

COPY

FII FD


10 SEP 17 PM 3:15

CLERK U.S. DISTRICT COURT  
CENTRAL DIST. OF CALIF.  
LOS ANGELES


BY: \_\_\_\_\_

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

  
 Plaintiff,  
 v.  
 CHINA-BIOTICS, INC.; SONG JINAN; LI CHI  
 YUEN a/k/a RAYMOND LI; LEWIS FAN; YAN  
 YIHONG a/k/a EVA YAN; and TRAVIS CAI;  
 Defendants.

CASE NO. **09 10 6954-DSF**  
 CLASS ACTION **(JEM)**  
 COMPLAINT FOR VIOLATION OF  
 THE FEDERAL SECURITIES LAWS  
 JURY TRIAL DEMANDED

Plaintiff  individually and on behalf of all other persons similarly  
 situated, by his undersigned attorneys, for his complaint against Defendants, alleges the following  
 based upon personal knowledge as to himself and his own acts, and information and belief as to  
 all other matters, based upon, *inter alia*, the investigation conducted by and through his attorneys,  
 which included, among other things, a review of Defendants' public documents, conference calls

1 and announcements made by Defendants, United States Securities and Exchange Commission  
2 (“SEC”) filings, wire and press releases published by and regarding China-Biotics, Inc. (“China-  
3 Biotics”, or the “Company”), securities analysts’ reports and advisories about the Company, and  
4 information readily obtainable on the Internet. Plaintiff believes that substantial evidentiary  
5 support will exist for the allegations set forth herein after a reasonable opportunity for discovery.  
6

7 Plaintiff believes that further substantial evidentiary support will exist for the allegations  
8 set forth herein after a reasonable opportunity for discovery. Most of the facts supporting the  
9 allegations contained herein are known only to defendants or are exclusively within their control.

10 **NATURE OF THE ACTION**

11 1. This is a federal securities class action on behalf of a class consisting of all persons  
12 other than Defendants who purchased the securities of China-Biotics between July 10, 2008 and  
13 August 30, 2010 (the “Class Period”), seeking to recover damages caused by Defendants’  
14 violations of federal securities laws and pursue remedies under the Securities Exchange Act of  
15 1934 (the “Exchange Act”).  
16

17 **JURISDICTION AND VENUE**

18 2. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of  
19 the Exchange Act, (15 U.S.C. §78j(b) and 78t(a)), and Rule 10b-5 promulgated thereunder (17  
20 C.F.R. §240.10b-5).  
21

22 3. This Court has jurisdiction over the subject matter of this action pursuant to §27 of  
23 the Exchange Act (15 U.S.C. §78aa) and 28 U.S.C. § 1331.

24 4. Venue is proper in this Judicial District pursuant to §27 of the Exchange Act, 15  
25 U.S.C. § 78aa and 28 U.S.C. § 1391(b).

26 5. In connection with the acts, conduct, and other wrongs alleged in this Complaint,  
27 Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce,  
28

1 including but not limited to, the United States mails, interstate telephone communications, and the  
2 facilities of the national securities exchange.

3 PARTIES

4 6. Plaintiff [REDACTED] as set forth in the accompanying certification  
5 incorporated by reference herein, purchased China-Biotics securities at artificially inflated prices  
6 during the Class Period and has been damaged thereby.

8 7. Defendant China-Biotics is a Delaware Corporation with its principal executive  
9 offices located in Pudong, Shanghai in the People's Republic of China. China-Biotics and its  
10 subsidiaries purportedly engage in the research, development, production, marketing of  
11 distribution of probiotics products in China. The Company markets and sells its products under  
12 the "Shining" brand name. Throughout the Class Period the Company touted that its products  
13 were sold through numerous retail branded outlets and stores. The Company's stock is listed on  
14 the NASDAQ under ticket "CHBT."

16 8. Defendant Song Jinan ("Song") at all relevant times herein served as the  
17 Company's CEO, President, Director and Secretary.

18 9. Defendant Li Chi Yuen a/k/a Raymond Li ("Li") served as the Company's Chief  
19 Financial Officer from the beginning of the Class Period until March 6, 2009, when he was  
20 replaced by Lewis Fan. Li continued with the Company as its Vice President of Finance.

22 10. Defendant Lewis Fan ("Fan") served as the Company's CFO from March 2009  
23 until his sudden resignation on effective October 21, 2009.

