)	(6,784,051)
Chang in fair value	(15,078,241)	(14,631,455)
Ending Balance	$ 1,218,616	$ 18,497,227

The Company did not identify any other non-recurring assets and liabilities that are required to be presented on the consolidated balance sheets at fair value in accordance with the relevant accounting standards.

An accounting standard became effective for the Company on July 1, 2008 which provided the Company with the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis with the difference between the carrying value before election of the fair value option and the fair value recorded upon election as an adjustment to beginning retained earnings. The Company chose not to elect the fair value option.

Stock-based compensation

The Company records stock-based compensation expense pursuant to the governing accounting standard which requires companies to measure compensation cost for stock-based employee compensation plans at fair value at the grant date and recognize the expense over the employee's requisite service period. The Company estimates the fair value of the awards using the Black-Scholes option pricing model. Under this accounting standard, the Company’s expected volatility assumption is based on the historical volatility of Company’s stock or the expected volatility of similar entities. The expected life assumption is primarily based on historical exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Stock-based compensation expense is recognized based on awards expected to vest, and there were no estimated forfeitures as the Company has a short history of issuing options.

The Company uses the Black-Scholes option-pricing model which was developed for use in estimating the fair value of options. Option-pricing models require the input of highly complex and subjective variables including the expected life of options granted and the Company’s expected stock price volatility over a period equal to or greater than the expected life of the options. Because changes in the subjective assumptions can materially affect the estimated value of the Company’s employee stock options, it is management’s opinion that the Black-Scholes option-pricing model may not provide an accurate measure of the fair value of the Company’s employee stock options. Although the fair value of employee stock options is determined in accordance with the accounting standards using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

Comprehensive income

FASB’s accounting standard regarding comprehensive income establishes standards for reporting and display of comprehensive income and its components in financial statements. It requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The accompanying consolidated financial statements include the provisions of this accounting standard.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and demand deposits in accounts maintained with state-owned banks within the People's Republic of China ("PRC.") The Company considers all highly liquid instruments with original maturities of three months or less, and money market accounts to be cash and cash equivalents.

Restricted cash

Restricted cash represents amounts set aside by the Company in accordance with the Company's debt agreements with certain financial institutions. These cash amounts are designated for the purpose of paying down the principal amounts owed to the financial institutions, and these amounts are held at the same financial institutions with which the Company has debt agreements. Due to the short-term nature of the Company's debt obligations to these banks, the corresponding restricted cash balances have been classified as current in the consolidated balance sheets.

Investments

Investments are comprised of marketable equity securities of publicly traded companies and are stated at fair value based on the quoted prices of these securities. These investments are classified as trading securities based on the Company's intent to sell them in the near term. Restricted investments are marketable equity securities of publicly traded companies that were acquired through the reverse merger and contained certain SEC Rule 144 restrictions on the securities. Restricted investments are carried at fair value based on the trade price of these securities. These securities were classified as available-for-sale and reflected as restricted and noncurrent. As of March 31, 2011, restrictions on restricted investments were fully lifted as the Company met the holding period requirement and the Company has reclassified those investments as investments trading securities.

The following is a summary of the components of the gain/loss on investments and restricted investments for the three and nine months ended March 31, 2011 and 2010:

	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2011	2010	2011	2010
Realized (gain) loss on trading securities	$ 6,085	$ (205)	$ 3,241	$ 406,346
Unrealized (gain) loss on trading securities	49,264	(4,592)	68,210	(270,339)
Unrealized gain on restricted investments – available-for-sale securities	-	(32,164)	-	(88,535)

All unrealized gains and losses related to available-for-sale securities have been properly reflected as a component of accumulated other comprehensive income.

Accounts receivable

During the normal course of business, the Company extends credit to its customers without requiring collateral or other security interests. Management reviews its accounts receivable at each reporting period to provide for an allowance against accounts receivable for an amount that could become uncollectible. This review process may involve the identification of payment problems with specific customers. The Company estimates this allowance based on the aging of the accounts receivable, historical collection experience, and other relevant factors, such as changes in the economy and the imposition of regulatory requirements that can have an impact on the industry. These factors continuously change, and can have an impact on collections and the Company's estimation process. These impacts may be material.

Certain accounts receivable amounts are charged off against allowances after unsuccessful collection efforts. Subsequent cash recoveries are recognized as income in the period when they occur.

Inventories

Inventories, consisting of raw materials, work-in-process, packing materials and finished goods related to the Company's products, are stated at the lower of cost or market utilizing the weighted average method. The Company reviews its inventory periodically for possible obsolete goods or to determine if any reserves are necessary. As of March 31, 2011 and June 30, 2010, the Company determined that no reserves were necessary.

Advance to suppliers

Advances to suppliers represent partial payments or deposits for future inventory purchases. These advances to suppliers are non-interest bearing and unsecured.

Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Additions and improvements to plant and equipment accounts are recorded at cost. When assets are retired or disposed of, the cost and accumulated depreciation are removed from the accounts, and any resulting gains or losses are included in the results of operations in the period of disposition. Maintenance, repairs, and minor renewals are charged directly to expense as incurred. Major additions and betterments to plant and equipment accounts are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of the assets are as follows:

	Useful Life
Building and building improvements	5 – 40 Years
Manufacturing equipment	5 – 20 Years
Office equipment and furniture	5 – 10 Years
Vehicles	5 Years

Intangible assets

All land in the PRC is owned by the PRC government and cannot be sold to any individual or company. The Company has recorded the amounts paid to the PRC government to acquire long-term interests to utilize land underlying the Company's facilities as land use rights. This type of arrangement is common for the use of land in the PRC. The land use rights are amortized on the straight-line method over the terms of the land use rights of 50 years.

Patents and licenses include purchased technological know-how, secret formulas, manufacturing processes, technical and procedural manuals, and the certificate of drugs production, and is amortized using the straight-line method over the expected useful economic life of 5 years, which reflects the period over which those formulas, manufacturing processes, technical and procedural manuals are kept secret to the Company as agreed between the Company and the selling parties.

The estimated useful lives of intangible assets are as follows:

	Useful Life
Land use rights	50 Years
Patents	5 Years
Licenses	5 Years
Customer list and customer relationships	3 Years
Trade secrets - formulas and know how technology	5 Years

Impairment of long-lived assets

Long-lived assets of the Company are reviewed if circumstances dictate, to determine whether their carrying values have become impaired. The Company considers assets to be impaired if the carrying values exceed the future projected cash flows from related operations. The Company also re-evaluates the periods of depreciation to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of March 31, 2011, the Company expects these assets to be fully recoverable.

Beneficial conversion feature of convertible notes

In accordance with accounting standards governing the beneficial conversion feature of convertible notes, the Company has determined that the convertible notes contained a beneficial conversion feature because on November 6, 2007, the effective conversion price of the $5,000,000 convertible note was $5.81 when the market value per share was $16.00, and on May 30, 2008, the effective conversion price of the $30,000,000 convertible note was $5.10 when the market value per share was $12.00. Total value of beneficial conversion feature of $2,904,092 for the November 6, 2007 convertible note and $19,111,323 for the May 30, 2008 convertible note was discounted from the carrying value of the convertible notes. The beneficial conversation feature is amortized using the effective interest method over the terms of the notes. As of March 31, 2011 and June 30, 2010, total of $1,167,871 and $8,637,647, respectively, remained unamortized for the beneficial conversion feature.

Income taxes

The Company accounts for income taxes in accordance with the FASB's accounting standard for income taxes. This standard requires a company to use the asset and liability method of accounting for income taxes, whereby deferred tax assets are recognized for deductible temporary differences, and deferred tax liabilities are recognized for taxable temporary differences. Deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Under this accounting standard, the effect on deferred income taxes of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized if it is more likely than not that some portion, or all of, a deferred tax asset will not be realized. As of March 31, 2011 and June 30, 2010, the Company did not have any net deferred tax assets or liabilities.

