

CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD.

Form 10-Q

August 14, 2008

**UNITED STATES**

**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 June 30, 2008

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-04494

**CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation)

**13-5661446**

(IRS Employer Identification  
Number)

**Wenyang Town**

**Feicheng City**

**ShanDong, China 271603**

(Address of principal executive offices)

**86 538 3850 703**

(Registrant's telephone number, including area code)

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 shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

As of June 30, 2008 the Issuer had 26,000,000 shares of common stock issued and outstanding.

**PART I-FINANCIAL INFORMATION**

**ITEM 1.**

**FINANCIAL STATEMENTS.**

The consolidated financial statements of China RuiTai International Holdings Co., Ltd. (the "Company"), a Delaware corporation, included herein were prepared, without audit, pursuant to rules and regulations of the Securities and Exchange Commission. Because certain information and notes normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America were condensed or omitted pursuant to such rules and regulations, these financial statements should be read in conjunction with the financial statements and notes thereto included in the audited financial statements of the Company in the Company's Form 10-KSB/A for the fiscal year ended December 31, 2007.

**CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD.**

**FINANCIAL STATEMENTS**

**PERIOD ENDED JUNE 30, 2008**

<b>INDEX TO FINANCIAL STATEMENTS:</b>	<b>Page</b>
Balance Sheet	3-4
Statements of Operations	5-6
Statements of Cash Flows	7-8
Notes to Unaudited Financial Statements	9-29



**CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD.  
AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 5,563,312	\$ 4,166,713
Bank checks and commercial paper	761,827	621,204
Accounts receivable, net (Note 5)	4,612,199	3,053,295
Due from unaffiliated suppliers (Note 6)	1,354,600	1,112,948
Prepaid expenses (Note 7)	2,482,700	2,876,820
Inventory (Note 8)	10,470,396	6,656,028
Advance to employees (Note 14)	233,050	113,297
Restricted cash (Note 11)	16,160,399	14,738,564
Due from a related party-current portion (Note 14)	3,884,874	4,448,878
Total current assets	45,523,357	37,787,747
Property and Equipment, net (Note 9)	12,671,491	11,306,271
Land use right, net (Note 10)	5,126,339	4,859,620
Long-term investment	884,484	830,984
Due from a related party (Note 14)	10,380,715	10,380,715
Total Assets	\$ 74,586,386	\$ 65,165,337

**LIABILITIES AND SHAREHOLDERS'  
EQUITY**

Current Liabilities:

Edgar Filing: CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD. - Form 10-Q

Bank loan (Note 13)	\$	21,965,136	\$	19,269,317
Bank checks payable (Note 12)		25,466,400		22,059,772
Accounts payable and accrued expenses		6,972,423		7,657,437
Taxes payable		4,375,270		3,560,918
Deferred revenue		256,591		737,027
Due to employees (Note 14)		1,743,340		1,265,898
Employee security deposit		931,265		810,802

Total Current Liabilities	61,710,425	55,361,171
Minority Interest	127,763	98,053
Shareholders' Equity:		
Preferred stock, par value \$0.001, 10,000,000 shares authorized, authorized, no shares outstanding	-	-
Common stock, par value \$0.001, 50,000,000 shares authorized, 26,000,000 shares issued and outstanding as of June 30, 2008 and December 31, 2007	26,000	26,000
Additional paid-in capital	2,908,171	2,366,171
Unamortized contractual services costs	(441,067)	-
Statutory Reserves	1,042,355	1,042,355
Retained earnings	7,951,491	5,700,875
Accumulated other comprehensive income	1,261,248	570,712
Shareholders' Equity	12,748,198	9,706,113
Total Liabilities and Shareholders' Equity	\$ 74,586,386	\$ 65,165,337

**See Notes to Consolidated Financial Statements**





**CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

	For the Three Months Ended		For the Six Months Ended	
	June 30,		June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>
Revenues				
Sales	\$ 9,823,948	\$ 9,617,588	\$ 19,245,939	\$ 16,588,463
Costs of Sales	7,084,546	6,132,424	13,496,330	10,553,148
Gross Profit	2,739,402	3,485,164	5,749,609	6,035,315
Operating Expenses				
Selling expenses				
Sales commission	113,189	85,072	324,914	233,039
Freight-out	194,466	200,453	380,923	460,442
Adverting	16,748	21,812	17,433	30,150
Travel and entertainment	31,511	95,546	63,086	180,940
Other selling expenses	33,008	64,048	77,456	92,800
Total selling expenses	388,922	466,931	863,812	997,371
General and administrative expenses				
Payroll and employees benefits	146,010	70,658	272,774	94,336
Insurance	72,182	64,832	163,828	151,127
Consultant fees	126,910	-	287,724	-
Office expenses	120,983	13,527	277,875	23,956
Travel and entertainment	118,697	48,749	152,682	102,376

Edgar Filing: CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD. - Form 10-Q

Other general and administrative	84,752	129,346	203,985	206,114
Total Operating Expenses	669,534	327,112	1,358,868	577,909
Total Operating Expenses	1,058,456	794,043	2,222,680	1,575,280
Income (Loss) from Operation	1,680,946	2,691,121	3,526,929	4,460,035
Other Income (Expense)				
Interest income	319,020	74,069	720,997	95,575
Interest expense	(597,794)	(394,665)	(1,225,020)	(686,441)

Other income (expense)	10,394	(2,243)	8,225	97,035
Total other income (expense)	(268,380)	(322,839)	(495,798)	(493,831)
Income (Loss) before Provision Income Tax and Minority Interest	1,412,566	2,368,282	3,031,131	3,966,204
Provision for Income Tax	353,141	710,486	757,782	1,189,862
Income before Minority Interest	1,059,425	1,657,796	2,273,349	2,776,342
Minority Interest	(10,594)	(16,578)	(22,733)	(27,763)
Net Income	1,048,831	1,641,218	2,250,616	2,748,579
Other Comprehensive Income (Loss) Effects of Foreign Currency Conversion	232,755	100,139	690,536	137,691
Comprehensive Income (Loss)	\$ 1,281,586	\$ 1,741,357	\$ 2,941,152	\$ 2,886,270

**See Notes to Consolidated Financial Statements**



**CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	For the Six Months Ended June 30,	
	<u>2008</u> <u>(unaudited)</u>	<u>2007</u> <u>(unaudited)</u>
<u>Operating Activities</u>		
Net income (loss)	\$ 2,250,616	\$ 2,748,579
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Minority interest	22,733	27,763
Depreciation	503,881	316,506
Amortization of land use rights	51,444	47,271
Amortization of contractual service costs	100,933	-
Changes in operating assets and liabilities:		
(Increase)/Decrease in bank checks and commercial paper	(97,771)	(2,105,321)
(Increase)/Decrease in accounts receivable	(1,323,644)	(2,009,953)
(Increase)/Decrease in prepaid expenses	562,884	(2,428,774)
(Increase)/Decrease in inventory	(3,289,699)	259,910
(Increase)/Decrease in advance to employees	(109,265)	(69,282)
Increase/(Decrease) in accounts payable and accrued expenses	(1,144,563)	1,983,187
Increase/(Decrease) in bank checks payable	1,929,976	1,680,058
Increase/(Decrease) in taxes payable	568,480	1,074,459
Increase/(Decrease) in deferred revenue	(512,898)	1,262,821

Increase/(Decrease) in employee security deposit	66,324	56,426
Net cash provided (used) by operating activities	(420,569)	2,843,650

Investing Activities

Purchase of fixed assets	(1,081,706)	(2,558,547)
Purchase of land use rights	(7,069)	(109,006)
Loans to unaffiliated suppliers	(165,171)	625,542
Loans to a related party	-	(2,536,255)
Payback of loans to a related party	1,475,634	-
Net cash (used) by investing activities	221,688	(4,578,266)

Financing Activities

Bank loans	1,413,904	-
Payback of bank loans	-	(348,207)
Decrease (Increase) in restricted cash to secure bank checks	(459,510)	(1,997,968)
Loans from employees	384,698	-
Payback of loans from employees	-	(113,076)
Net cash provided (used) by financing activities	1,339,092	(2,459,251)
Increase (decrease) in cash	1,140,211	(4,193,867)
Effects of exchange rates on cash	256,388	112,128
Cash at beginning of period	4,166,713	6,286,289
Cash at end of period	\$ 5,563,312	\$ 2,204,550

## Supplemental Disclosures of Cash Flow Information:

Cash paid (received) during year for:

Interest	\$ 1,140,679	\$ 480,338
Income taxes	\$ 374,129	\$ 406,731

**See Notes to Consolidated Financial Statements.**





**CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1- BASIS OF PRESENTATION**

The accompanying unaudited financial statements as of June 30, 2008 and for the three months and six months ended June 30, 2008 and 2007 have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information. They do not include all of the information and footnotes for complete financial statements as required by GAAP. In Management's opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2008 and 2007 presented are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the fiscal year ended December 31, 2007.

**Note 2- ORGANIZATION AND BUSINESS BACKGROUND**

China Ruitai International Holdings Co., Ltd. ("China Ruitai" or the "Company") was initially organized under the laws of the State of Delaware on November 15, 1955 as Inland Mineral Resources Corp. The Company subsequently changed its name to Parker-Levitt Corporation, and in 1997 changed its name to Commercial Property Corporation, and in 2006 changed its name to Shandong Ruitai Chemical Co., Ltd. On March 12, 2007, the Company changed its name to China Ruitai International Holdings Co., Ltd. On February 26, 2007, the Company changed its fiscal year end from October 31 to December 31.