24 11. Defendant Yan Yihong a/k/a Eva Yan ("Yan") served as the Company's CFO  
25 from October 2009 until she suddenly resigned on January 22, 2010.

26 12. Defendant Travis Cai ("Cai") served as the Company's CFO from January 2010  
27 through the end of the Class Period.

1           13. Song, Li, Fan, Yan, and Cai are collectively referred to hereinafter as the  
2 “Individual Defendants.”

3           14. Each of the Individual Defendants:

4                   (a) directly participated in the management of the Company;  
5                   (b) was directly involved in the day-to-day operations of the Company at the  
6 highest levels;

7                   (c) was privy to confidential proprietary information concerning the Company  
8 and its business and operations;

9                   (d) was involved in drafting, producing, reviewing and/or disseminating the  
10 false and misleading statements and information alleged herein;

11                   (e) was aware of or recklessly disregarded the fact that the false and  
12 misleading statements were being issued concerning the Company; and

13                   (f) approved or ratified these statements in violation of the federal securities  
14 laws.

15           15. As officers, directors, and controlling persons of a publicly-held company whose  
16 securities is and was registered with the SEC pursuant to the Exchange Act, and was traded on the  
17 NASDAQ and governed by the provisions of the federal securities laws, the Individual  
18 Defendants each had a duty to disseminate accurate and truthful information promptly with  
19 respect to the Company's financial condition and to correct any previously-issued statements that  
20 had become materially misleading or untrue to allow the market price of the Company's publicly-  
21 traded securities to reflect truthful and accurate information.

22           16. China-Biotics is liable for the acts of the Individual Defendants and its employees  
23 under the doctrine of *respondeat superior* and common law principles of agency as all of the  
24

25  
26  
27  
28

1 wrongful acts complained of herein were carried out within the scope of their employment and  
2 with authorization.

3 17. The scienter of the Individual Defendants and other employees and agents of the  
4 Company is similarly imputed to China-Biotics under *respondeat superior* and agency principles.  
5

6 **PLAINTIFF'S CLASS ACTION ALLEGATIONS**

7 18. Plaintiff brings this action as a class action pursuant to Federal Rules of Civil  
8 Procedure 23(a) and (b)(3) on behalf of a Class consisting of all persons who purchased the  
9 securities of China-Biotics during the Class Period and who were damaged thereby. Excluded  
10 from the Class are Defendants, the officers and directors of the Company at all relevant times,  
11 members of their immediate families and their legal representatives, heirs, successors or assigns  
12 and any entity in which defendants have or had a controlling interest.

13 19. The members of the Class are so numerous that joinder of all members is  
14 impracticable. Throughout the Class Period, CSP's securities were actively traded on the  
15 NASDAQ. While the exact number of Class members is unknown to Plaintiff at this time and  
16 can only be ascertained through appropriate discovery, Plaintiff believes that there are at least  
17 hundreds of members in the proposed Class. Members of the Class may be identified from  
18 records maintained by China-Biotics or its transfer agent and may be notified of the pendency of  
19 this action by mail, using a form of notice customarily used in securities class actions.  
20

21 20. Plaintiff's claims are typical of the claims of the members of the Class, as all  
22 members of the Class are similarly affected by Defendants' wrongful conduct in violation of  
23 federal law that is complained of herein.  
24

25 21. Plaintiff will fairly and adequately protect the interests of the members of the Class  
26 and has retained counsel competent and experienced in class and securities litigation.  
27  
28



1 operations and to build up our retail experience and expertise. We have also repackaged  
2 our products for sale in our stores, and have introduced several new products which are  
3 sold exclusively in our stores. As at March 31, 2008, we had a total of 60 Shining retail  
4 stores. 46 of these stores are located in Shanghai and the rest are located in 5 cities in  
5 China including Changchun and Jilin.

6 \* \* \*

7 In preparation for the opening of additional retail stores, we have also been actively  
8 recruiting and training retail sales staff since the beginning of 2006. We have already  
9 successfully recruited a number of very experienced sales professionals and have trained a  
10 pool of sales staff. We have also designed and implemented control systems to manage  
11 this new business.

12 \* \* \*

13 At March 2008, we had 60 Shining branded stores in Shanghai and 5 other major cities in  
14 China.

15 25. On August 14, 2008 the Company filed with the SEC its financial results for the  
16 first quarter ended June 30, 2008 on Form 10-Q. The 10-Q was signed by Li and separately  
17 certified pursuant to SOX by Li and Song. The 10-Q states that “[a]s at [sic] June 30, 2008, we  
18 have opened 83 outlets in Shanghai and 8 other cities in China (as of June 30, 2007, we had 14  
19 retail outlets).”