The FASB's accounting standards clarify the accounting and disclosure for uncertain tax positions and prescribe a recognition threshold and measurement attribute for recognition and measurement of a tax position taken or expected to be taken in a tax return. The accounting standards also provide guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Under this accounting standard, evaluation of a tax position is a two-step process. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation based on the technical merits of that position. The second step is to measure a tax position that meets the more-likely-than-not threshold to determine the amount of benefit to be recognized in the financial statements. A tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent period in which the threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not criteria should be de-recognized in the first subsequent financial reporting period in which the threshold is no longer met. Penalties or interest incurred relating to underpayment of income taxes are classified as income tax expense in the period incurred. No significant penalties or interest relating to income taxes have been incurred during the nine months ended March 31, 2011 and 2010.

The Company’s operations are subject to income and transaction taxes in the United States and in the PRC jurisdictions. Significant estimates and judgments are required in determining the Company’s worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations, and as a result the ultimate amount of tax liability may be uncertain. However, the Company does not anticipate any events that would lead to changes to these uncertainties.

Value added tax

The Company is subject to value added tax (“VAT”) for manufacturing products and business tax for services provided. The applicable VAT rate is 17% for products sold in the PRC. The amount of VAT liability is determined by applying the applicable tax rate to the invoiced amount of goods sold (output VAT) less VAT paid on purchases made with the relevant supporting invoices (input VAT). Under the commercial practice of the PRC, the Company pays VAT based on tax invoices issued. The tax invoices may be issued subsequent to the date on which revenue is recognized, and there may be a considerable delay between the date on which the revenue is recognized and the date on which the tax invoice is issued. In the event that the PRC tax authorities dispute the date on which revenue is recognized for tax purposes, the PRC tax office has the right to assess a penalty, which can range from zero to five times the amount of the taxes which are determined to be late or deficient, and will be charged to operations in the period if and when a determination is made by the taxing authorities that a penalty is due.

VAT on sales and VAT on purchases amounted to approximately $3,099,000 and $836,000 for the three months ended March 31, 2011, respectively, and approximately $4,347,000 and $924,000 for the three months ended March 31, 2010, respectively. VAT on sales and VAT on purchases amounted to approximately $11,764,000 and $3,089,000, respectively, for the nine months ended March 31, 2011, respectively, and approximately $11,583,000 and $2,662,000, respectively, for the nine months ended March 31, 2010, respectively. Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

Shipping and handling

Shipping and handling costs related to costs of goods sold are included in selling, general and administrative expenses. Shipping and handling costs amounted to approximately $113,000 and $146,000, respectively, for the three months ended March 31, 2011 and 2010, respectively. Shipping and handling costs amounted to approximately $397,000 and $411,000 for the nine months ended March 31, 2011 and 2010, respectively.

Advertising

Expenses incurred in the advertising of the Company and the Company's products are charged to operations. Advertising expenses amounted to approximately $15,000 and $1,077,000 for the three months ended March 31, 2011 and 2010, respectively. Advertising expenses amounted to approximately $2,172,000 and $4,346,000 for the nine months ended March 31, 2011 and 2010, respectively.

Research and development

Research and development costs are expensed as incurred. These costs primarily consist of cost of materials used and salaries paid for the development of the Company's products, and fees paid to third parties to assist in such efforts.

Recent accounting pronouncements

In the third quarter of 2011, The Financial Accounting Standards Board ("FASB") has issued ASU No. 2011-01 through ASU 2011-3, which is not expected to have a material impact on the consolidated financial statements upon adoption.

Note 3 - Earnings per share

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

The following is a reconciliation of the basic and diluted earnings per share computations for the three months ended March 31, 2011 and 2010:

Basic earnings per share

	For the Three Months Ended March 31, 2011	2010
Net income for basic and diluted earnings per share	$5,057,747	$15,184,266
Weighted average shares used in basic computation	13,486,711	11,419,991
Earnings per share – Basic	$0.38	$1.33

Diluted earnings per share

	For the Three Months Ended March 31, 2011	2010
Net income for basic earnings per share	$5,057,747	$15,184,266
Add: interest expense	338,520	2,753,645
Add: financing cost amortization	37,696	198,230
Add: note discount amortization	2,339,710	3,862,102
Subtract: unamortized financing cost at beginning of the period	(116,353)	(763,915)
Subtract: unamortized debt discount at beginning of the period	(4,172,977)	(20,945,255)
Net income for diluted earnings per share	$3,484,343	$289,073
Weighted average shares used in basic computation	13,486,711	11,419,991
Diluted effect of stock options and warrants	-	391,931
Diluted effect of convertible note	2,172,500	3,423,889
Weighted average shares used in diluted computation	15,659,211	15,235,811
Earnings per share – Diluted	$0.22	$0.02

The following is a reconciliation of the basic and diluted earnings per share computations for the nine months ended March 31, 2011 and 2010:

Basic earnings per share

	For the Nine Months Ended March 31, 2011	2010
Net income for basic earnings per share	$26,762,071	$22,664,082
Weighted average shares used in basic computation	12,818,593	10,965,346
Earnings per share – Basic	$2.09	$2.07

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Diluted earnings per share

	For the Nine Months Ended March 31,	
	2011	2010
Net income for basic earnings per share	$ 26,762,071	$ 22,664,082
Add: interest expense	1,900,456	3,744,360
Add: financing cost amortization	356,976	670,985
Add: note discount amortization	11,836,485	11,409,937
Subtract: unamortized financing cost at beginning of the period	(435,634)	(1,236,669)
Subtract: unamortized debt discount at beginning of the period	(13,669,752)	(28,493,090)
Net income for diluted earnings per share	$ 26,750,602	$ 8,759,605
Weighted average shares used in basic computation	12,818,593	10,965,346
Diluted effect of stock options and warrants	6,480	383,837
Diluted effect of convertible note	2,367,299	3,884,974
Weighted average shares used in diluted computation	15,192,372	15,234,157
Earnings per share – Diluted	$ 1.76	$ 0.57

For the three and nine months ended March 31, 2011, 7,500 vested stock options with an average exercise price of $17.93 were not included and 1,882,500 warrants with an average exercise price of $10.00 in the diluted earnings per share calculation because of the anti-dilutive effect. For the three and nine months ended March 31, 2010, 7,500 vested stock options with an average exercise price of $17.93 were not included in the diluted earnings per share calculation because of the anti-dilutive effect.

Note 4 – Accounts receivable, net

Accounts receivable consist of the followings:

	March 31, 2011 (Unaudited)	June 30, 2010
Accounts receivable	21,497,034	34,538,622
Less: accumulated depreciation	(737,268)	(1,343,421)
Total	$ 20,759,766	$ 33,195,201

The activities in the allowance for doubtful accounts are as follows for the periods ended March 31, 2011 and June 30, 2010:

	March 31, 2011 (Unaudited)	June 30, 2010
Beginning allowance for doubtful accounts	$ 1,343,421	$ 694,370
Bad debt additions	-	642,499
Reduction of allowance	(644,457)	-
Foreign currency translation adjustments	38,304	6,552
Ending allowance for doubtful accounts	$ 737,268	$ 1,343,421

Note 5 - Inventories

Inventories consisted of the following:

	March 31, 2010 (Unaudited)	June 30, 2010
Raw materials	$ 996,141	$ 924,996
Work-in-process	185,596	140,328
Packing materials	343,639	224,295
Finished goods	1,371,501	910,995
Total	$ 2,896,877	$ 2,200,614

Note 6 - Plant and equipment, net

Plant and equipment consisted of the following:

	March 31, 2011 (Unaudited)	June 30, 2010
Buildings and building improvements	$ 13,577,707	$ 12,891,331
Manufacturing equipment	2,998,644	2,783,090
Office equipment and furniture	197,926	222,172
Vehicles	497,962	479,999
Total	17,272,239	16,376,592
Less: accumulated depreciation	(3,802,758)	(3,092,280)
Total	$ 13,469,481	$ 13,284,312

For the three months ended March 31, 2011 and 2010, depreciation expense amounted to approximately $212,000 and $225,000, respectively. For the nine months ended March 31, 2011 and 2010, depreciation expense amounted to approximately $629,000 and $616,000, respectively.