The Company was engaged in various real estate and development projects. The Company was not successful and discontinued the majority of its operations by 1981. On November 19, 1997, the Company issued common stock that resulted in a change in control and entered into a new development stage as defined in Statement of Financial Accounting Standards No. 7, "Accounting and Reporting by Development Stage Enterprises".

On August 29, 2007, the Company entered into a Share Exchange Agreement with Pacific Capital Group Co., Ltd., ( Pacific Capital Group ) a corporation incorporated under the laws of the Republic of Vanuatu, and the stockholders of

Pacific Capital Group (the Stockholders ). Pursuant to the terms of the Share Exchange Agreement, the Stockholders agreed to transfer all of the issued and outstanding shares of common stock in Pacific Capital Group to the Company in exchange for the issuance of an aggregate of 22,645,348 shares of the Company s common stock to the Stockholders, thereby causing Pacific Capital Group's and Pacific Capital Group s majority-owned operating subsidiary, TaiAn RuiTai Cellulose Co., Ltd. ( TaiAn ), a Chinese limited liability company, to become wholly-owned and majority owned-subidiaries, respectively of the Company. The parties closed the share exchange contemplated by the Share Exchange Agreement on November 8, 2007.

The Share Exchange is being accounted for as a reverse merger, since the stockholders of Pacific Capital Group own a majority of the outstanding shares of the Company s common stock immediately following the Share Exchange. Pacific Capital Group is deemed to be the acquirer in the reverse merger. Consequently, the assets and liabilities and the historical operations that will be reflected in the financial statements for periods prior to the Share Exchange will be those of Pacific Capital Group and its subsidiary and will be recorded at the historical cost basis. After completion of the Share Exchange, the Company s consolidated financial statements will include the assets and liabilities of both China Ruitai and Pacific Capital Group, the historical operations of Pacific Capital Group and the operations of the Company and

its subsidiaries from the closing date of the Share Exchange.

Pacific Capital Group was incorporated on November 23, 2006 under the laws of the Republic of Vanuatu as a holding company, for the purposes of seeking and consummating a merger or acquisition with a business entity. On April 26, 2007, following the approval by the relevant governmental authorities in the PRC, Pacific Capital Group acquired a 99% ownership interest in TaiAn, which was formed in the PRC on November 10, 1999. As a result of the transaction, TaiAn became a majority-owned subsidiary of Pacific Capital Group.

TaiAn is the only one of these affiliated companies that is engaged in business operations. China RuiTai and Pacific Capital Group are holding companies, whose business is to hold an equity ownership interest in TaiAn. TaiAn is engaged in the production, sales, and exportation of deeply processed chemicals, with a primary focus on non-ionic cellulose ether products. TaiAn's assets exist solely in the PRC, and its revenues are derived from its operations therein.

China Ruitai, Pacific Capital Group, and TaiAn are hereafter referred to as the Company.

### **Note 3- CONTROL BY PRINCIPAL OWNERS**

The directors, executive officers, their affiliates, and related parties own, directly or indirectly, beneficially and in the aggregate, the majority of the voting power of the outstanding capital of the Company. Accordingly, directors, executive officers and their affiliates, if they voted their shares uniformly, would have the ability to control the approval of most corporate actions, including approving significant expenses, increasing the authorized capital and the dissolution, merger or sale of the Company's assets.

### **Note 4- SIGNIFICANT ACCOUNTING POLICIES**

#### **Basis of consolidation**

The consolidated financial statements include the accounts of the Company and all its majority-owned subsidiaries which require consolidation. Inter-company transactions have been eliminated in consolidation.

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP"). This basis of accounting differs from that used in the statutory accounts of the Company, which are prepared in accordance with the "Accounting Principles of China" ("PRC GAAP"). Certain accounting principles, which are stipulated by US GAAP, are not applicable in the PRC GAAP. The difference between PRC GAAP accounts of the Company and its US GAAP financial statements is immaterial.

### **Foreign Currencies Translation**

The Company maintains its books and accounting records in PRC currency "Renminbi" ("RMB"), which is determined as the functional currency. Transactions denominated in currencies other than RMB are translated into RMB at the exchange rates quoted by the People's Bank of China ( PBOC ) prevailing at the date of the transactions. Monetary assets and liabilities denominated in currencies other than RMB are translated into RMB using the applicable exchange rates quoted by the PBOC at the balance sheet dates. Exchange differences are included in the statements of changes in owners' equity. Gain and losses resulting from foreign currency transactions are included in operations.

The Company's financial statements are translated into the reporting currency, the United States Dollar

( US\$ ). Assets and liabilities of the Company are translated at the prevailing exchange rate at each reporting period end. Contributed capital accounts are translated using the historical rate of exchange when capital is injected. Income and expense accounts are translated at the average rate of exchange during the reporting period. Translation adjustments resulting from translation of these financial statements are reflected as accumulated other comprehensive income (loss) in the owners' equity.

Translation adjustments resulting from this process are included in accumulated other comprehensive income (loss) in the consolidated statement of changes in shareholders' equity and amounted to \$1,261,793 as of June 30, 2008, and \$570,712 as of December 31, 2007. The balance sheet amounts with the exception of equity at June 30, 2008 were translated at 6.87 RMB to \$1.00 USD as compared to 7.31 RMB at December 31, 2007. The equity accounts were stated at their historical rate. The average translation rates applied to income statement accounts for the six months ended June 30, 2008 and 2007 were 7.07 RMB and 7.73 RMB, respectively.

### **Statement of Cash Flows**

In accordance with SFAS No. 95, Statement of Cash Flows, cash flows from the Company's operations is calculated based upon the functional currency. As a result, amounts related to assets and liabilities reported on the statement of cash flows may not necessarily agree with changes in the corresponding balances on the balance sheet.

### **Revenue Recognition**

The Company recognizes revenue when the earnings process is complete. This generally occurs when products are shipped to unaffiliated customer or picked up by unaffiliated customers in the Company's warehouse, title and risk of loss have been transferred, collectibility is reasonably assured and pricing is fixed or determinable. The corresponding freight-out and handling costs are included in the selling expenses.

The Company does not provide an unconditional right of return, price protection or any other concessions to our customers. Sales returns and other allowances have been immaterial in our operation.

### **Deferred Revenue**

Deferred revenue consists of prepayments to the Company for products that have not yet been delivered to the customers. Payments received prior to satisfying the Company's revenue recognition criteria are recorded as deferred revenue.

### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expenses during the reporting period. Actual results when ultimately realized could differ from those estimates.

### **Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, deposits in banks with maturities of three months or less, and all highly liquid investments which are unrestricted as to withdrawal or use, and which have original maturities of three months or less at the time of purchase.

### **Bank checks and commercial paper**

Bank checks and commercial paper include bank checks and commercial paper with original maturities of approximately 180 days or less at the time of issuance. Book value approximates fair value because of the short maturity of those instruments. The Company receives these financial instruments as payments from its customers in the ordinary course of business.

### **Accounts Receivable**

Accounts receivable are recorded at the invoiced amount and do not bear interest. We generally grant new customers a one-month period in which to pay for goods that we have delivered to them, and we grant existing customers a two to three month period in which to pay for goods that we have delivered to them. We used an indirect method of accounting to write off any accounts receivable which exceeded the allotted three month time period which we provide to our customers. In circumstances in which we receive payment for accounts receivable which have previously been written off, we reverse the allowance and bad debt expenses.

### **Concentrations of Credit Risk**

Financial instruments that subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents. The Company maintains its cash and cash equivalents with high-quality institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally these deposits may be redeemed upon demand and therefore bear minimal risk.

### **Fair Value of Financial Instruments**

The carrying value of financial instruments including cash and cash equivalents, bank checks and commercial paper, receivables, accounts payable and accrued expenses, approximates their fair value due to the relatively short-term nature of these instruments.

## **Inventory**

Inventories are stated at the lower of cost or market value. Actual cost is used to value raw materials and supplies. Finished goods and work-in-progress are valued on the weighted-average-cost method. Elements of costs in finished good and work-in-progress include raw materials, direct labor, and manufacturing overhead.

## **Due from unaffiliated suppliers**

The Company has been extending temporally short-term loans to some unaffiliated suppliers. These loans are unsecured, non-interest bearing and have no fixed terms of repayment, therefore, deemed payable on demand. Cash flows from due from unaffiliated suppliers are classified as cash flows from investing activities.

The Management believes the loans can help theses suppliers run their business, and in turn these suppliers can provide raw materials and services to the Company in a stable price. The Managements evaluates the financial resources of the borrowers on a regular basis, to make sure the suppliers have the capability to pay back these loans. Also, the Company has never had any bad debt with these suppliers. Therefore, the Management believes that these loans are collectable.



### **Long-term investment**

The long-term investment represents monetary investments in the Wenyang Xinyong Bank, a local state owned bank in Wenyang County, Shandong Province, PRC. The investments are transferable in accordance with the laws of the PRC. The investments are carried at cost which approximates fair value. The Company did not purchase any such long-term investment in the six months ended June 30, 2008 and 2007, respectively. Dividend income on these investment is recorded when received. There were no dividend received in the six months ended June 30, 2008 and 2007, respectively. The Company may sell these investments back to the bank at the book value.