20 26. On November 10, 2008 the Company filed with the SEC its financial results for  
21 the second quarter ended September 30, 2008 on Form 10-Q. The 10-Q was signed by Li and  
22 separately certified pursuant to SOX by Li and Song. The 10-Q states that “[a]s at [sic]  
23 September 30, 2008, we have opened 110 outlets in Shanghai and 12 other cities in China (as of  
24 September 30, 2007, we had 22 retail outlets in Shanghai and Changchun).”

25 27. On February 13, 2009 the Company filed with the SEC its financial results for the  
26 third quarter ended December 31, 2008 on Form 10-Q. The 10-Q was signed by Li and  
27 separately certified pursuant to SOX by Li and Song. The 10-Q states that “[a]s at [sic]  
28 December 31, 2008, we have opened 107 outlets in Shanghai and 12 other cities in China (as of  
December 31, 2007, we had 27 retail outlets in Shanghai and Changchun).”

28 28. Through March 2009 and continuing through June 2009, the Company amended  
the above periodic reports and others to conform to comments made by the SEC.

1           29.    On July 14, 2009 the Company filed with the SEC its financial results for fiscal  
2 year ended March 31, 2009 on Form 10-K. The 10-K was signed by Song and Fan and separately  
3 certified by them pursuant to SOX. In the 10-K the Company described its retail stores as  
4 follows:

5           We opened the first Shining retail outlet in Shanghai in March 2006. We have also  
6 repackaged our products for sale in our outlets, and have introduced several new products  
7 which are sold exclusively in our outlets. As at March 31, 2009, we have opened 106  
8 outlets in Shanghai and 12 other cities in China.

9           In preparation for the opening of additional retail outlets, we have also been actively  
10 recruiting and training retail sales staff since the beginning of 2006. We have already  
11 successfully recruited a number of very experienced sales professionals and have trained a  
12 pool of sales staff. We have also designed and implemented control systems to manage  
13 this new business.

14           Currently, we have a network of 106 outlets in China. We continue to survey cities in  
15 China to assess and select suitable locations for new outlets.

16           As part of our strategy, we will also consider licensing franchisees to operate retail outlets  
17 in due course. We intend to finance the costs of our business expansion by our internal  
18 working capital.

19           30.    On August 14, 2009 the Company filed with the SEC its financial results for the  
20 first quarter ended June 30, 2009 on Form 10-Q. The 10-Q was signed by Song and separately  
21 certified pursuant to SOX by Song and Fan. The 10-Q states that “[a]s at [sic] June 30, 2009, we  
22 have opened 107 outlets in Shanghai and 12 other cities in China (as of June 30, 2008, we had 27  
23 retail outlets in Shanghai and Changchun).”

24           31.    On November 16, 2009 the Company filed with the SEC its financial results for  
25 the second quarter ended September 30, 2009 on Form 10-Q. The 10-Q was signed by Song and  
26 separately certified pursuant to SOX by Song and Yan. The 10-Q states that “[a]s at [sic]  
27 September 30, 2009, we have opened 107 outlets in Shanghai and 12 other cities in China (as of  
28 September 30, 2008, we had 110 retail outlets).”



1 by market commentators, the Company's 2008 financial statements are contradicted by financial  
2 statements filed with Chinese authorities and the Company's purported retail "outlets" and  
3 "stores" do not exist.

4 36. On June 29, 2009 the Company filed with the SEC a notification stating that it  
5 would not be able to timely file with the SEC its annual report for the fiscal year ended March 31,  
6 2009 because the Company explained in relevant part:

8 China-Biotics, Inc. (the "Company") will be unable to file its Annual Report on Form 10-  
9 K for the fiscal year ended March 31, 2009 (the "Form 10-K") within the prescribed time  
10 period without unreasonable effort or expense. The late filing is due to delays in the  
11 review and confirmation of back-up materials and supporting documentation required by  
the Company's auditors in order to finalize the audit of the Company's financial  
statements.

12 The Company expects to file the Form 10-K as soon as practicable after audit has been  
13 finalized, which the Company expects will be no later than July 14, 2009.

14 37. This announcement caused the Company's stock to fall from \$16.35 per share to  
15 \$12.22 per share on June 29, 2009 and to \$10.80 per share on June 30, 2009.