Note 7 - Intangible assets, net

Intangible assets consisted of the following:

	March 31, 2010 (Unaudited)	June 30, 2010
Land use rights	$29,399,040	$28,359,388
Patents	5,161,219	4,964,010
Customer lists and customer relationships	1,171,131	1,129,716
Trade secrets, formulas and manufacturing process know-how	1,068,900	1,031,100
Licenses	24,356	23,494
Total	36,824,646	35,507,708
Less: accumulated amortization	(5,227,506)	(2,913,382)
Total	$31,597,140	$32,594,326

Amortization expense for the three months ended March 31, 2011 and 2010 amounted to approximately $1,386,000, and $391,000, respectively. Amortization expense for the nine months ended March 31, 2011 and 2010 amounted to approximately $2,155,000 and $1,194,000, respectively.

The following table summarizes the amortization expense for the next five years and thereafter:

Twelve month periods ending March 31,	
2012	$ 2,032,165
2013	1,727,592
2014	1,557,841
2015	597,613
2016 and thereafter	25,681,929
Total	$ 31,597,140

Note 8 - Debt

Short term bank loan

Short term bank loan represents an amount due to a bank that is due within one year. This loan can be renewed with the bank upon maturity. The Company’s short term bank loan consisted of the following:

	March 31, 2011 (Unaudited)	June 30, 2010
Loan from Communication Bank; due December 2010; interest rate of 6.37% per annum; monthly interest payment; guaranteed by related party, Jiangbo Chinese-Western Pharmacy.	$ -	$ 2,209,500
Total	$ -	$ 2,209,500

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Interest expense related to the short term bank loan amounted to approximately $0 and $37,000 for three months ended March 31, 2011 and 2010, respectively. Interest expense related to the short term bank loan amounted to approximately $61,000 and $73,000 for the nine months ended March 31, 2011 and 2010, respectively.

Notes Payable

Notes payable represents amounts due to a bank which are collateralized and typically renewed. All notes payable are secured by the Company's restricted cash. The Company's notes payables consist of the following:

	March 31, 2011 (Unaudited)	June 30, 2010
Commercial Bank, various amounts, non-interest bearing, due from April 2011 to July 2011; collateralized by 100% of restricted cash deposited	$10,383,600	$11,135,880
Total	$10,383,600	$11,135,880

Note 9 - Related party transactions

Other receivables - related parties

The Company leases two of its buildings to Jiangbo Chinese-Western Pharmacy, a company owned by the Company's Chairman of the Board and other majority shareholders. For the three months ended March 31, 2011 and 2010, the Company recorded other income of approximately $84,000 and $81,000 from leasing the two buildings to this related party. For the nine months ended March 31, 2011 and 2010, the Company recorded other income of approximately $248,000 and $242,000 from leasing the two buildings to this related party. As of March 31, 2011 and June 30, 2010, amount due from this related party was approximately $252,000 and $324,000, respectively.

Other payables - related parties

Other payables-related parties primarily consist of accrued salary payable to the Company's officers and directors, and advances from the Company's Chairman of the Board. These advances are short-term in nature and bear no interest. The amounts are expected to be repaid in the form of cash.

Other payables - related parties consisted of the following:

	March 31, 2011 (Unaudited)	June 30, 2010
Payable to Wubo Cao, Chairman of the Board	$ 204,732	$ 154,866
Payable to Shandong Hilead Biotechnology Co., Ltd., majority owned by Wubo Cao, Chairman of the Board and former Chief Executive Officer (1)	-	48,609
Payable to Michael Marks, Director	27,500	-
Payable to Haibo Xu, Former Chief Operating Officer and Director	-	33,688
Payable to Elsa Sung, Former Chief Financial Officer	11,308	5,932

Payable to Jian Ge, Director	112,500	-
Payable to Huang Lei, Director	112,500	-
Payable to Xiaowei Feng, Director	22,500	-
Payable to John Wang, Director	35,500	12,500
Total other payable - related parties	$ 526,540	$ 255,595

(1) The Company leases two warehouses from Shandong Hilead Biotechnology Co., Ltd., a company majority owned by the Company's Chairman and former Chief Executive Officer. The rent expense related to this lease for the periods ended at March 31, 2011 and 2010 were immaterial.

On December 23, 2010, the Company advanced approximately $104,000 to Jiangbo Chinese-Western Pharmacy, an entity that is 90% owned by Wubo Cao, the Company's Chairman, on an unsecured and interest free basis. The amount was fully repaid by Jiangbo Chinese-Western Pharmacy on December 30, 2010.

Note 10 – Concentration of Business

a. Concentration of Credit risk

Assets that the Company potentially subject to significant concentration of credit risks primarily consist of cash and cash equivalents and accounts receivable. The Company maintains cash deposits in financial institutions that exceed the amounts insured by the U.S. government. Balances at financial institutions or state-owned banks within the PRC are not covered by insurance. Non-performance by these institutions could expose the Company to losses for amounts in excess of insured balances. As of March 31, 2011 and June 30, 2010, the Company's bank balances, including restricted cash balances, exceeded government-insured limits by approximately $157,201,000 and $119,675,000, respectively. To date, the Company has not experienced any losses in such accounts.

Accounts receivable are typically unsecured and the risk with respect to accounts receivable is mitigated by credit evaluations. The Company monitors customers with outstanding balances.

b. Concentration of major customers, suppliers, and products

For the three months ended March 31, 2011 and 2010, sales from four products accounted for 96.8% and 99.8%, respectively, of the Company's total sales. For the nine months ended March 31, 2011 and 2010, the four products accounted for 97.8% and 99.4%, respectively, of the Company's total sales.

For the three months ended March 31, 2011 and 2010, three customers accounted for approximately 39.1% and 28.0%, respectively, of the Company's total revenue. For the nine months ended March 31, 2011 and 2010, the three customers accounted for approximately 35.0% and 25.8%, respectively, of the Company's total revenue. The three customers represented 37.7% and 28.7% of the Company's total accounts receivable as of March 31, 2011 and June 30, 2010, respectively.

For the three months ended March 31, 2011 and 2010, top three suppliers accounted for approximately 66.4% and 65.7%, respectively, of the Company's purchases. For the nine months ended March 31, 2011 and 2010, top three suppliers accounted for approximately 65.1% and 61.7%, respectively, of the Company's purchases. Top three suppliers represented 59.8% and 61.5% of the Company's total accounts payable as of March 31, 2011 and June 30, 2010, respectively.

Note 11 - Taxes payable

The Company is subject to the United States federal income tax at a tax rate of 34%. No provision for U.S. income taxes has been made as the Company had no U.S. taxable income during the nine months ended March 31, 2011 and 2010.

The Company's wholly owned subsidiaries Karmoya International Ltd. ("Karmoya") and Union Well International Ltd. ("Union Well") were incorporated in the British Virgin Island ("BVI") and the Cayman Islands, respectively. Under the current laws of the BVI and Cayman Islands, the two entities are not subject to income taxes.