### **Impairment of Long-life Assets**

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

### **Restricted cash, and Bank checks payable**

The Company pays its suppliers with bank checks in its ordinary business transactions. Generally, the Company deposits 40% to 100% of the bank check amount into a restricted bank account, the bank then issues a bank check payable to a supplier in 180 days or less. The Company delivers the bank check as payment to the supplier, who can discount the bank check before its maturity. When the bank check reaches maturity, the bank takes the deposit in the restricted bank accounts and the balance, if any, from other bank account(s) that the Company has with the bank. While the bank does not charge interest expenses on the balance, the bank pays interest on the deposit in the restricted bank account to the Company. The bank generally charges 0.0005% of the bank check amount as service fee for issuance of the bank check.

### **Property, Plant and Equipment**

Property, plant and equipment are carried at cost. Maintenance, repairs and minor renewals are expensed as incurred; major renewals and improvements that extend the lives or increase the capacity of plant assets are capitalized.

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 income in the reporting period of disposition.

Depreciation is calculated on a straight-line basis over the estimated useful life of the assets without residual value. The percentages or depreciable life applied are:

Building and warehouses	20 years
Machinery and equipment	7 to 10 years
Office equipment and furniture	5 years
Motor vehicles	5 years

### **Land Use Right**

All land belongs to the State in PRC. Enterprises and individuals can pay the State a fee to obtain a right to use a piece of land for commercial purpose or residential purpose for an initial period of 50 years or 70 years, respectively. The land use right can be sold, purchased, and exchanged in the market. The successor owner of the land use right will reduce the amount of time which has been consumed by the predecessor owner.

The Company owns the right to use a piece of land, approximately 23 acre, located in the Wenyang County, Shandong Province for a fifty-year period ended December 2, 2055; and a piece of land, approximately 36 acre, also located in the Wenyang County, Shanxi Province for a forty-eight-year period ended June 5, 2054. The costs of these land use rights are amortized over their prospective beneficial period, using the straight-line method with no residual value. The Company's production facilities and headquarters building are located in these two pieces of land.

### **Government Subsidies**

The Company records government grants as current liabilities upon reception. A government subsidy revenue is recognized only when there is reasonable assurance that the Company has complied with all conditions attached to the grant. The Company did not recognize government subsidy revenue for the six months ended June 30, 2008 and 2007, respectively.

### **Research and Development Costs**

Research and development costs relating to the development of new products and processes, including significant improvements and refinements to existing products, are expensed when incurred. The major components of these research and development costs include experimental materials and labor costs. The Research and development cost was immaterial for the Company in the six months ended June 30, 2008 and 2007, respectively, and was included into general and administration expenses.

### **Advertising Costs**

Advertising costs are expensed as incurred and included as part of selling and marketing expenses in accordance with the American Institute of Certified Public Accountants ("AICPA") Statement of Position 93-7, "Reporting for Advertising Costs". Advertising costs was \$17,433 and \$30,150 for the six months ended December 31, 2007 and 2006, respectively.

### **Value-added Tax (VAT)**

Sales revenue represents the invoiced value of goods, net of a value-added tax (VAT). All of the Company's products that are sold in PRC are subject to a Chinese value-added tax at a rate of 17% of the gross sales price or at a rate approved by the Chinese local government. This VAT may be offset by VAT paid on purchase of raw materials included in the cost of producing the finished goods.

### **Comprehensive Income**

Statement of Financial Accounting Standards (SFAS) No. 130, Reporting Comprehensive Income, establishes standards for reporting and display of comprehensive income, its components and accumulated balances. Comprehensive income as defined includes all changes in equity during a period from non-owner sources. Accumulated comprehensive income, as presented in the accompanying statements of changes in owners' equity consists of changes in unrealized gains and losses on foreign currency

translation. This comprehensive income is not included in the computation of income tax expense or benefit.

### **Segment Reporting**

SFAS No. 131 Disclosures about Segments of an Enterprise and Related Information establishes standards for reporting information about operating segments on a basis consistent with the Company's internal organization structure as well as information about geographical areas, business segments and major customers in financial statements. The Company currently operates in one principal business segment.

### **Related parties**

For the purposes of these financial statements, parties are considered to be related if one party has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Company and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

### **Pension and Employee Benefits**

Full time employees of the PRC entities participate in a government mandated multi-employer defined contribution plan pursuant to which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labor regulations require the Company to accrue for these benefits based on certain percentages of the employees' salaries. The Management believes full time employees who have passed the probation period are entitled to such benefits. The total provisions for such employee benefits were \$55,643, and \$65,454 for the six months ended June 30, 2008 and 2007, respectively.

### **Statutory Reserves**

Pursuant to the applicable laws in PRC, PRC entities are required to make appropriations to three non-distributable reserve funds, the statutory surplus reserve, statutory public welfare fund, and discretionary surplus reserve, based on after-tax net earnings as determined in accordance with the PRC GAAP, after offsetting any prior years' losses. Appropriation to the statutory surplus reserve should be at least 10% of the after-tax net earnings until the reserve is

equal to 50% of the Company's registered capital. Appropriation to the statutory public welfare fund is 5% to 10% of the after-tax net earnings. The statutory public welfare fund is established for the purpose of providing employee facilities and other collective benefits to the employees and is non-distributable other than in liquidation. No appropriations to the discretionary surplus reserve are made at the discretion of the Board of Directors.

The Company makes appropriations to these three reserve funds at the fiscal year end pursuant to PRC GAAP. Accordingly, the Company made no appropriations for the six months ended June 30, 2008 and 2007, respectively.

### **Income Taxes**

The Company accounts for income tax using SFAS No. 109 Accounting for Income Taxes, which requires the asset and liability approach for financial accounting and reporting for income taxes. Under this approach, deferred income taxes are provided for the estimated future tax effects attributable to temporary differences between financial statement carrying amounts of assets and liabilities and their respective tax bases, and for the expected future tax benefits from loss carry-forwards and provisions, if any. Deferred tax

assets and liabilities are measured using the enacted tax rates expected in the years of recovery or reversal and the effect from a change in tax rates is recognized in the statement of operations in the period of enactment. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of the deferred tax assets will not be realized.

The Company accounts for income taxes in interim periods as required by Accounting Principles Board Opinion No. 28 "Interim Financial Reporting" and as interpreted by FASB Interpretation No. 18, "Accounting for Income Taxes in Interim Periods". The Company has determined an estimated annual effect tax rate. The rate will be revised, if necessary, as of the end of each successive interim period during the Company's fiscal year to its best current estimate.

The estimated annual effective tax rate is applied to the year-to-date ordinary income (or loss) at the end of the interim period.

### **Earnings (Loss) Per Share**

The Company reports earnings per share in accordance with the provisions of SFAS No. 128, Earnings Per Share. SFAS No. 128 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 (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. There are no potentially dilutive securities outstanding (options and warrants) for in the six months ended June 30, 2007. However, there are 275,000 shares of warrants issued and outstanding as of June 30, 2008, as more fully disclosed in Note 16.

### **Recent Accounting Pronouncements**

In June 2008, the Financial Accounting Standards Board ( FASB ) issued FSP No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities ( FSP EITF 03-6-1 ). FSP EITF 03-6-1 concludes that unvested share-based payment awards that contain rights to receive non-forfeitable dividends or dividend equivalents are participating securities, and thus, should be included in the two-class method of computing earnings per share ( EPS ). FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. Early application of EITF 03-6-1 is prohibited. It also requires that all prior-period EPS data be adjusted retrospectively. We have not yet determined the effect, if any, of the adoption of this statement on our financial condition or results of operations.

In April 2008, the FASB issued Staff Position FAS 142-3, Determination of the Useful Life of Intangible Assets ( FSP FAS 142-3 ) which amends the factors an entity should consider in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS No. 142, Goodwill and Other Intangible Assets ( FAS No. 142 ). FSP FAS 142-3 applies to intangible assets that are acquired individually or with a group of assets and intangible assets acquired in both business combinations and asset acquisitions. It removes a provision under FAS No. 142, requiring an entity to consider whether a contractual renewal or extension clause can be accomplished without substantial cost or material modifications of the existing terms and conditions associated with the asset. Instead, FSP FAS 142-3 requires that an entity consider its own experience in renewing similar arrangements. An entity would consider market participant assumptions regarding renewal if no such relevant experience exists. FSP FAS 142-3 is effective for year ends beginning after December 15, 2008 with early adoption prohibited. We have not yet determined the effect, if any, of the adoption of this statement on our financial



condition or results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Hedging Instruments and Hedging Activities* an amendment of FASB Statement No. 133 ( SFAS 161 ). SFAS 161, which is effective January 1, 2009, requires enhanced qualitative and quantitative disclosures with respect to derivatives and hedging activities. The Management does not expect that the adoption of SFAS No. 161 would have a material effect on the Company's financial position and results of operations.

In December 2007, the FASB issued Statements of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ) and No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment to ARB No. 51 ( SFAS 160 ). Both SFAS 141R and SFAS 160 are to be adopted effective January 1, 2009. SFAS 141R requires the application of several new or modified accounting concepts that, due to their complexity, could introduce a degree of volatility in periods subsequent to a material business combination. SFAS 141R requires that all business combinations result in assets and liabilities acquired being recorded at their fair value, with limited exceptions. Other areas related to business combinations that will require changes from current GAAP include: contingent consideration, acquisition costs, contingencies, restructuring costs, in process research and development and income taxes, among others. SFAS 160 will primarily impact the presentation of minority or noncontrolling interests within the Balance Sheet and Statement of Operations as well as the accounting for transactions with noncontrolling interest holders. Management does not expect that the adoption of SFAS No. 141 (revised 2007) and SFAS No. 160 would have a material effect on the Company's financial position and results of operations.