16 38. On October 23, 2009 the Company announced that its CFO at the time, Fan, had  
17 resigned. This announcement caused the Company's stock to fall \$2.00 per share to \$14.42 per  
18 share on October 23, 2009 and an additional \$.72 per share decline on October 26, 2010.

19 39. On August 30, 2010, Citron Research issued a report questioning the Company's  
20 disclosures about its stores and retail outlets. The report states in relevant part:

22 Posted in Citron Reports by CitronResearch on the August 30th, 2010

23 It Doesn't Take a Microscope to See What's Wrong with China-Biotics  
24 (NASDAQ:CHBT)  
Citron Probes the Obvious: Where are the Stores?

25 Amazing how fraud is like water, it just finds the path of least resistance. When Citron  
26 started this column nine years ago this week, the frauds were OTCBB stock promotions  
27 run out of boiler rooms. The progressed to internet campaigns and mailers, and now roost  
28 recently to the greatest promotion of 'em all: CHINA. In this past weekend's Barron's

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

Magazine, Bill Alpert does a fine job in describing the web of fraud that exists in small cap Chinese stocks that were brought to market via reverse merger.

[http://online.barrons.com/article/SB50001424052970204304404575449812943183940.html?mod=BOL\\_hpp\\_mag](http://online.barrons.com/article/SB50001424052970204304404575449812943183940.html?mod=BOL_hpp_mag)

In the article, Barron’s observes:

“The SEC’s enforcement staff can’t subpoena evidence of any fraudulent activities in China, and Chinese regulators have little incentive to monitor shares sold only in the U.S. Many reverse-merged companies admit in prospectuses that they haven’t gotten required approvals under China’s financial regulations.”

Citron has written about a reversed merged China stock in 2007 (Xinhua Finance Media NASDAQ:XFML). When we published, it was \$10.00 and now it is .18 cents (ticker now XSEL). After reading this weekend’s Barron’s, we thought we would share the interesting case of China-Biotics as it seems so timely and relevant.

While the world “biotics” might sound impressive, it really is nothing more than a food supplement that in this case comes in the form of an acidophilus pill. Worldwide, there are literally dozens of manufacturers of the bacteria concentrate in these supplements. It is a mature and stable low-margin industry.

We could probably write 10 pages on what stinks about this China Biotics and what raises the red flags for fraud.

- It would be easy to look at the gross discrepancies between the company’s SAIC and SEC filings.
- It would also be possible to show pictures of the half-finished over-budget manufacturing facility side-by-side with company claims that it was already in production, or the photos of their current production facilities the size of a “bathroom” where the acidophilus pills drop out of a machine two by two.
- Most compelling, it would be simple to question how a company who sells the bulk of their product through distributors, who then purportedly resell them to Wal Mart (so they claim) can generate EBIDTA margins of 40-45% when their competition is at 27% max. (Multinational companies in the business include Danisco, Yakult, Perrigo, Cargill and others.) The company claims its high margins are due to its “retail channel”.
- Or, as if one needs any more of a red flag, we could discuss how the company has been through 5 CFOs in only 4 years

CHBT CFO History	Start Date	End Date
Song Jinan	3/22/2006	11/13/2006
Li Chi Yuen (Raymond)	11/13/2006	03/06/2009
Lewis Fan	03/06/2009	10/21/2009
Yan Yihong (Eva)	10/21/2009	01/22/2010
Travis Cai	01/22/2010	Present

- We could discuss the company’s \$50 million plus financial commitments due in 2010 or its looming potential tax liability from questionable past financial transactions that could also be as high as another \$50 million.

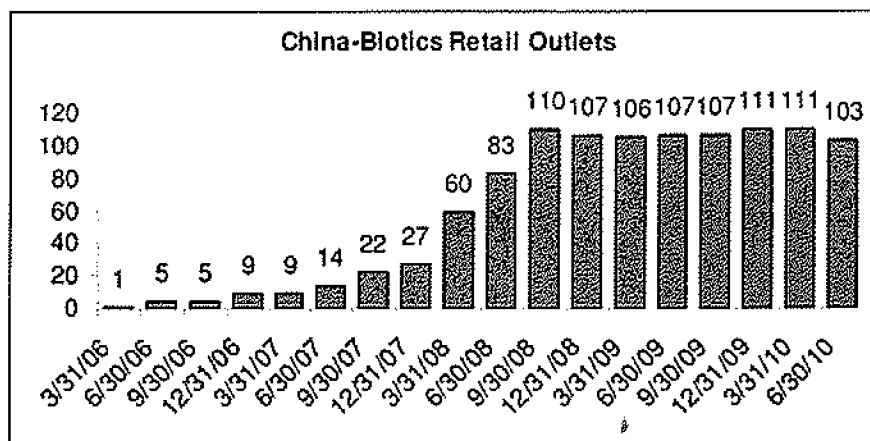
But all of those arguments would either require Citron to prove a negative or use arguments of inference. Or it would require shareholders to actually use some form of skepticism and analytics when judging the numbers. So instead we will ask an easy question that the company and shareholders should have no problem answering:

China-Biotics - Where are your stores????

According the CHBT’s SEC filings,

“As of March 31, 2010, we had 111 Shining branded outlets in Shanghai and 12 other major cities in China where we sell our products directly to the end users.”

Below is a chart showing the company’s alleged retail store growth since the company completed its reverse takeover in March 2006.



CHBT disclosed that “about three quarters of these outlets are located in Shanghai and the rest are located in 12 other cities in China.” As a result, we should expect that the company has at least 70 outlets in Shanghai.

Amazing that a company that is not at all shy in its use of PR’s had this explosive store growth without one: ribbon cutting, new store pr, or notice of opening.

Extensive web searches through <http://map.baidu.com/>, <http://shanghai.aibang.com/>, and <http://www.mapbar.com/> using the company’s disclosed brand names reveal only a handful of stores. We can find only 6 or 7 stores in Shanghai, and one each in Xeitou, NanMatou, Jingyu, Zhang YangLu, LingNan, FengZhuang.

In going through the corporate filings, it appears that the company’s retail outlets go under the brand 益生有益. That is also the name that we can see on the sign of the few stores

1 that we actually could identify. Put that into <http://map.baidu.com/> and see if your  
2 results differ.

3 Citron has heard from a handful of investors who all report that they have been unable to  
4 find any sign of even 25 locations, let alone over 100.

5 The company claims there are more than 100 retail outlets, with at least 70 of them in  
6 Shanghai. Proving that should be fairly easy: management should simply publicly disclose  
7 the addresses for every one of the company's retail outlets.

8 Since a picture is worth a thousand words, here's a look at the store China-Biotics  
9 identifies as its "flagship". There's very scant inventory, but a lot of photos of what looks  
10 like a sales meeting for an MLM organization, a business model the company denies  
11 being a part of. Yet the excuse made by the proprietor of this store for the obvious lack  
12 of sales is that "most of the sales are generated through a 'buying club' ".  
13

14 NOTE: MLM sales organizations are strictly prohibited in China. See what happened to  
15 Avon: [http://www.chinaretailnews.com/2009/07/06/2798-avon-china-investigated-for-  
16 multi-level-marketing/](http://www.chinaretailnews.com/2009/07/06/2798-avon-china-investigated-for-multi-level-marketing/)

17 OK, OK ... those used to our stringent US disclosure standards may be asking..."What  
18 about the auditors... certainly they have seen or have knowledge of all of the stores, no ? "

19 The auditors of CHBT are BDO Limited....who should not be confused with BDO  
20 Seidman, as all they really share with that big-name firm are 3 letters in their name as  
21 explained in this article by China Company Analyst.

22 <http://seekingalpha.com/article/213213-orient-paper-not-all-bdos-are-the-same>

23 BDO seems to have become the auditor du jour for questionable Chinese public  
24 companies.

25 "Well Citron, what about just going to the corporate website and getting the locations  
26 there?"

27 You do it. If you try it on one of those days where the corporate website actually works ( <http://www.chn-biotics.com/> ), you will not find a list of store addresses. How can any  
28 company claiming to be in the retail business (with over 100 stores) not even list store  
locations on their site... anyone, anyone??

Conclusion

Investors need to be wary of the growing scrutiny that Barron's and other investigative reports will bring upon these shenanigans. Citron doesn't believe the current regulatory "enforcement-free zone" for US-listed China-based companies is in the best economic interests of either the US or China, and it is not sustainable.