On March 16, 2007, the National People's Congress of China passed the new Enterprise Income Tax Law ("EIT Law"), and on November 28, 2007, the State Council of China passed the Implementing Rules for the EIT Law ("Implementing Rules") which became effective on January 1, 2008. The EIT Law and Implementing Rules impose a unified EIT rate of 25.0% on all domestic-invested enterprises and FIEs, unless they qualify under certain limited exceptions. Therefore, nearly all FIEs are subject to the new tax rate alongside other domestic businesses rather than benefiting from the EIT Law and its associated preferential tax treatments, beginning January 1, 2008.

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In addition to the changes to the current tax structure, under the EIT Law, an enterprise established outside of China with "de facto management bodies" within China is considered a resident enterprise and will normally be subject to an EIT of 25.0% on its global income. The Implementing Rules define the term "de facto management bodies" as "an establishment that exercises, in substance, overall management and control over the production, business, personnel, accounting, etc., of a Chinese enterprise." If the PRC tax authorities subsequently determine that the Company should be classified as a resident enterprise, then the organization's global income will be subject to PRC income tax of 25.0%. Laiyang Jiangbo and GJBT were subject to 25% income tax rate since January 1, 2008.

The table below summarizes the differences between the U.S. statutory federal rate and the Company’s effective tax rate for the three months ended March 31, 2011 and 2010:

	For the Three Months Ended	
	2011 (Unaudited)	2010 (Unaudited)
U.S. Statutory rates	34.0%	34.0%
Foreign income not recognized in the U.S	(34.0)%	(34.0)%
China income taxes	25.0%	25.0%
Other items (a)	(1.7)%	(6.1)%
Total provision for income taxes	23.3%	18.9%

(a) The (1.7)% and (6.1)% represent the expenses incurred by the Company that are not deductible for PRC income tax purpose, and the gain on change in fair value of derivative liabilities and interest expense in relation to the convertible notes which were not subject to the income tax or bring tax benefits for the three months ended March 31, 2011 and 2010, respectively.

The table below summarizes the differences between the U.S. statutory federal rate and the Company’s effective tax rate for the nine months ended March 31, 2011and 2010:

	For the Nine Months Ended	
	2011 (Unaudited)	2010 (Unaudited)
U.S. Statutory rates	34.0%	34.0%
Foreign income not recognized in the U.S	(34.0)%	(34.0)%
China income taxes	25.0%	25.0%
Other items(a)	(0.3)%	2.5%
Total provision for income taxes	24.7%	27.5%

(a) The (0.3)% and 2.5% represent the expenses incurred by the Company that are not deductible for PRC income tax purpose , for the nine months ended March 31, 2011 and 2010 respectively.

Taxes payable

The following table reflects taxes payable as of:

	March 31, 2011 (Unaudited)	June 30, 2010
Value added taxes	$ 665,256	$ 1,372,353
Income taxes	1,809,885	4,698,174
Other taxes	388,802	188,744
Total	$ 2,863,943	$ 6,259,271

Jiangbo incurred net operating losses of approximately $1,651,000 for income tax purposes for nine months ended March 31, 2011. The estimated net operating loss carryforwards for US income taxes amounted to approximately $6,535,000 which may be available to reduce future years' taxable income. These carryforwards will expire, if not utilized, from 2027 through 2030. Management believes that the realization of the benefits from these losses appears uncertain due to the Company's limited operating history and continuing losses for US income tax purposes. Accordingly, the Company has provided a 100% valuation allowance on the deferred tax asset benefit to reduce the asset to zero. The net change in the valuation allowance for the nine months ended March 31, 2011 was approximately $561,000 and the accumulated valuation allowance as of March 31, 2011 amounted to approximately $2,222,000. Management reviews this valuation allowance periodically and makes adjustments as necessary.

The Company has cumulative undistributed earnings of foreign subsidiaries of approximately $141,828,000 as of March 31, 2011, and is included in consolidated retained earnings and will continue to be indefinitely reinvested in international operations. Accordingly, no provision has been made for U.S. deferred taxes related to future repatriation of these earnings, nor is it practicable to estimate the amount of income taxes that would have to be provided if the Company concluded that such earnings will be remitted in the future.

Note 12 - Convertible Debt

November 2007 Convertible Debentures

On November 7, 2007, the Company entered into a Securities Purchase Agreement (the "November 2007 Purchase Agreement") with Pope Investments, LLC ("Pope") (the "November 2007 Investor"). Pursuant to the November 2007 Purchase Agreement, the Company issued and sold to the November 2007 Investor, $5,000,000 principal amount of 6% convertible subordinated debentures due November 30, 2010 (the "November 2007 Debenture") and a three-year warrant to purchase 250,000 shares of the Company's common stock, par value $0.001 per share, exercisable at $12.80 per share, subject to adjustments as provided therein. The November 2007 Debenture bears interest at the rate of 6% per annum and the initial conversion price of the debentures is $10 per share. In connection with the offering, the Company placed in escrow 500,000 shares of its common stock. As of March 31, 2011, the 500,000 shares are still in escrow. In connection with the May 2008 financing, the November 2007 Debenture conversion price was subsequently adjusted to $8 per share (Post 40-to-1 reverse split).

The Company evaluated the FASB's accounting standard regarding convertible debentures and concluded that the convertible debenture has a beneficial conversion feature. The Company estimated the intrinsic value of the beneficial conversion feature of the November 2007 Debenture at $2,904,093. The fair value of the warrants was estimated at $2,095,907. The two amounts are recorded in full value of the bond as debt discount and amortized using the effective interest method over the three-year term of the debentures.

The fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.5%), (2) expected warrant life of 3 years, (3) expected volatility of 197%, and (4) zero expected dividends. The total estimated fair value of the warrants granted and beneficial conversion feature of the November 2007 Debenture should not exceed the $5,000,000 November 2007 Debenture, and the calculated warrant value was used to determine the allocation between the fair value of the beneficial conversion feature of the November 2007 Debenture and the fair value of the warrants.

In connection with the private placement, the Company paid the placement agents a fee of $250,000 and incurred other expenses of $104,408, which were capitalized as deferred debt issuance costs and are being amortized to interest expense over the life of the debentures. For the three months ended March 31, 2011 and 2010, amortization of debt issuance costs related to the November 2007 Purchase Agreement was $0 and $24,876, respectively. For the nine months ended March 31, 2011 and 2010, amortization of debt issuance costs related to the November 2007 Purchase Agreement was $32,117 and $102,951, respectively. The amortization of debt issuance costs has been included in interest expense. The remaining balance of unamortized debt issuance costs of the November 2007 Purchase Agreement at March 31, 2011 and June 30, 2010 was $0 and $32,118, respectively. The amortization of debt discounts was $0 and $436,202, respectively, for the three months ended March 31, 2011 and 2010. The amortization of debt discounts was $1,255,430 and $1,830,624, respectively, for the nine months ended March 31, 2011 and 2010, respectively. The amortization of debt discount has been included in interest expense on the accompanying consolidated statements of income. The balance of the debt discount was $0 and $1,255,430 at March 31, 2011 and June 30, 2010, respectively.