#### Note 5- ACCOUNTS RECEIVABLE

Accounts receivable consists of the following:

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Accounts receivable	\$ 6,036,688	\$ 4,397,598
Less: Allowance for doubtful accounts	(1,424,489)	(1,344,303)
Accounts receivable, net	\$ 4,612,199	\$ 3,053,295

Bad debt expense charged to operations was \$0 and \$0 for the six months ended June 30, 2008 and 2007, respectively.

**Note 6- DUE FROM UNAFFILIATED SUPPLIERS**

Due from unaffiliated suppliers consist of following:

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Feicheng Kaiyuan Chemicals Co., Ltd.	\$ 854,652	\$ 169,533

Fencheng Sanying Spin and Weave Co., Ltd.	-	150,392
Shangdong Taipeng Shiye Co., Ltd.	-	273,440
Shangdong Jinzhengyuan Co., Ltd.	-	66,993
Fengcheng Yingbo Food Co., Ltd.	291,045	273,440
Taian Dongyue Co., Ltd.	145,522	136,720
Other companies	63,381	42,430
	\$ 1,354,600	\$ 1,112,948

**Note 7- PREPAID EXPENSES**

Prepaid expenses consist of following:

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Machinery and parts	\$ 445,773	\$ 366,753
Raw materials and supplies	1,567,654	2,146,958
Packing and supply materials	379,264	300,665
Freight-out	3,018	5,196
Adverting	5,126	6,457
Consultancy fees	48,703	205
Office expenses	8,423	27,344
Utility	24,739	23,242
	\$ 2,482,700	\$ 2,876,820

**Note 8- INVENTORIES**

Inventories consist of following:

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Finished goods	\$ 6,481,529	\$ 4,414,633
Work-in-progress	1,383,163	-
Raw materials	2,523,979	2,157,685
Supplies and packing materials	81,725	83,710
	\$ 10,470,396	\$ 6,656,028

**Note 9- PROPERTY, PLANT AND EQUIPMENT**

The following is a summary of property, plant and equipment:

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Building and warehouses	\$ 4,600,930	\$ 4,209,954
Machinery and equipment	8,007,455	6,699,636
Office equipment and furniture	62,907	53,175
Motor vehicles	452,542	425,169
	13,123,834	11,387,934
Less: Accumulated depreciation	(3,657,560)	(2,989,099)
Add: Construction in progress	3,205,217	2,907,436
Total	\$ 12,671,491	\$ 11,306,271

Depreciation expense charged to operations was \$503,881 and \$316,506 for the six months ended June 30, 2008 and 2007, respectively.

**Note 10-LAND USE RIGHT**

The following is a summary of land use right, less amortization:

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Land use right	\$ 5,382,712	\$ 5,050,290

Less: Amortization	(256,373)	(190,670)
Land use right, net	\$ 5,126,339	\$ 4,859,620

Amortization expense charged to operations was \$51,444 and \$47,271 for the six months ended June 30, 2008 and 2007, respectively.

**Note 11-RESTRICTED CASH**

Restricted cash consists of following:

<u>Financial Institutions</u>	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Jinan Branch of Shanghai Pudong Development Bank	\$ 2,910,446	\$ 2,734,400
Feicheng Branch of Bank of China	3,055,968	1,503,920
Wenyang Branch of Agriculture Bank	2,473,878	1,640,788
Wenyang Credit Bank	4,627,608	4,757,856
Feicheng Branch of Construction Bank	182,053	1,367,200
Feicheng Branch of Transportation Bank	2,910,446	2,734,400
	\$ 16,160,399	\$ 14,738,564

**Note 12-BANK CHECKS PAYABLE**

Bank checks payable consists of following:

<u>Financial Institutions</u>	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Feicheng Branch of Bank of China	\$ 6,111,936	\$ 3,007,840
Feicheng Branch of Transportation Bank	5,093,280	4,101,600
Wenyang Credit Bank	7,712,681	7,929,760
Jinan Branch of Shanghai Pudong Development Bank	2,910,446	2,734,400
Feicheng Branch of Construction Bank	-	1,551,772
Wenyang Branch of Agriculture Bank	3,638,057	2,734,400
	\$ 25,466,400	\$ 22,059,772





**Note 13-BANK LOANS**

Bank loans consist of the following as of June 30, 2008:

<u>Financial Institutions</u>	<u>Loan Amount</u>	<u>Duration</u>	<u>Monthly Interest Rate</u>	<u>Guaranteed By</u>
Feicheng Branch of Bank of China	\$ 436,567	02/28/2008-01/27/2009	7.47	
Feicheng Branch of Bank of China	1,455,223	02/28/2008-02/27/2009	7.47	
Feicheng Branch of Bank of China	698,507	03/19/2008-03/18/2009	7.47	
Feicheng Branch of Bank of China	611,194	03/19/2008-03/18/2009	7.47	Shandong Ashide Chemicals Co., Ltd.
Feicheng Branch of Bank of China	873,134	03/26/2008-03/25/2009	6.8475	
Feicheng Branch of Bank of China	1,455,223	04/24/2008-04/23/2009	6.8475	
Feicheng Branch of Bank of China	1,018,656	05/25/2008-05/24/2009	6.8475	
Feicheng Branch of Bank of China	1,309,701	06/03/2008-06/02/2009	6.8475	
Feicheng Branch of Bank of China	1,455,223	12/20/2007-11/19/2008	8.019	
Taian Branch of Transportation Bank	727,611	08/22/2007-08/22/2008	7.722	
Wenyang Branch of Feicheng Credit Bank	873,134	05/28/2008-05/28/2009	6.225	Shandong Ruifu Chemicals Co., Ltd.
Wenyang Branch of Feicheng Credit Bank	1,207,835	01/31/2008-01/31/2009	6.225	Shandong Zhuiyuan Mining Group Co., Ltd
Wenyang Branch of Feicheng Credit Bank	1,111,790	01/30/2008-01/30/2009	6.225	
Wenyang Branch of Feicheng Credit Bank	1,455,223	01/29/2008-01/29/2009	6.225	
Jinan Branch of Shanghai Pudong Bank	2,910,446	08/28/2007-08/28/2008	6.435	Shandong Ashide Chemicals Co., Ltd.
Wenyang Branch of Agriculture Bank	1,455,223	11/23/2007-11/23/2008	8.748	Feicheng Shuolide Co., Ltd.
Wenyang Branch of Agriculture Bank	1,455,223	12/23/2007-11/24/2008	8.964	Shandong Ashide Chemicals Co., Ltd.
Wenyang Branch of Agriculture Bank	1,455,223	01/24/2008-01/22/2009	8.0925	

Total                      \$ 21,965,136

Interest expense charged to operations for these bank loans was \$851,725 for the six months ended June 30, 2008.

## **Note 14- RELATED PARTY TRANSACTIONS**

### **Advance to employees**

Advance to employee are advances to employees who are working on projects on behalf of the Company. After the work is finished, they will submit expense reports with supporting documents to the accounting department. Then, the expenses are debited into the relevant accounts and the advances are credited out. Cash flows from these activities are classified as cash flows from operating activities.

### **Due from a related party**

Due from a related party" represents loans to Shandong Ruitai Chemicals Co., Ltd. ("Shandong Ruitai"), then a majority owner of TaiAn. Shandong Ruitai had owned 75% equity ownership interest of TaiAn January 2000 through February 2007. On March 20, 2007, Shandong sold 74% equity ownership interest of TaiAn to Pacific Capital Group Co., Ltd. Mr. Xingfu Lv, our President, and Mr. Dianmin Ma, our CEO, collectively own 100% of equity ownership interest in Shandong Ruitai.

TaiAn has been extending loans to Shangdong Ruitai and the balance amounted to \$14,829,593 as of December 31, 2007. These loans were unsecured, non-interest bearing and have no fixed terms of repayment, therefore, deemed payable on demand. Cash flows from due from a shareholder are classified as cash flows from investing activities. The Managements evaluates the financial resources of the borrower on a regular basis, to make sure Shandong Ruitai has the capability to pay back these loans.

As TaiAn became the only operating subsidiary of a public company, TaiAn signed loan agreement with Shangdong Ruitai in December 2007. Pursuant to the loan agreement, Shangdong will pay 7 interest on the outstanding balance monthly. The Management believes that the interest rate approximates the fair market interest rate as compared to the Company's bank loans. Shandong Ruitai pledges its electricity generation plant as collateral for the loans and Mr. Lv and Mr. Ma guarantee the loans. Also, Shandong Ruitai will gradually pay off these loans in a three-year period ended December 31, 2010, with 30% in 2008, 30% in 2009, and the rest of 40% in 2010.

The following is a summary of due from Shandong Ruitai:

	June 30, <u>2008</u> <u>(unaudited)</u>	December 31, <u>2007</u>
Due from Shandong Ruitai-current portion	\$ 3,884,874	\$ 4,448,878
Due from Shandong Ruitai-long-term portion	10,380,715	10,380,715
Total due from Shandong Ruitai	\$ 14,265,589	\$ 14,829,593

Imputed interest income recognized from due from Shangdong Ruitai amounted to \$502,282 and \$0 for the six months ended June 30, 2008 and 2007.

While the current portion of the loans to Shandong Ruitai decreased from \$4,448,878 at December 31, 2007 to \$3,884,874 at June 30, 2008, the amount increased by \$3,705,689 as compared to \$179,185 at March 31, 2008. This increase was primarily attributable to the extra fund that Shandong Ruitai borrowed to purchase coal for its electricity generation plant due to the increase in coal price. The Management believes Shandong Ruitai is operating in good condition and has the capacity to payback the current portion of the loans as it promised.