1 Within China, the country's credibility in the international marketplace is regarded as a  
2 national strategic priority. It may seem that China's culture has different standards when  
3 it concerns of questionable business ethics, but when the state becomes aware of a real  
4 economic threat, they come down hard. Just look at what happened to the CEO's of  
5 companies involved in the melamine in milk scandal, the lead in toys scandals, etc. Its no  
6 wonder that the first sign a US investor may get of trouble in a Chinese company is when  
7 the CEO "disappears".

8 There's no need to get embroiled in "shorts vs longs" battleground rhetoric here. It's a  
9 very simple matter: where are the stores? If there are no stores, there's no margins, no  
10 profit and nothing credible about this company or its management to hang an investment  
11 thesis on....period.

12 Alpert's article shows how bad the odds are for investors in these poorly documented and  
13 regulated reverse-merger entities. But at the bottom of the class is a company whose  
14 entire operation is based on fiction.

15 40. The information contained in the report caused the Company's stock to fall August  
16 30, 2010 \$2.66 per share to \$12.03 per share.

17 41. On August 31, 2010, Citron Research issued a report further questioning the  
18 Company's disclosures about its stores and retail outlets. The report states in relevant part:

19 Posted in Citron Reports by CitronResearch on the August 31st, 2010

20 "Where are the stores ?" Update August 31, 2010...Either the Company does not know  
21 how to communicate...or it is a fraud. You decide.

22 China Biotics (NASDAQ:CHBT) is out with a response to Citron's report of yesterday, in  
23 which we questioned the accuracy and credibility of the company's disclosures. The  
24 company is hosting an "Investor Day" in Shanghai "by reservation only". Citron suggests  
25 that this event is unlikely to produce credible answers needed to tough questions about all  
26 the aspects of this company's disclosures that don't line up with reality.

27 More significantly, the company for the first time posted a list of locations when its  
28 corporate website returned to service today.

<http://www.chn-biotics.com/c4426/c4435/default.html>

Citron can't help but conclude the newly posted list of locations is in response to our  
publicly posted challenge yesterday.

The problem is, here's what the company says about its retail locations:

From China Biotics 10-K

"As of March 31, 2010, we had 111 Shining branded outlets in Shanghai and 12 other  
major cities in China. We have been hiring consultants who have many years of

1 experience in the direct selling industry to facilitate the development of new Shining  
2 brand outlets.”

3 The company states it is expensing \$3.9 million US annually for its tiny office and  
4 production facilities, plus, presumably the retail locations it describes above:

5 “Rental expense, which was charged to expense, amounted to \$3,906,098, \$3,363,300,  
6 \$990,300 for the years ended March 31, 2010, 2009 and 2008, respectively.”

7 Elsewhere it states it employs 232 retail outlet employees.

8 You would assume that this kind of expense and employee footprint is commensurate with  
9 a 100-branch retail network, no? Something matching the classy photo of the yogurt shop  
10 they show here, right?

11 Well, it appears the majority of the 100 locations they just published are not in fact leased  
12 company stores, but are locations of supermarkets, mostly located around the greater  
13 Shanghai area.

14 For example, their first listed location , 62 Wensu Road, Jiading District, is this Jiadeli  
15 Supermarket, a chain of over 140 stores.  
16 [http://icexpat.com/nm\\_AddressDetails:mid\\_3711366A2FD34ABF824EA1F0A7FF6014.s  
17 html](http://icexpat.com/nm_AddressDetails:mid_3711366A2FD34ABF824EA1F0A7FF6014.shtml)

18 Further down the page is “Jiading District, 420 Yumin Road” This is Jiadeli Supermarket  
19 #59.  
20 [http://www.icexpat.com/nm\\_AddressDetails:mid\\_62F4670E393C478E967D3751049F74  
21 8F.shtml](http://www.icexpat.com/nm_AddressDetails:mid_62F4670E393C478E967D3751049F748F.shtml)

22 At least 10 other locations listed on the company’s website are found on this single listing  
23 of Supermarkets in the greater Shanghai metro area:  
24 <http://webcache.googleusercontent.com/search?q=cache:z6eRGG1ewnwJ:chinaunique.com/html/Shanghai/2009423/arts-5808.html+88+Baode&cd=5&hl=en&ct=clnk&gl=us>

25 For example, look at 1538 Caoan , 501 Sanmen Road, 1557 Yunchuan, 8991 Nanfeng,  
26 1218 Wuzhong, 88 Baode, 3155 Qixin Road. 1500 Xincun, 1688 Tongchuan, Lane 133  
27 Linping, 8 Baoming etc., etc.