The November 2007 Debenture bears interest at the rate of 6% per annum, payable in semi-annual installments on May 31 and November 30 of each year, with the first interest payment due on May 31, 2008. The initial conversion price ("November 2007 Conversion Price") of the November 2007 Debentures was $10 per share. If the Company issues common stock at a price that is less than the effective November 2007 Conversion Price, or common stock equivalents with an exercise or conversion price less than the then effective November 2007 Conversion Price, the November 2007 Conversion Price of the November 2007 Debenture and the exercise price of the warrants will be reduced to such price. The November 2007 Debenture may not be prepaid without the prior written consent of the Holder, as defined. In connection with the Offering, the Company placed in escrow 500,000 shares of common stock issued by the Company in the name of the escrow agent. In the event the Company's consolidated Net Income Per Share (as defined in the November 2007 Purchase Agreement), for the year ended June 30, 2008, was less than $1.52, the escrow agent was required to deliver the 500,000 shares to the November 2007 Investor. The Company concluded that its fiscal 2008 Net Income Per Share met the required amount and no shares were delivered to the November 2007 Investor. As of March 31, 2011, the 500,000 shares were still in escrow. The original due date for the November 2007 Debenture was November 30, 2010. The Company was unable to repay the November 2007 on that date due to its inability to transfer sufficient cash out of the PRC. On January 19, 2011, the Company and Pope reached a settlement agreement; Pope agreed to extend the maturity date of November 2007 Debenture remaining outstanding balance of $3.5 million to February 28, 2011. The Company was unable to make the principal payment due to its continued inability to transfer sufficient cash out of the PRCand became delinquent on the November 2007 Debentures on February 28, 2011. As of March 31, 2011 and the date of this report, no formal event of default notice has been presented by the Holder of the November 2007 Debentures and the Company is currently in discussion with the holder to resolve the delinquent situation.

The financing was completed through a private placement to accredited investors and is exempt from registration pursuant to Section 492 of the Securities Act of 1933, as amended ("Securities Act").

During the three and nine months ended March 31, 2011, the Company issued 0 and 1,062,500 shares of its common stock upon conversion of 0 and $500,000 November 2007 Notes, respectively. As of March 31, 2011, a total of $1,500,000 November 2007 Debentures has been converted into shares of common stock of the Company.

May 2008 Convertible Debentures

On May 30, 2008, the Company entered into a Securities Purchase Agreement (the "May 2008 Securities Purchase Agreement") with certain investors (the "May 2008 Investors"), pursuant to which, on May 30, 2008, the Company sold to the May 2008 Investors 6% convertible debentures (the "May 2008 Notes") and warrants to purchase 1,875,000 shares of the Company's common stock ("May 2008 Warrants"), for an aggregate amount of $30,000,000 (the "May 2008 Purchase Price"), in transactions exempt from registration under the Securities Act (the "May 2008 Financing"). Pursuant to the terms of the May 2008 Securities Purchase Agreement, the Company will use the net proceeds from the financing for working capital purposes. In addition, pursuant to the terms of the May 2008 Securities Purchase Agreement, the Company was required, among other things, to increase the number of its authorized shares of common stock to 22,500,000 by August 31, 2008, and is prohibited from issuing any "Future Priced Securities" as such term is described by NASD IM-4350-1 for one year following the closing of the May 2008 Financing. The Company satisfied the increase in the number of its authorized shares of common stock in August 2008 (post 40-to-1 reverse split).

The May 2008 Notes are due May 30, 2011, and are convertible into shares of the Company's common stock at a conversion price equal to $8 per share, subject to adjustments pursuant to customary anti-dilution provisions and automatic downward adjustments in the event of certain sales or issuances by the Company of common stock at a price per share less than $8. Interest on the outstanding principal balance of the May 2008 Notes is payable at a rate of 6% per annum, in semi-annual installments payable on November 30 and May 30 of each year, with the first interest payment due on November 30, 2008. At any time after the issuance of the May 2008 Note, any May 2008 Investor may convert its May 2008 Notes, in whole or in part, into shares of the Company's common stock, provided that such May 2008 Investor shall not affect any conversion if immediately after such conversion, such May 2008 Investor and its affiliates would, in the aggregate, beneficially own more than 9.99% of the Company's outstanding common stock. The May 2008 Notes are convertible at the option of the Company if the following four conditions are met: (i) effectiveness of a registration statement with respect to the shares of the Company's common stock underlying the May 2008 Notes and the Warrants; (ii) the Volume Weighted Average Price ("VWAP" of the common stock has been equal to or greater than 250% of the conversion price, as adjusted, for 20 consecutive trading days on its principal trading market; (iii) the average dollar trading volume of the common stock exceeds $500,000 on its principal trading market for the same 20 days; and (iv) the Company achieves 2008 Guaranteed EBT (as hereinafter defined) and 2009 Guaranteed EBT (as hereinafter defined). A holder of the May 2008 Notes may require the Company to redeem all or a portion of such May 2008 Notes for cash at a redemption price as set forth in the May 2008 Notes, in the event of a change in control of the Company, an event of default or if any governmental agency in the PRC challenges or takes action that would adversely affect the transactions contemplated by the Securities Purchase Agreement. The May 2008 Warrants are exercisable for a five-year period, beginning on May 30, 2008, at an initial exercise price of $10 per share.

The Company estimated the intrinsic value of the beneficial conversion feature of the May 2008 Note at $19,111,323. The fair value of the warrants was estimated at $10,888,677. The two amounts are recorded together as debt discount and amortized using the effective interest method over the three-year term of the debentures.

The fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.2%), (2) expected warrant life of 5 years, (3) expected volatility of 95%, and (4) zero expected dividends. The total estimated fair value of the warrants granted and beneficial conversion feature of the May 2008 Notes should not exceed the $30,000,000 debenture, and the calculated warrant value was used to determine the allocation between the fair value of the beneficial conversion feature of the May 2008 debenture and the fair value of the warrants.

In connection with the private placement, the Company paid the placement agents a fee of $1,500,000 and incurred other expenses of $186,500, which were capitalized as deferred debt issuance costs and are being amortized to interest expense over the life of the notes. During the three months ended March 31, 2011 and 2010, amortization of debt issuance costs related to the May 2008 Purchase Agreement was $69,813 and $173,355, respectively. During the nine months ended March 31, 2011 and 2010, amortization of debt issuance costs related to the May 2008 Purchase Agreement was $356,976 and $568,033, respectively. The remaining balance of unamortized debt issuance costs of the May 2008 Purchase Agreement at March 31, 2011 and June 30, 2010 was $46,540 and $403,516, respectively. The amortization of debt discounts was $2,339,710 and $3,425,900 for the three months ended March 31, 2011 and 2010, and was $10,581,055 and $9,579,312 for the nine months ended March 31, 2011 and 2010 respectively, which has been included in interest expense on the accompanying consolidated statements of income. The balance of the unamortized debt discount was $1,833,267 and $12,414,322 at March 31, 2010 and June 30, 2010, respectively.

In connection with the May 2008 Financing, the Company entered into a holdback escrow agreement (the “Holdback Escrow Agreement”) dated May 30, 2008, with the May 2008 Investors and Loeb & Loeb LLP, as Escrow Agent, pursuant to which $4,000,000 of the May 2008 Purchase Price was deposited into an escrow account with the Escrow Agent at the closing of the Financing. Pursuant to the terms of the Holdback Escrow Agreement, (i) $2,000,000 of the escrowed funds will be released to the Company upon the Company’s satisfaction no later than 120 days following the closing of the Financing of an obligation that the board of directors be comprised of at least five members (at least two of whom are to be fluent English speakers who possess necessary experience to serve as a director of a public company), a majority of whom will be independent directors acceptable to Pope and (ii) $2,000,000 of the escrowed funds will be released to the Company upon the Company’s satisfaction no later than six months following the closing of the Financing of an obligation to hire a qualified full-time chief financial officer (as defined in the May 2008 Securities Purchase Agreement). In the event that either or both of these obligations are not so satisfied, the applicable portion of the escrowed funds will be released pro rata to the Investors. The Company has satisfied both requirements and the holdback money was released to the Company in July 2008.