### **Due to employees**

Due to Employees represents loans from employees to finance the Company's operations due to a lack of cash resources. There are no formal loan agreements for these loans, therefore, these loans were unsecured, and have no fixed terms of repayment. The employees can inject or withdraw funds as they wish. The Company pays 6% interest on these loans monthly beginning from July 1, 2007. Cash flows from these activities are classified as cash flows from financing activities. The Company paid interest of \$83,915 and \$0 for the six months ended June 30, 2008 and 2007, respectively.

### **Land use right transaction**

On October 25, 2006, the Company purchase the use right of a piece of land, approximately 36 acre, located in Wenyang County, Shandong Province, from its majority shareholder, Shandong Ruitai, for \$3,352,840. The local government approved the transaction and certified that the purchase price is at the fair market value. The consideration has been paid to the seller, and the title transfer is under going. The Management believes the transaction is on terms no less favorable to the Company than those reasonably obtainable from third parties.

### **Note 15-PRC INCOME TAX**

The Company's operating subsidiary, TaiAn, is governed by the Income Tax Law of PRC concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws ("the Income Tax Laws").

Beginning January 1, 2008, the new Enterprise Income Tax ( EIT ) law has replaced the old laws for Domestic Enterprises ( DES ) and Foreign Invested Enterprises ( FIEs ).

The key changes are:

a.

The new standard EIT rate of 25% replaces the 33% rate applicable to both DES and FIEs, except for High Tech companies that pay a reduced rate of 15%;

b.

Companies established before March 16, 2007 continue to enjoy tax holiday treatment approved by local government for a grace period of either for the next 5 years or until the tax holiday term is completed, whichever is sooner.

In addition, the new EIT also grants tax holidays to entities operating in certain beneficial industries, such as the agriculture, fishing, and environmental protection. Entities in beneficial industries enjoy a three-year period tax exempt and a three-year period with 50% reduction in the income tax rates.

The Company's operating subsidiary, TaiAn, is subject to effective income tax rate of 25% beginning from January 1, 2008.

#### **Note 16-WARRANT**

During March 2008 the Company engaged a consultant to conduct a program of investor relations activities, for a primary period of twelve months ended February 28, 2009, and continue on a month-to-month basis thereafter upon mutual consent. The terms of the agreement are for the consultant to receive a cash payment per month plus a warrant to purchase 150,000 shares of the Company's restricted common stock at a price of \$3.05 per share. The warrant has a term of four (4) years and is vested 50% on March 1,

2008 and 50% on September 30, 2008. The Management valued the warrant at \$1.16 per share using the Black-Schole pricing model with assumptions summarized below, for a total of \$174,000, which will be amortized over the prospective beneficial period.

Grant Date	Exercise		Risk Free	Expected
<u>Stock Price</u>	<u>Price</u>	<u>Warrant Life</u>	<u>Interest Rate</u>	<u>Volatility</u>
\$2.90	\$4.00	4.0 years	2.00%	51%

Risk free interest rate: Current interest rate of short-dated government bonds such as discount rate on U.S. Government Treasury Bills with 30 days left until maturity.

Volatility: 51% is the volatility of our common stock price October 9, 2007 through March 3, 2008, which is the only available period for our common stocks price quoted in the OTCBB.

Warrant costs charged to operation for the six months ended June 30, 2008 and 2007 were \$58,000 and \$0, respectively.

On May 19, 2008, the Company engaged a consultant to as its exclusive investment banker and agent for a one-year period ended May 19, 2009, and subject to cancellation by thirty (30) days written notice by certified mail. One of the compensation to the consultant is to issue the consultant a warrant to purchase 200,000 shares of the Company's common stock at a price of \$4.00 per share. The warrant has a term of five (5) years and was issued on May 19, 2008.

The Management valued the warrant at \$1.84 per share using the Black-Schole pricing model with assumptions summarized below, for a total of \$368,000, which will be amortized over the prospective beneficial period.

Grant Date	Exercise		Risk Free	Expected
<u>Stock Price</u>	<u>Price</u>	<u>Warrant Life</u>	<u>Interest Rate</u>	<u>Volatility</u>
\$4.00	\$4.00	5.0 years	2.00%	51%

Risk free interest rate: Current interest rate of short-dated government bonds such as discount rate on U.S. Government Treasury Bills with 30 days left until maturity.

Volatility: 51% is the volatility of our common stock price October 9, 2007 through May 19, 2008, which is the only available period for our common stocks price quoted in the OTCBB.

Warrant costs charged to operation for the six months ended June 30, 2008 and 2007 were \$42,933 and \$0, respectively.

**Note 17- EARNINGS PER SHARE**

The following is information of net income per share:

	For the three Months Ended		For the six Months Ended	
	June 30,		June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>
Net Income for basic and diluted earnings per share	\$ 1,048,831	\$ 1,641,218	\$ 2,250,616	\$ 2,748,579



Weighted average shares used in basic computation	26,000,000	22,645,348	26,000,000	22,645,348
Effect of dilutive securities:				
Warrants	165,110	-	95,330	-
Weighted average shares used in diluted computation	26,165,110	22,645,348	26,095,330	22,645,348
Earnings per share:				
Basic	\$ 0.04	\$ 0.07	\$ 0.09	\$ 0.12
Diluted	\$ 0.04	\$ 0.07	\$ 0.09	\$ 0.12

**Note 18- SEGMENT REPORTING**

The major products consist of following:

	For the Six Months Ended June 30,	
	<u>2008</u>	<u>2007</u>
<b>Revenue</b>		
1 Methyl Cellulose (MC)	2,174,326	2,689,241
2 Hydroxypropyl Methyl Cellulose (HPMC)	14,356,449	10,918,708
3 Hydroxypropyl Cellulose (HPC)	109,977	179,319
4 Ethyl Cellulose (EC)	981,889	1,046,436
5 Hydroxyethyl Cellulose (HEC)	569,311	637,924
6 HEMC	187,548	161,818
7 Hydroxypropyl Cellulose (HPC)	4,342	22,880
8 HP	121,210	64,898

Edgar Filing: CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD. - Form 10-Q

9 Microcrystalline Cellulose (MCC)	28,916	19,409
10 CMC	69,661	6,043
11 Film Coating Pre-Mixed Reagent.	365,831	324,081
12 Raw materials	276,479	517,706

**Cost of Sales**

1 Methyl Cellulose (MC)	1,773,444	1,901,429
2 Hydroxypropyl Methyl Cellulose (HPMC)	9,813,530	6,691,187
3 Hydroxypropyl Cellulose (HPC)	40,701	77,253
4 Ethyl Cellulose (EC)	613,526	550,168
5 Hydroxyethyl Cellulose (HEC)	533,406	543,612
6 HEMC	154,466	117,359
7 Hydroxypropyl Cellulose (HPC)	4,547	7,951
8 HP	47,010	24,319
9 Microcrystalline Cellulose (MCC)	23,699	18,591
10 CMC	103,576	52
11 Film Coating Pre-Mixed Reagent.	103,096	104,490
12 Raw materials	285,329	516,737

**Gross Profit**

1 Methyl Cellulose (MC)	400,882	787,812
2 Hydroxypropyl Methyl Cellulose (HPMC)	4,542,919	4,227,521
3 Hydroxypropyl Cellulose (HPC)	69,276	102,066
4 Ethyl Cellulose (EC)	368,363	496,268
5 Hydroxyethyl Cellulose (HEC)	35,905	94,312
6 HEMC	33,082	44,459
7 Hydroxypropyl Cellulose (HPC)	(205)	14,929
8 HP	74,200	40,579
9 Microcrystalline Cellulose (MCC)	5,217	818
10 CMC	(33,915)	5,991
11 Film Coating Pre-Mixed Reagent.	262,735	219,591
12 Raw materials	(8,850)	969

**Geographic Areas Information**

While all of the Company's assets are located in the PRC, the Company sales products to customers located in the United States, Finland, and other countries, as summarized in the following:

Geographic <u>Areas</u>	For the Six Months Ended June 30, <u>2008</u>		For the Six Months Ended June 30, <u>2007</u>	
	<u>Revenue</u>	Percentage of <u>Total Revenue</u>	<u>Revenue</u>	Percentage of <u>Total Revenue</u>
PRC	14,176,934	73.66%	14,183,157	85.50%

United States	1,200,693	6.24%	237,867	1.43%
Finland	1,580,102	8.21%	1,046,947	6.31%
Other Countries	2,288,210	11.89%	1,120,492	6.75%
Total	19,245,939	100.00%	16,588,463	100.00%

#### Major Customers

The Company has a diversified customer base. There was one major customer who made sales over 5% of the Company's total sales as summarized in the following:

Major Customer	For the Six Months Ended June 30, <u>2008</u>		For the Six Months Ended June 30, <u>2007</u>	
	<u>Revenue</u>	<u>Percentage of Total Revenue</u>	<u>Revenue</u>	<u>Percentage of Total Revenue</u>
Customer A	1,580,102	8.21%	1,046,947	6.31%
Total	1,580,102	8.21%	1,046,947	6.31%

#### Note 19- ASSET RETIREMENT OBLIGATIONS

The Company operates within the requirements of numerous regulations at the local, province, and national levels regarding issues such as the handling and disposal of hazardous chemicals, waste-water treatment and effluent and emissions limitations among others. From a practical standpoint, certain environmental contamination cannot be reasonably determined until a facility or asset is retired or an event occurs that otherwise requires the facility to be tested and monitored. In the absence of such requirements to test for environmental contamination prior to an asset or facility retirement, the Company has concluded that it cannot reasonably estimate the cost associated with such environmental-related asset retirement obligations ( ARO ).