28 Research is ongoing, but it appears the company is being intentionally misleading in these  
disclosures. Shelf space in a supermarket does not equate to a freestanding retail location,  
period. They have had ample opportunity to respond to a simple question and this is their  
answer. This only leads to more troubling questions, such as: “Where is the money really  
going? Where are the 232 employees stationed? Why post huge capital commitments to  
the animal feed business, with obviously far lower margins ? Why scurry away from the  
retail business after making such a big deal about its retail network ?

Conclusion

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

There is no such thing as “half a lie” when it comes to public company disclosures. It simply leads to deeper questions about every aspect of the company’s integrity. Citron reminds investors of the regulatory gap that allows Chinese companies with US listings to live in the margins, held accountable by neither Chinese authorities nor the SEC.

Sorry folks. This one is a recipe for indigestible investor losses. The company is now caught in a web of its own deception, and will be greatly challenged to square its disclosures with verifiable data points. On the financial side, its claims of a stock buyback plan and a huge cash hoard are inconsistent with its capital-raising activities. Its reported gross margins do not square with its recent production capacities, and its gross revenues are inexplicably high related to its peers in the industry. Its SEC and AIC financial reporting profile two entirely different realities.

42. On September 14, 2010 Citron Research issued another report providing additional information concerning the Company. The report states in relevant part:

Posted in Citron Reports by CitronResearch on the September 14th, 2010

\* \* \*

Citron Research has been writing about stock fraud for over 9 years. In that time, we uncovered numerous frauds that have subsequently been delisted and management charged by the SEC. Yes, we have made mistakes in the past, as have even the best researchers, but we have NEVER been wrong about a fraud.

With that, Citron is confident to state “China Biotics is a fraud” If we are lying, then please sue us and we will prove it in court. Or, put out a press release defending yourself and explicitly blame Citron Research, and we will sue you proactively to prove that you are committing securities fraud on the investing public.

We do not use the fraud word lightly, but frauds have a certain way of playing out, and sure enough CHBT management is following along right with the script. You don’t have to be Sherlock Holmes or even Encyclopedia Brown to figure this one out.

The curious case of the missing stores and the ol’ switcheroo trick. Two weeks ago in our first article, Citron questioned the “network of stores” that are claimed by CHBT – the same stores referenced in years’ worth of SEC filings, but are also discussed in every analyst report. More importantly, the stores that investors relied upon when they forked over \$75 million for shares . Citron does not believe that Roth Capital intentionally tried to defraud the public, rather they became collateral damage.

In the second line under use of proceeds, the registration statement states “to expand our retail operations”.

Once we questioned the stores existence, CHBT immediately put on their website a list of the “branded stores” as they state in their SEC filings.

\* \* \*

1 Within hours Citron was able to determine that these were not their stores, 95% of them  
2 were just supermarkets and retail outlets. We took it a step further and hired two private  
3 investigators to take pictures and prove what we knew. Once we brought that to the  
4 attention of the investing public, the company changed their website again to eliminate the  
5 word "stores"... a play right out of the scamsters' handbook. They also eliminated the  
6 line "The Company's most recognizable customers include Bright Dairy, and Relax  
7 Xinqiao." Why? Now it just says "the following is a list of sample locations where you  
8 can find our product."

9 <http://www.chn-biotics.com/c4426/c4435/default.html>

10 Just to remove any doubt about "what they said" and "what they meant", reference the  
11 company's June 2010 investor presentation: [http://www.chn-  
12 biotics.com/files/CHBT%20June%202010.pdf](http://www.chn-biotics.com/files/CHBT%20June%202010.pdf)

13 Page 4, bottom: China-biotics operated 111 retail outlets as of March 31, 2010, each  
14 outlet has an average payback of less than one year."

15 Where are the stores? Where is the money that goes to salaries and leases for these  
16 stores? Whose pockets is it in??? Did we mention this is a fraud??

17 *The curious case of the missing money... check this out.*

18 *When you put money in the bank you get interest... DUH.*

19 China Biotics claims its cash in the bank is \$159.7 million in the bank, according to its  
20 June 30 SEC filing – every dollar of which is supposedly available for corporate  
21 purposes. Yet it reports interest of just \$87,876. So where is the interest? How can the  
22 company be earning interest of less than 1/10th of comparable companies? Companies  
23 with large cash balances earn interest. Interest rates on free cash balances in China earn  
24 1% for 3 month to 1 year term deposits, and 2% for 1 to 2 year term deposits.