In connection with the May 2008 Financing, Mr. Cao, the Company’s Chairman of the Board, placed 3,750,000 shares of common stock of the Company owned by him into an escrow account pursuant to a make good escrow agreement dated May 30, 2008 (the “Make Good Escrow Agreement”). In the event that either (i) the Company’s adjusted 2008 earnings before taxes is less than $26,700,000 (“2008 Guaranteed EBT”) or (ii) the Company’s 2008 adjusted fully diluted earnings before taxes per share is less than $1.60 (“2008 Guaranteed Diluted EBT”), 1,500,000 of such shares (the “2008 Make Good Shares”) are to be released pro rata to the May 2008 Investors. In the event that either (i) the Company’s adjusted 2009 earnings before taxes is less than $38,400,000 (“2009 Guaranteed EBT”) or (ii) the Company’s adjusted fully diluted earnings before taxes per share is less than $2.32 (or $2.24 if the 500,000 shares of common stock held in escrow in connection with the November 2007 private placement have been released from escrow) (“2009 Guaranteed Diluted EBT”), 2,250,000 of such shares (the “2009 Make Good Shares”) are to be released pro rata to the May 2008 Investors. Should the Company successfully satisfy these respective financial milestones, the 2008 Make Good Shares and 2009 Make Good Shares will be returned to Mr. Cao. In addition, Mr. Cao is required to deliver shares of common stock owned by him to the Investors on a pro rata basis equal to the number of shares (the “Settlement Shares”) required to satisfy all costs and expenses associated with the settlement of all legal and other matters pertaining to the Company prior to or in connection with the completion of the Company’s October 2007 share exchange in accordance with formulas set forth in the May 2008 Securities Purchase Agreement (post 40-to-1 reverse split). The Company has concluded that both thresholds for the years ended June 30, 2009 and June 30, 2008 have been met. Neither the 2008 Make Good Shares nor the 2009 Make Good Shares had been returned to Mr. Cao as of March 31, 2011 and as of the date of this filing.

The security purchase agreement set forth permitted indebtedness which the Company’s lease obligations and purchase money indebtedness is limited up to $1,500,000 per year in connection with new acquisition of capital assets and lease obligations. Permitted investment set forth with the security purchase agreement limits capital expenditure of the Company not to exceed $5,000,000 in any rolling 12 months.

Pursuant to a Registration Rights Agreement, the Company agreed to file a registration statement covering the resale of the shares of common stock underlying the May 2008 Notes and Warrants, (ii) the 2008 Make Good Shares, (iii) the 2009 Make Good Shares, and (iv) the Settlement Shares. The Company must file an initial registration statement covering the shares of common stock underlying the Notes and Warrants no later than 45 days from the closing of the Financing and to have such registration statement declared effective no later than 180 days from the closing of the Financing. If the Company does not timely file such registration statement or cause it to be declared effective by the required dates, then the Company will be required to pay liquidated damages to the Investors equal to 1.0% of the aggregate May 2008 Purchase Price paid by such Investors for each month that the Company does not file the registration statement or cause it to be declared effective. Notwithstanding the foregoing, in no event shall liquidated damages exceed 10% of the aggregate amount of the May 2008 Purchase Price. The Company satisfied its obligations under the Registration Rights Agreement by filing the required registration statement and causing it to be declared effective within the time periods set forth in the Registration Rights Agreement.

During the three and nine months ended March 31, 2011, the Company issued 0 and 1,062,500 shares of its common stock upon conversion of $500,000 and $8,000,000 May 2008 Notes, respectively. As of March 31, 2011, a total of $16,120,000 May 2008 Notes has been converted into common shares.

The above two convertible debenture liabilities are as follows:

	March 31, 2011 (Unaudited)	June 30, 2010
November 2007 convertible debenture note payable	$ 3,500,000	$ 4,000,000
May 2008 convertible debenture note payable	13,880,000	21,880,000
Total convertible debenture note payable	17,380,000	25,880,000
Less: Unamortized discount on November 2007 convertible debenture note payable	-	(1,255,430)
Less: Unamortized discount on May 2008 convertible debenture note payable	(1,833,267)	(12,414,322)
Convertible debentures, net	$ 15,546,733	$ 12,210,248

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Interest and Penalties

As a result of the delay in its ability to transfer cash out of the PRC (partially due to the stricter foreign exchange restrictions and regulations imposed in the PRC starting in December 2008), the Company became delinquent on the payment of interest under the November 2007 Debenture and May 2008 Notes in December 2009. In February 2010, the Company, the holder of the November 2007 Debenture and the majority holder of the May 2008 Notes holders entered to a waiver agreement regarding the delinquent interest payment; the waiver agreement required the Company to make the delinquent interest payments by February 25, 2010 and to have its common stock listed on the NASDAQ stock market on or prior to April 15, 2010. The Company was not able to meet the waiver letter requirements and has continued dialogue with the November 2007 Debenture and May 2008 Notes holders. No formal event of default notice was presented by the November 2007 Debenture or the May 2008 Notes holders. On January 19, 2011, the Company and the holder of the November 2007 Debenture and majority holder of the May 2008 Notes (the “ Holder”) entered into a Letter Agreement (the “Letter Agreement”) whereby the Company agreed to issue a total of 886,277 shares of its common stock to the Holder and other holders of the May 2008 Notes by January 20, 2011 for all accrued interest and related interest penalty and the Holder agreed to waive the Event of Default provisions set forth in the November 2007 Debenture and the May 2008 Notes. Of the 886,277 shares issued, 366,048 shares were related to accrued interest and 520,229 shares were related to penalties. The Holder also agreed to extend the due date of the November 2007 Debenture to February 28, 2011. Approximately $6,281,031 of the accrued interest and related interest penalty was settled accordingly.

The Company was unable to make the principal payment and again became delinquent on the November 2007 Debenture on March 1, 2011. As of March 31, 2011 and the date of this report, no formal event of default notice has been presented by the holder of the November 2007 Debenture and the Company is currently in discussion with the holder of the November 2007 Debenture to resolve the delinquent situation.

Accrued interest and related interest penalty as of March 31, 2011 related to the November 2007 Debenture and May 2008 Notes amounted to $291,394.

Note 13 - Shareholders’ equity

Common stock

In July 2010, the Company issued 3,250 shares of common stock to a consultant for services. The Company valued these shares at the fair value on the service contract date of $8.40 per share, or $27,300 in total, based on the trading price of common stock. For the nine months ended March 31, 2011, the Company recorded stock-based compensation expense of $27,300 related to this issuance accordingly.

In July 2010, the Company issued 562,500 shares of its common stock in connection with the conversion of $4,500,000 of May 2008 Notes at the conversion price of $8. In connection with the conversion, the Company recorded $2,636,210 in interest expense to fully amortize the unamortized discount and deferred financing costs related to the converted dentures.

In August 2010, the Company issued 125,000 shares of its common stock in connection with the conversion of $1,000,000 of May 2008 Notes at the conversion price of $8. In connection with the conversion, the Company recorded $541,033 in interest expense to fully amortize the unamortized discount and deferred financing costs related to the converted dentures.

In September 2010, the Company issued 250,000 shares of its common stock in connection with the conversion of $2,000,000 of May2008 Notes at the conversion price of $8. In connection with the conversion, the Company recorded $999,286 in interest expense to fully amortize the unamortized discount and deferred financing costs related to the converted dentures.

In September 2010, the Company issued 1,450 shares of common stock to the Company's Chairman as director fee. The Company valued these shares at the fair market value on the date of grant of $7.49 per share, or $10,860 in total, based on the trading price of common stock. For the nine months ended March 31, 2011, the Company recorded stock based compensation expense of $10,860 related to this issuance accordingly.

In October 2010, the Company issued 62,500 shares of its common stock in connection with the conversion of $500,000 of May 2008 Notes at the conversion price of $8. In connection with the conversion, the Company recorded $226,132 in interest expense to fully amortize the unamortized discount and deferred financing costs related to the converted dentures.