In addition, the Company anticipates operating its manufacturing facilities indefinitely into the future thereby rendering the potential range of settlement dates as indeterminate. Therefore, the Company has not recorded any AROs to recognize legal obligations associated with the retirement of tangible long-lived assets, as contemplated by

the Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations ( SFAS 143 ) and FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143 ( FIN 47 ).

## **Note 20- COMMITMENTS AND CONTINGENCIES**

### **PRC's political and economic system**

The Company faces a number of risks and challenges not typically associated with companies in North America and Western Europe, since its assets exist solely in the PRC, and its revenues are derived from its operations therein. The PRC is a developing country with an early stage market economic system, overshadowed by the state. Its political and economic systems are very different from the more developed countries and are in a state of change. The PRC also faces many social, economic and political challenges that may produce major shocks and instabilities and even crises, in both its domestic arena and in its relationships with other countries, including the United States. Such shocks, instabilities and crises may in turn significantly and negatively affect the Company's performance.

## **Environmental**

In the ordinary course of its business, the Company is subject to numerous environmental laws and regulations covering compliance matters or imposing liability for the costs of, and damages resulting from, cleaning up sites, past spills, disposals and other releases of hazardous substances. Currently, our environmental compliance costs principally include the costs to run our waste water treatment facility and routine inspection fees paid to the local environmental department. These amounts are immaterial to our operating costs. However, changes in these laws and regulations may significantly increase our environmental compliance costs and therefore have a material adverse effect on the Company's financial position and results of operations. Also, any failure by the Company to adequately comply with such laws and regulations could subject the Company to significant future liabilities.

## **Governmental control of currency conversion**

The PRC government imposes controls on the convertibility of Renminbi into foreign currencies and, in certain cases, the remittance of currency out of the PRC. The Company receives most of its revenues in Renminbi, which is currently not a freely convertible currency. Shortages in the availability of foreign currency may restrict the Company's ability to remit sufficient foreign currency to satisfy foreign currency dominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from the transaction, can be made in foreign currencies without prior approval from the PRC State Administration of Foreign Exchange by complying with certain procedural requirements. However, approval from appropriate governmental authorities is required where Renminbi is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of bank loans denominated in foreign currencies.

The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents the Company from obtaining sufficient foreign currency to satisfy its currency demands, the Company may not be able to pay certain of its expenses as they come due.

## **Contingent liabilities**

Prior to the merger with Pacific Capital Group on November 8, 2007, the Company has not been active since discontinuing its real estate operations in 1981. Management believes that there are no valid outstanding liabilities from prior operations. If a creditor were to come forward and claim a liability, the Company has committed to contest

such claim to the fullest extent of the law. No amount has been accrued in the financial statements for this contingent liability.

### **Guaranteed Loans**

The Company has guaranteed certain loans for third-party enterprises, which, in turn, have guaranteed loans for the Company. These guarantees require payment from the Company in the event of default on payment by the respective debtor and, if the debtor defaults, the Company may be required to pay amounts outstanding under the related agreements in addition to the principal amount guaranteed, including accrued interest and related fees.

The Company and these third-party enterprises have been guaranteeing loans for each other in the day-to-day operation. Both these enterprises and the Company are considered good reputation debtors by local banks. The banks allow these companies guarantee loans for each other instead of requiring the loans be secured by collateral. None of the enterprises, for which the Company has guaranteed loans, has defaulted



on any loan repayments, and accordingly, the Company has not recorded any liabilities or losses on such guarantees.

Bank loans that the Company has guaranteed for third-party enterprises consist of the following as of June 30, 2008:

<u>Borrower</u>	<u>Financial Institutions</u>	<u>Loan Amount</u>	<u>Duration</u>	<u>Monthly Interest Rate</u>	<u>Guaranteed By</u>
Shangdong Lulong Group Co., Ltd.	Feicheng Branch of Agriculture Bank	\$ 1,367,200	11/23/2007-11/23/2008	10.026	
Shangdong Ashide Chemical Co., Ltd.	Feicheng Branch of Bank of China	328,128	05/14/2008-05/13/2009	7.47	
Shangdong Ashide Chemical Co., Ltd.	Feicheng Branch of Bank of China	1,093,760	09/19/2007-9/18/2008	8.748	
Shangdong Ashide Chemical Co., Ltd.	Feicheng Branch of Bank of China	1,093,760	10/19/2007-10/18/2008	8.748	The Company
Shangdong Ashide Chemical Co., Ltd.	Feicheng Branch of Bank of China	1,500,000	01/12/2007-01/08/2012	8.34	
Shangdong Ashide Chemical Co., Ltd.	Feicheng Branch of Bank of China	800,000	02/02/2007-01/08/2011	8.41	
Shangdong Ashide Chemical Co., Ltd.	Feicheng Branch of Bank of China	890,000	12/30/2006-01/08/2011	8.32938	
Shangdong Ashide Chemical Co., Ltd.	Feicheng Branch of Bank of China	700,000	12/30/2006-01/08/2011	8.32938	
	Total	\$ 7,772,848			



## ITEM 2.

### MANAGEMENT'S DISCUSSIONS AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CERTAIN STATEMENTS IN THIS REPORT, INCLUDING STATEMENTS IN THE FOLLOWING DISCUSSION, ARE WHAT ARE KNOWN AS "FORWARD LOOKING STATEMENTS", WHICH ARE BASICALLY STATEMENTS ABOUT THE FUTURE. FOR THAT REASON, THESE STATEMENTS INVOLVE RISK AND UNCERTAINTY SINCE NO ONE CAN ACCURATELY PREDICT THE FUTURE. WORDS SUCH AS "PLANS," "INTENDS," "WILL," "HOPES," "SEEKS," "ANTICIPATES," "EXPECTS" AND THE LIKE OFTEN IDENTIFY SUCH FORWARD LOOKING STATEMENTS, BUT ARE NOT THE ONLY INDICATION THAT A STATEMENT IS A FORWARD LOOKING STATEMENT. SUCH FORWARD LOOKING STATEMENTS INCLUDE STATEMENTS CONCERNING OUR PLANS AND OBJECTIVES WITH RESPECT TO THE PRESENT AND FUTURE OPERATIONS OF THE COMPANY, AND STATEMENTS WHICH EXPRESS OR IMPLY THAT SUCH PRESENT AND FUTURE OPERATIONS WILL OR MAY PRODUCE REVENUES, INCOME OR PROFITS. NUMEROUS FACTORS AND FUTURE EVENTS COULD CAUSE THE COMPANY TO CHANGE SUCH PLANS AND OBJECTIVES OR FAIL TO SUCCESSFULLY IMPLEMENT SUCH PLANS OR ACHIEVE SUCH OBJECTIVES, OR CAUSE SUCH PRESENT AND FUTURE OPERATIONS TO FAIL TO PRODUCE REVENUES, INCOME OR PROFITS. THEREFORE, THE READER IS ADVISED THAT THE FOLLOWING DISCUSSION SHOULD BE CONSIDERED IN LIGHT OF THE DISCUSSION OF RISKS AND OTHER FACTORS CONTAINED IN THIS REPORT ON FORM 10-Q AND IN THE COMPANY'S OTHER FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION. NO STATEMENTS CONTAINED IN THE FOLLOWING DISCUSSION SHOULD BE CONSTRUED AS A GUARANTEE OR ASSURANCE OF FUTURE PERFORMANCE OR FUTURE RESULTS.

#### Overview

China RuiTai International Holdings was originally incorporated in Delaware on November 15, 1955, under the name "Inland Mineral Resources Corp." and was formed for the purpose of engaging in all lawful businesses. On March 12, 2007, the Company changed its name to China RuiTai International Holdings Co., Ltd. Currently, the Company, through its wholly-owned subsidiary, Pacific Capital Group and its majority-owned subsidiary, TaiAn, is engaged in the production, sales, and exportation of deeply processed chemicals, with a primary focus on non-ionic cellulose ether products. Cellulose ether is an organic chemical that dissolves in water and other organic solvents. Due to the surface-active properties of cellulose ether, it acts as a thickener and stabilizer in aqueous solutions, making it a beneficial additive in a wide variety of commercial industries and products, including, but not limited to the pharmaceutical industry, the construction industry, PVC products, food and beverage products, petroleum, and cosmetics. Specific examples of applications in which cellulose ether products are used include: as a stabilizer and thickener in latex paint; in mortar dry mix for building materials; to improve the performance of resin in PVC production; as a membrane reagent, stabilizer, and thickener in pharmaceuticals; and to improve jam, ice cream, toothpaste and lipsticks in the food and cosmetic industries. TaiAn is one of the largest non-ionic cellulose ether producers in China.

## **Results of Operations**

The following discussion and analysis provides information that we believe is relevant to an assessment and understanding of our results of operation and financial condition for the three and six months ended June 30, 2008.

The following discussion should be read in conjunction with the Financial Statements and related Notes appearing elsewhere in this Form 10-Q.