In November 2010, the Company issued 62,500 shares of its common stock in connection with the conversion of $500,000 of November 2007 Debentures at the conversion price of $8. The Company did not recorded interest expense as the debenture discount and deferred financing costs related to the converted dentures have been fully amortized prior to the conversion.

In November 2010, the in connection with the settlement (see Note 19) with China West II, the Company issued 22,500 shares of its common stock and the shares were valued at fair market value on the date of settlement at $6.71 per share or $150,976 in total, based on the trading price of the common stock. For the nine months ended March, 2011, the Company recorded settlement income of approximately $91,000 related to this settlement.

In December 2010, the Company issued a total of 7,950 shares of common stock to four of the Company's director, officers and employees. as director fee. The Company valued these shares at the fair market value on the date of grant of $5.72 per share, or $45,471 in total, based on the trading price of common stock. For the nine months ended March 31, 2011, the Company recorded stock based compensation expense of $45,474 related to this issuance accordingly.

In January 2011, the Company issued 3,250 shares of common stock to a consultant for services. The Company valued these shares at the fair market value on the service contract date of $8.40 per share, or $27,300 in total, based on the trading price of common stock on the contract date. For the nine months ended March 31, 2011, the Company recorded stock-based compensation expense of $27,300 related to this issuance accordingly.

In January 2011, in connection with the settlement (see Note 12) with the November 2007 Debentures and May 2008 Notes holders, the Company issued 886,277 shares of its common stock and the shares were valued at fair market value on the date of settlement at $6.64 per share or $5,884,879 in total, based on the trading price of the common stock. For the nine months ended March, 2011, the Company recorded settlement income of approximately $262,000 related to this settlement.

In March 2011, the Company issued a total of 3,200 shares of common stock to two of the Company's directors and officers as compensations. The Company valued these shares at the fair market value on the date of grant of $4.38 per share, or $14,016 in total, based on the trading price of common stock. For the nine months ended March 31, 2011, the Company recorded stock based compensation expense of $14,016 related to this issuance accordingly.

Registered capital contribution receivable

At inception, Karmoya issued 1,000 shares of common stock to its founder. The shares were valued at par value. On September 20, 2007, the Company issued 9,000 shares of common stock to nine individuals at par value. The balance of $10,000 is shown as capital contribution receivable on the accompanying consolidated financial statements. As part of its agreements with the shareholders, the Company was to receive the $10,000 in October 2007. As of March 31, 2011, the Company has not received the $10,000.

Union Well was established on May 9, 2007, with a registered capital of $1,000. In connection with Karmoya's acquisition of Union Well, the registered capital of $1,000 is reflected as capital contribution receivable on the accompanying consolidated financial statements. The $1,000 was due in October 2007, however, as of March 31, 2011, the Company has not received the $1,000.

Note 14 - Warrants

In connection with the $5,000,000 November 2007 6% Convertible Debenture, the Company issued a three-year warrant to purchase 250,000 shares of common stock, at an exercise price of $12.80 per share. The calculated fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.5%), (2) expected warrant life of 3 years, (3) expected volatility of 197%, and (4) zero expected dividends. In connection with the May 2008 financing, the exercise price of outstanding warrants issued in November 2007 was reduced to $8 per share and the total number of warrants to purchase common stock was increased to 400,000. The 400,000 warrants were expired in November 2010.

In connection with the $30,000,000 May 2008 6% Convertible Notes, the Company issued a five-year warrant to purchase 1,875,000 shares of common stock, at an exercise price of $10 per share. The calculated fair value of the warrants granted with this private placement was computed using the Black-Scholes option-pricing model. Variables used in the option-pricing model include (1) risk-free interest rate at the date of grant (4.2%), (2) expected warrant life of 5 years, (3) expected volatility of 95%, and (4) zero expected dividends.

On February 15, 2009, the Company granted 40,000 stock warrants to a consultant at an exercise price of $6.00 per share exercisable for a period of three years. The warrants fully vest on July 15, 2009. The fair value of this warrant grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: (1) risk-free interest rate at the date of grant (1.83%), (2) expected warrant life of three years, (3) expected volatility of 106%, and (4) zero expected dividends. In connection with these warrants, the Company recorded stock-based compensation expense of $126,616 for the six months ended December 31, 2009.

A summary of the warrants as of March 31, 2011, and changes during the period are presented below:

	Number of Warrants
Outstanding as of June 30, 2009	2,315,000
Granted	-
Forfeited	-
Exercised	-
Outstanding as of June 30, 2010	2,315,000
Granted	-
Forfeited	400,000
Exercised	-
Outstanding as of March 31, 2011 (unaudited)	1,915,000

The following is a summary of the status of warrants outstanding at March 31, 2011:

Outstanding Warrants			Exercisable Warrants		
Exercise Price	Number	Average Remaining Contractual Life (Years)	Average Exercise Price	Number	Average Remaining Contractual Life (Years)
$ 6.00	40,000	0.88	$ 6.00	40,000	0.88
$ 10.00	1,875,000	2.17	$ 10.00	1,875,000	2.17
Total	1,915,000			1,915,000	

The Company has 1,915,000 warrants outstanding and exercisable at an average exercise price of $9.92 per share as of March31, 2011.

Note 15 - Stock options

On June 10, 2008, 7,500 options were granted and the fair value of these options was estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Expected Life	Expected Volatility	Dividend Yield	Risk Free Interest Rate	Grant Date Average Fair Value
Current officer	5 years	95%	0%	2.51%	$ 8.00

As of March 31, 2011, of the 7,500 options held by the Company's executives, directors, and employees were fully vested.

The following is a summary of the option activity:

	Number of Options
Outstanding as of June 30, 2009	140,900
Granted	-
Forfeited	-

Exercised	-
Outstanding as of June 30, 2010	140,900
Granted	-
Forfeited	133,400
Exercised	-
Outstanding as of March 31, 2011 (unaudited)	7,500

Following is a summary of the status of options outstanding at March 31, 2011:

Outstanding Options			Exercisable Options		
Average Exercise Price	Number	Weighted Average Remaining Contractual Life (years)	Average Exercise Price	Number	Weighted Average Remaining Contractual Life (years)
$ 12.00	2,000	2.20	$ 12.00	2,000	2.20
$ 16.00	1,750	2.20	$ 16.00	1,750	2.20
$ 20.00	1,875	2.20	$ 20.00	1,875	2.20
$ 24.00	1,875	2.20	$ 24.00	1,875	2.20
Total	7,500		Total	7,500	

At March 31, 2011 and June 30, 2010, there was no compensation expense recorded related to options granted as related compensation expenses has been fully charged in prior periods.

Note 16 - Employee pension plan

The employee pension in the Company generally includes two parts: the first part to be paid by the Company is 30.6% of $128 for each qualified employee each month. The other part, paid by the employees, is 11% of $128 each month. For the three months ended March 31, 2011 and 2010, the Company made pension contributions in the amount of $28,655 and $28,096, respectively. For the nine months ended March 31, 2011 and 2010, the Company made pension contributions in the amount of $110,655 and $58,368, respectively.

Note 17 - Statutory reserves

The Company is required to make appropriations to reserve funds, comprising the statutory surplus reserve and discretionary surplus reserve, based on after-tax net income determined in accordance with generally accepted accounting principles of the People's Republic of China ("PRC GAAP"). Appropriations to the statutory surplus reserve is required to be at least 10% of the after tax net income determined in accordance with PRC GAAP until the reserve is equal to 50% of the entities' registered capital. Appropriations to the discretionary surplus reserve are made at the discretion of the Board of Directors.

The statutory surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

The discretionary surplus fund may be used to acquire fixed assets or to increase the working capital to expend on production and operation of the business. The Company's Board of Directors decided not to make an appropriation to this reserve for 2008.

Pursuant to the Company's articles of incorporation, the Company is required to appropriate 10% of the net profit as statutory surplus reserve up to 50% of the Company’s registered capital. During the year ended June 30, 2008, the Company’s statutory surplus reserve reached 50% of its registered capital.

Note 18 - Accumulated other comprehensive income

The components of accumulated other comprehensive income is as follows:

Balance, June 30, 2009	$	6,523,602
Foreign currency translation gain		927,723
Unrealized gain on marketable securities		166,378
Balance, June 30, 2010	$	7,617,703
Foreign currency translation gain		6,595,950
Balance, March 31, 2011 (unaudited)	$	14,213,653

Note 19 - Commitments and Contingencies

Commitments

R&D Agreement

In September 2007, the Company entered into a three year Cooperative Research and Development Agreement ("CRADA") with a provincial university. Under the CRADA, the university is responsible for designing, researching and developing designated pharmaceutical projects for the Company. Additionally, the university will also provide technical services and trainings to the Company. As part of the CRADA, the Company will pay approximately $3.5 million (RMB 24,000,000) plus out-of-pocket expenses to the university annually and provide internship opportunities for students of the university. The Company will have the primary ownership of the designated research and development project results.

In November 2007, the Company entered into a five year CRADA with a research institute. Under this CRADA, the institute is responsible for designing, researching and developing designated pharmaceutical projects for the Company. Additionally, the university will also provide technical services and trainings to the Company. As part of the CRADA, the Company pays approximately $880,000 (RMB 6,000,000) to the institute annually. The Company will have the primary ownership of the designated research and development project results.

For the three months ended March 31, 2011 and 2010, approximately $233,000 and $1,093,000, respectively was incurred as research and development expense. For the nine months ended March 31, 2011 and 2010, approximately $1,426,000 and $3,299,000, respectively was incurred as research and development expense. As of March 31, 2011, the Company's future estimated payments to the remaining one CRADA amounted to approximately $1.5 million.

Contingencies

a. Delinquent in the Repayment of Principal on November 2007 Debenture

As discussed in Note 12, the Company became delinquent in the payment of principal on its November 2007 Debenture on March 1, 2011. To date, the Company has remained unable to make these payments. The Company is required to repay the then outstanding aggregate principal amount of the November 2007 Debentures, together with all accrued interest and penalties. The Company continues to be engaged in discussions with the sole holder of the November 2007 Debenture with respect to this payment delinquency. To date, the Company has not received a formal acceleration notice under the terms of the November 2007 Debentures, nor have any actions been taken against the Company to secure the obligations.

In the event that the Company is unable to repay the November 2007 Debentures, upon such an acceleration, or in the event that the Company is unable to repay the November 2007 Debentures, when due, it is likely that the sole holder of the November 2007 Debenture will institute legal proceedings against the Company to collect the amounts due under the November 2007 Debentures. The occurrence of any of these events would be materially adverse to the Company's ability to continue its business as it is presently conducted.

b. SEC Investigation

The Company received a letter of informal investigation dated December 22, 2010 from the U.S. Securities and Exchange Commission ("SEC") requesting the Company to provide certain documents. The letter indicated that the Company should not construe the investigation as an indication by the SEC or its staff that any violation of law has occurred or any adverse reflection on any person, entity or security.

In February 2011, the Company, through its Audit Committee, commenced an internal investigation into certain transactions. On March 26, 2011, the staff of the SEC having been informed by the Company of its internal investigation, notified the Company that it had begun a non-public formal investigation and requested certain information and materials relating to certain aspects of the Company's public disclosures and operations. The SEC has advised the Company that its investigation is not intended to suggest that the SEC believes at this time that the Company has done anything wrong and is in fact a fact finding investigation. The Company is committed to cooperating with the SEC Investigation and has responded to the SEC's request for materials and information. In light of the SEC's investigation, the Company, through its Audit Committee, decided that the investigation should be conducted as an independent investigation and that the scope of the independent investigation should cover all issues raised by the SEC Investigation. To that end the Audit Committee retained an international, U.S.-based law firm and an international professional accounting firm to conduct a comprehensive review of the issues raised by the SEC Investigation. The SEC Investigation and the Independent Investigation are still in their early stages, and the Company cannot predict the duration or outcome of the investigations, or the impact, if any, those investigations may have on the Company's financial condition or results of operations.

Operations based in the PRC

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition, and results of operations may be influenced by the political, economic, and legal environments in the PRC, and by the general state of the PRC's economy.

The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, the political, economic, and legal environments, and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among others.

Legal proceedings

China West II, LLC and Genesis Technology Group, Inc., n/k/a Jiangbo Pharmaceuticals, Inc. (Arbitration)

In April 2010, China West II, LLC ("CW II") filed a Demand For Arbitration with the American Arbitration Association on the case of CW II and Genesis Technology Group, Inc. n/k/a Jiangbo Pharmaceuticals, Inc. In that matter, CW II seeks repayment and interest on a $142,500 promissory note dated August 3, 2007 made by Genesis Equity Partners II LLC ("GEP"), a subsidiary of the Company prior to the October 2007 reverse merger, and guaranteed by the Company. In November 2010, the Company signed a settlement agreement with CW II. The Company agreed to issue 22,500 shares of its common stock to CW II and CW II agreed to pay the Company $25,000 in cash. The Company and CW II generally and fully released each other from all claims and liabilities. In connection with the settlement, the Company recorded approximately $91,000 settlement gain.

Note 20- Subsequent event

The Company became delinquent in the payment of principal on its November 2007 Debenture on March 1, 2011. To date, the Company has remained unable to make these payments. The Company is required to repay the then outstanding aggregate principal amount of the November 2007 Debentures, together with all accrued interest and penalties. As of March 31, 2011 and the date of this report, no formal event of default notice has been presented by the sole holder of the November 2007 Debentures and the Company is currently in discussions with the sole holder of the November 2007 Debenture to resolve the delinquent situation. However, the sole holder of the November 2007 Debentures may deliver an acceleration notice to the Company at any time. In the event that an acceleration notice is delivered to the Company, a cross-default will occur with respect to our May 2008 Notes and the majority holder of the May 2008 Notes will have the right to deliver an acceleration notice with respect to the May 2008 Notes. In addition, on May 30, 2011, the Company will be required to repay the then outstanding aggregate principal amount of the May 2008 Notes, together with all accrued interest. There can be no assurance that the Company will be able to make the repayments on time. In the event that the Company is unable to repay the May 2008 Notes, when due, the majority holder of the May 2008 Notes may deliver an acceleration notice to the Company with respect to the May 2008 Notes. In the event that an acceleration notice is delivered to the Company, the Company may be forced to seek protection under the United States Bankruptcy Code.

Management has considered all events occurring through the date the financial statements have been issued, and has determined that there are no such events that are material to the financial statement, or all such material events have been fully disclosed.

Item 6. Exhibits

No.	Description
10.1	Employment Contract between Ms. Ziling Sun, the Company and Laiyang Jiangbo Pharmaceuticals, Co., Ltd., dated May 12, 2011 (1).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Interim Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Interim Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to the Company’s Current Report on Form 8-K filed on May 16, 2011.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	JIANGBO PHARMACEUTICALS, INC.	
Date: May 27, 2011	By:	/s/ Jin Linxian Jin Linxian Chief Executive Officer (Principal Executive Officer)
Date: May 27, 2011	By:	/s/ Ziling Sun Ziling Sun Interim Chief Financial Officer (Principal Accounting and Financial Officer)

EXHIBIT INDEX

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32.1	Certification of Chief Executive Officer and Interim Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to the Company's Current Report on Form 8-K filed on May 16, 2011.