### ***Results of Operations for the Three Month Period Ended June 30, 2008 Compared to the Three Month Period Ended June 30, 2007***

## Revenue

Revenue. During the three month period ended June 30, 2008, the Company had revenues of \$9,823,948 as compared to revenues of \$9,617,588 during the three month period ended June 30, 2007, an increase of \$206,360, or approximately 2.1%. During the three month period ended June 30, 2008, the Company sold approximately 1,630 metric tons of cellulose ether products in 11 categories, as compared to 1,802 metric tons of cellulose ether products during the three month period ended June 30, 2007. Additionally, during the three month period ended June 30, 2008, HPMC continued to be the Company's best-selling product accounting for approximately 76% of the Company's total revenues. During the three month period ended June 30, 2008, the Company exported approximately 480 metric tons of cellulose ether products to markets in the United States, Europe, India, Japan, and South East Asia, as compared to 404 metric tons in exports during the three month period ended June 30, 2007. The small increase in sales is attributable in part to severe weather conditions, and in part to decreased demand as a result of rising prices. The Company is focused on increasing sales of higher margin products and sales to export markets.

Cost of Sales. During the three month period ended June 30, 2008, the Company's cost of sales was \$7,084,546, as compared to cost of sales of \$6,132,424 for the three month period ended June 30, 2007, an increase of \$952,122, or approximately 15.5%. This increase in cost of sales experienced by the Company was primarily attributable to an increase in the price of raw materials that the Company uses for its manufacturing.

## Operating Expenses

The operating expenses for the Company are divided into Selling Expenses and General and Administrative Expenses, both of which are discussed below:

Selling Expenses. Selling expenses which consist of sales commission, freight charges, advertising and promotion expenses totaled \$388,922 for the three month period ended June 30, 2008, as compared to \$466,931 for the three month period ended June 30, 2007, a decrease of \$78,009, or approximately 16.7%. This decrease is primarily attributable to the decrease in the traveling expenses as the Company ceased reimbursing its sales staffs' traveling expenses.

General and Administrative Expenses. General and administrative expenses totaled \$669,534 for the three month period ended June 30, 2008, as compared to \$327,112 for the three month period ended June 30, 2007, an increase of \$342,422 or approximately 105%. This increase is primarily attributable to an increase in consultant fees and office

expenses for the three month period ended June 30, 2008. The Company engaged two consultants, one to act as its investor relations advisor, and another to act as its investment banker for its financing activities.

### **Income From Operations**

For the three month period ended June 30, 2008, the Company had income from operations in the amount of \$1,680,946 as compared to income from operations of \$2,691,121 for the three month period ended June 30, 2007, a decrease of \$1,010,175, or approximately 38%. The decrease in income from operations experienced by the Company was primarily attributable to the increase in the costs of goods sold and consultant fees.

### **Interest Expense**

For the three month period ended June 30, 2008, the Company incurred interest expense in the amount of \$572,666, as compared to interest expense of \$394,665 for the three month period ended June 30, 2007, an

increase of \$178,001, or approximately 45%. The increase in interest expense incurred by the Company resulted from increases in interest expenses on bank loans. The interest expenses on bank loans increased from \$250,836 for the three months ended June 30, 2007 to \$462,548 for the three months ended June 30, 2008, an increase of \$211,712, or 84%. For the same period, the interest expenses on discount on bank check decrease from \$84,157 to \$51,571, a decrease of \$32,586, or 38%.

## **Net Income**

The Company had a net income of \$1,048,831 for the three month period ended June 30, 2008 as compared to \$1,641,218 for the three month period ended June 30, 2007, a decrease of \$592,387 or approximately 36%. The decrease in net income is attributable to the fact that the Company experienced a limited increase in revenue, while at the same time it experienced a significant increase in the cost of sales, as a result of higher raw materials and energy costs.

## ***Results of Operations for the Six Month Period Ended June 30, 2008 Compared to the Six Month Period Ended June 30, 2007***

### **Revenue**

Revenue. During the six month period ended June 30, 2008, the Company had revenues of \$19,245,939 as compared to revenues of \$16,588,463 during the six month period ended June 30, 2007, an increase of \$2,657,476 approximately 16%. The increase in revenue experienced by the Company was primarily attributable to the following factors: i) *Changes in Sales Price* the price per ton of cellulose ether increased from the six month period ended June 30, 2007 to the six month period ended June 30, 2008. For the six month period ended June 30, 2008, the average sales price of one ton of cellulose ether was \$6,167, as compared to an average sales price of \$5,431 per ton for the six month period ended June 30, 2007, an increase of \$736 per ton, or approximately 13%; and ii) *Changes in Exchange Rates* in addition to the foregoing, some of the growth in the Company's revenue was attributable to changes in the foreign exchange rate, which increased from 7.73 RMB to \$1.00 USD in the six months ended June 30, 2007 to 7.07 RMB to \$1.00 USD in the six months ended June 30, 2008, or approximately 8.5%.

Cost of Sales. During the six month period ended June 30, 2008, the Company's cost of sales was \$13,496,330, as compared to costs of sales of \$10,553,148 for the six month period ended June 30, 2007, an increase of \$2,943,182, or approximately 28%. This increase in cost of sales experienced by the Company was primarily attributable to the increase in sales volume experienced by the Company as discussed above, and an increase in the price of raw materials that the Company uses for its manufacturing. For the six months ended June 30, 2008 the price of raw materials utilized by the Company was \$3,308 per ton, as compared to \$2,424 per ton for the six month period ended June 30, 2007, an increase of \$884, or approximately 36%.

## **Operating Expenses**

The operating expenses for the Company are divided into Selling Expenses and General and Administrative Expenses, both of which are discussed below:

Selling Expenses. Selling expenses which consist of sales commission, freight charges, advertising and promotion expenses totaled \$863,812 for the six month period ended June 30, 2008 as compared to \$997,371 for the six month period ended June 30, 2007, a decrease of \$133,559, or approximately 13%. This minor decrease is primarily attributable to the decrease in the traveling expenses as the Company ceased reimbursing the sales staffs' traveling expenses, which was offset by the increase in sales commission due to the increase in the amount of the Company's sales.



**General and Administrative Expenses.** General and administrative expenses totaled \$1,358,868 for the six month period ended June 30, 2008, as compared to \$577,909 for the six month period ended June 30, 2007, an increase of \$780,959, or approximately 135%. This increase is primarily attributable to an increase in payroll and consultant fees. The payroll increased from \$94,336 for the six months ended June 30, 2007 to \$272,774 for the six months ended June 30, 2008, an increase of \$178,438, or approximately 189%, due to the increase in pay rate. We engaged two consultants to act as our investor relations advisor and investment banker for our financial activities. We incurred expenses for compensation paid to these consultants, as well expenses for reimbursing their out-of-pocket expenses, totaling approximately \$550,000.

### **Income From Operations**

For the six month period ended June 30, 2008, the Company had income from operations in the amount of \$3,526,929 as compared to income from operations of \$4,460,035 for the six month period ended June 30, 2007, a decrease of \$933,106, or approximately 21%. The decrease in income from operations experienced by the Company was primarily attributable to the increase in costs of goods sold and consultant fees

### **Interest Income**

For the six month period ended June 30, 2008, the Company recorded interest income in the amount of \$720,997, as compared to interest income of \$95,578 for the six month period ended June 30, 2007, an increase of \$625,419, or approximately 654%. The increase in interest income incurred by the Company was primarily attributable to the interest income from the loans to a related party, Shandong Ruitai, which amounted to \$502,282 for the six months ended June 30, 2008, as compared to none in the six months ended June 30, 2007.

### **Interest Expense**

For the six month period ended June 30, 2008, the Company incurred interest expense in the amount of \$1,225,020, as compared to interest expense of \$686,441 for the six month period ended June 30, 2007, an increase of \$538,579, or approximately 78.5%. The increase in interest expense incurred by the Company resulted from increase in interest expenses on bank loans and discount on bank checks received from customers. The interest expenses on bank loans increased by \$408,185, or 92%. The increase in interest on bank loans was primarily a result of an increase of interest rates and average outstanding bank loans. The interest rate increased from an average monthly interest rate of 6.12% for the six months ended June 30, 2007 to an average monthly interest rate of 7.23% for the six months ended June 30,

2008, an increase of approximately 1.01%. Our average outstanding bank loans increased from \$15,861,000 for the six months ended June 30, 2007 to \$21,965,000 for the six months ended June 30, 2008, an increase of \$6,104,000, or approximately 38%. Our interest expenses on discount on bank checks increased from \$100,820 in six months ended June 30, 2007 to \$245,030 in the six months ended June 30, 2008, an increase of \$144,210, or approximately 143%. The increase in our interest expenses was due to the increase in amount of bank checks discounted as we needed additional cash resources for our business operations.

### **Net Income**

The Company had a net income of \$2,269,273 for the six month period ended June 30, 2008 as compared to \$2,748,579 for the six month period ended June 30, 2007, a decrease of \$479,306 or approximately 17.4%. The decrease in net income is attributable to an increase in cost of goods sold, as a result of increased prices for raw materials and energy costs, consultant fees, and interest expenses during the six month period ended June 30, 2008.

## **Liquidity and Capital Resources**

The Company anticipates that the existing cash and cash equivalents on hand, together with the net cash flows generated from its business activities will be sufficient to meet the working capital requirements for its on-going projects and to sustain the business operations for the next twelve months.

### **Total Current Assets & Total Assets**

As of June 30, 2008, our unaudited balance sheet reflects that we have: i) total current assets of \$45,523,357, as compared to total current assets of \$37,787,747 at December 31, 2007, an increase of \$7,735,610 or approximately 20.5%; and ii) total assets of \$74,586,386, as of June 30, 2008, compared to \$65,165,337 as of December 31, 2007, an increase of \$9,421,049 or approximately 14.5%. The Company's total assets increased substantially due to increases that the Company experienced in cash and cash equivalents, accounts receivable, inventory, restricted cash, and property and equipment, all of which are discussed below.

**Cash and Cash Equivalents.** As of June 30, 2008, our unaudited balance sheet reflects that we have cash and cash equivalents of \$5,563,312, as compared to \$4,166,713 at December 31, 2007, an increase of \$1,396,599, approximately 33.5%. The increase in the Company's cash and cash equivalents from 2007 to 2008 was primarily attributable to the bank loans that we obtained at the end of June 2008 and we put in our bank accounts.

**Accounts Receivable.** As of June 30, 2008, our unaudited balance sheet reflects that we have accounts receivable of \$4,612,199, as compared to accounts receivable of \$3,053,295 at December 31, 2007, an increase of \$1,558,904, or approximately 51%. The increase in the Company's accounts receivable from 2007 to 2008 was primarily attributable to facts that we experienced an increase in our client base and we extended credit to our new clients.

**Inventory.** As of June 30, 2008, the Company had Inventories of \$10,470,396, as compared to inventories of \$6,656,028 as of December 31, 2007, \$3,814,368 an increase of approximately 57%. The increase in inventories from 2007 to 2008 was attributable to following factors: i) while we increased our production capacity, the sales did not increase as we planned due to a general slowdown of the PRC's economy. Therefore, we increased finished goods by approximately 580 tons, or \$2,300,000; and ii) due to the occasional lack of the required power to operate our production facilities, we had to cease production periodically every month. As a result, we increased our inventory of raw materials by approximately 390 tons, or \$1,383,163 in work-in-progress. The occasional power outages were the result of energy restrictions imposed by the Chinese government to avoid power outages during the Olympic Games. Once the restrictions have been lifted, the Management plans to increase utilization beyond the current level of 80%.

Restricted Cash. As of June 30, 2008, the Company has Restricted Cash of \$16,160,399 as compared to Restricted Cash of \$14,738,564 as of December 31, 2007, an increase of \$1,421,835, or approximately 9.6%. The increase in Restricted Cash from primarily attributable to the increase in the bank checks and commercial paper that we took out from banks. Additionally, the banks required more compensation balance to secure such financial instruments.

Property and Equipment. As of June 30, 2008, our unaudited balance sheet reflects that we have property and equipment of \$12,671,491, as compared to property and equipment of \$11,306,271 at December 31, 2007, an increase of \$1,365,220, or approximately 12.1%. The increase in the Company's property and equipment from 2007 to 2008 was primarily attributable to additions made to our production equipment and changes in the foreign exchange rate, which increased from 7.31 RMB to \$1.00 USD as of December 31, 2007 to 6.87 RMB to \$1.00 USD as of June 30, 2008, or an increase of RMB 0.44, or approximately 6%

## **Total Current Liabilities**

As of June 30, 2008, our unaudited balance sheet reflects that we have total current liabilities of \$61,710,425, as compared to total current liabilities of \$55,361,171 at December 31, 2007, an increase of \$6,349,254, or approximately 11.5%. The increase in the Company's total current liabilities from 2007 to 2008 was primarily attributable to changes in the Company's bank loan, which increased by \$2,695,819 from 2007 to 2008, and the Company's Bank checks payable which increased by \$3,406,628 from 2007 to 2008.

Bank Loans. As of June 30, 2008, our unaudited balance sheet reflects that we have a bank loan of \$21,965,136, as compared to a bank loan of \$19,269,317 as of December 31, 2007, an increase of \$2,695,819, or approximately 14%. The increase in our bank loan was attributable to additional funds that we needed to borrow to purchase fixed assets and raw materials due to our increased production capacity in the six months June 30, 2008. The unit price of raw materials also increased.

Bank Checks Payable. As of June 30, 2008, our unaudited balance sheet reflects that we have a bank checks payable of \$25,466,400, as compared to a bank checks payable of \$22,059,772 as of December 31, 2007, an increase of \$3,406,628, or approximately 15%. The increase in our bank check payable was attributable to additional funds that we needed to take out in the form of bank checks and commercial paper to pay our raw material suppliers due to increase in unit price and our increased production capacity.

## **Operating Activities**

Net Cash of \$(420,569) was used by operating activities during the period ended June 30, 2008, compared to net cash provided by operating activities of \$2,843,650 during the period ended June 30, 2007. The change in net cash provided by our operating activities was primarily attributable to an increase in inventory.

## **Investing Activities**

During the period ended June 30, 2008, the net cash provided by investing activities was \$221,688, as compared to net cash used in investing activities of \$(4,578,266) for the period ended June 30, 2007. The change in net cash used in investing activities was primarily attributable to the payback of loans, \$1,475,634 to a related party, Shandong Ruitai in the six months ended June 2008, as compared to making loans of \$2,536,255 to the same party in the six months ended June 30, 2007.

### **Financing Activities**

During the period ended June 30, 2008, the net cash provided by financing activities was \$1,339,092, as compared to net cash used in financing activities of \$(2,459,251) for the period ended June 30, 2007. The change in net cash provided by financing activities was primarily attributable to the increase of \$1,413,902 in our bank loans in the six months ended June 30, 2007.

### **Recent Events**

On July 30, 2008, the Company successfully completed a pilot test for its newest product, biopolysaccharide, a water-soluble and viscous polysaccharide that can be made into film and fiber and applied as a functional additive in various products, such as medicine capsules, food, and food wrapping films. The Company's new two-story 4000-square meter plant, which will be capable of producing 100 tons of biopolysaccharide per year, is currently under construction. Management expects to begin mass production in the fourth quarter of 2008 and estimates a selling price for biopolysaccharide of RMB 200,000 (USD \$29,300) per ton. In addition to biopolysaccharide, the Company plans to produce new products that are still in development. The Company also plans to further improve the quality of its products and increase awareness of the RUTOCEL brand for

the export market by participating in international exhibitions in the U.S. and in Europe.

### **Off Balance Sheet Arrangements**

The Company does not have any off-balance sheet arrangements.

### **ITEM 3.**

#### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Not Applicable.

### **ITEM 4T.**

#### **CONTROLS AND PROCEDURES.**

##### **Disclosure Controls and Procedures**

The Securities and Exchange Commission defines the term "disclosure controls and procedures" to mean a company's controls and other procedures of an issuer that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. The Company maintains such a system of controls and procedures in an effort to ensure that all information which it is required to disclose in the reports it files under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified under the SEC's rules and forms and that information required to be disclosed is accumulated and communicated to principal executive and principal financial officers to allow timely decisions regarding disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are designed to provide reasonable assurance of achieving the objectives of timely alerting them to material information required to be included in our periodic SEC reports and of ensuring that such information is recorded, processed, summarized and reported with the time periods specified. Our chief executive officer and chief financial officer also concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance of the achievement of these objectives.

### **Changes in Internal Control over Financial Reporting**

There was no change in the Company's internal control over financial reporting during the period ended June 30, 2008, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II-OTHER INFORMATION**

### **ITEM 1.**

#### **LEGAL PROCEEDINGS.**



The Company is not a party to any pending legal proceedings, and no such proceedings are known to be contemplated. No director, officer or affiliate of the Company, and no owner of record or beneficial owner of more than 5.0% of the securities of the Company, or any associate of any such director, officer or security holder is a party adverse to the Company or has a material interest adverse to the Company in reference to pending litigation.

**ITEM 1A.**

**RISK FACTORS.**

Not Applicable.

**ITEM 2.**

**UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

During March 2008, the Company engaged a consultant to conduct a program of investor relations activities for a primary period of twelve months ending on February 28, 2009, and continuing on a month-to-month basis thereafter upon mutual consent. The terms of the agreement are for the consultant to receive a cash payment per month plus a warrant to purchase 150,000 shares of the Company's restricted common stock at a price of \$3.05 per share. The warrant has a term of four (4) years and is vested 50% on March 1, 2008 and 50% on September 30, 2008. The shares of common stock underlying the aforementioned warrants were not registered under the Securities Act in reliance upon the exemption from registration provided in Section 4(2) of the Securities Act. No underwriters were used, nor were any brokerage commissions paid in connection with the warrants.

On May 19, 2008, the Company engaged a consultant to as its exclusive investment banker and agent for a one-year period ended May 19, 2009, and subject to cancellation by thirty (30) days written notice by certified mail. Part of the compensation to the consultant was the issuance of a warrant to purchase 200,000 shares of the Company's common stock at a price of \$4.00 per share. The warrant has a term of five (5) years and was issued on May 19, 2008. The shares of common stock underlying the aforementioned warrants were not registered under the Securities Act in reliance upon the exemption from registration provided in Section 4(2) of the Securities Act. No underwriters were used, nor were any brokerage commissions paid in connection with the warrants.

**ITEM 3.**

**DEFAULTS UPON SENIOR SECURITIES.**

None.

**ITEM 4.**

**SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

None.

**ITEM 5.**

**OTHER INFORMATION.**

The information reported in Item 2 was not previously disclosed in a Form 8-K; in lieu of such filing, the information is being disclosed in this Form 10-Q. The information reported in Item 2 is hereby incorporated by reference.

**ITEM 6.**

**EXHIBITS.**

(a)

The following exhibits are filed herewith:

31.1

Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2

Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1

Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2

Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

## **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.

**CHINA RUITAI INTERNATIONAL HOLDINGS CO., LTD.**

By: /s/ Dian Min Ma, Chief Executive Officer

Date: August 14, 2008

By: /s/ Gang Ma, Chief Financial Officer

Date: August 14, 2008