25 Simple math tells us that at 1% interest the cash should generate \$400,000 per quarter in  
26 interest income. At 2% this same cash balance should generate \$800,000 per quarter.

27 So either the company is only getting 1/10th the interest rate that it should be getting in  
28 china, or 90% of the money is not IN THE BANK. One would assume that the company  
is using some of the funds for working capital and to build out its new operations.  
However the SEC filing states that it is all in the bank!

CHOP earned \$278,000 (1.44%) interest on \$77.3 million in the last quarter.

XIN earned \$554,000 (1.33%) interest on \$166 million in the last quarter

CAGC earned \$171,000 (1.32%) interest on \$51.7 million in the last quarter.

Even Orient Paper earned \$108K (1.55%) interest on its \$7 Million cash in 2009...

1 The curious case of the conflicting financials

2 A great debate is now ongoing about disclosure documents filed in China and those filed  
 3 in the US. Citron has read the "plausible deniability" explanations from Roth and others  
 4 about how variations in rollups and tax treatment might make for a partial misalignment  
 5 of the numbers in these reports. Other claims, such as fear of disclosing corporate secrets  
 to competitors, seem nonsensical and downright moronic as anyone has free access to  
 SEC documents.

6 The numbers are not just off because of different GAAP standards or maybe some  
 7 accounting practice, the difference between the two is as wide as the Great Wall. Just take  
 a look.

	<u>2008 Filings Disclosures</u>	<u>SAIC</u>	<u>SEC</u>
9	Cash	100,000	64,300,000
10	Accounts Receivable	1,000,000	13,200,000
	Revenues	500,000	42,300,000
11	Gross Profits	200,000	30,000,000
12	Net income	(1,200,000)	17,500,000

13 Now the "longs" or in this case people who are about to apologize to Citron will argue  
 14 that these are not audited and the company is lying to China and telling the truth to US  
 regulators and the investing public.

15 LOLOL

16 CHBT's SAIC filings are audited. Just go to page 80 of the filings and you will see the  
 17 audit report of a top 100 Chinese accounting firm.  
 18 <http://chinesecompanyanalyst.files.wordpress.com/2010/08/chbt-aic-filings-in-english-translated2.pdf>

19 And as for lying to the Chinese Government but not the SEC, you want us to believe that  
 20 management who lives and pays taxes in China, where white collar crime can be  
 punishable by death, will lie to the Chinese Government but they will not lie to the SEC?  
 21 And why are we supposed to believe this ? C'mon ... if only the stock market was always  
 22 this easy.

23 \* \* \*

24 The Company's Response

25 Well heck, they had to say something. On Friday September 10, the company released a  
 26 statement commenting on their stock.

27 <http://finance.yahoo.com/news/ChinaBiotics-Inc-Comments-on-prnews-1108787132.html?x=0&.v=62>  
 28

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

In it they don't defend their alleged stores claim explicitly. Instead they state that there are "market rumors". Where are the rumors?? These are facts. The generic press release blaming the shorts is so old, tired, and predictable. Cmon, you could have at least signed a distribution deal with Santa Claus to bring your products to all the boys and girls of the world.

Corporate Credibility

One of the big corporate news story over the past few months was the firing of Mark Hurd from HP for fudging an insignificant amount on an expense report. While this might have been a bit extreme, it shows Wall Street operates with zero tolerance for lying.

What amazes Citron is that the longs in this stock are proud of management's ability to selectively lie. It is OK to lie about the stores... because it is now just a small part of their future revenue projections. Well, it wasn't such a small part of the company's revenues when they used that very track record from those "branded stores" to raise \$75 million from US investors.

(we think the only fair thing for the company to do is offer the secondary buyers their money back immediately. )

Meanwhile, is it also OK to lie to the Chinese Government? We are sure there will be a great story as to where the money is now.

Citron believes that the whole business model is a lie from top to bottom and management has zero credibility to say anything different.

Don't forget the old adage: At every poker game there is a sucker, and if you don't know who the sucker is, it is you... You have been warned.

Cautious Investing To All

EXTRA CREDIT READING for the CURIOUS:

For those of you who still believe in the "stores", I guess we all need some blind faith, here is some fun reading.

The Results, and the photos

43 of the locations published on the company's website, until recently claimed to be "branded outlet" locations have now been surveyed, with photos:

Company stores (like those pictured on the company's website)	2
Supermarkets or drugstores carrying one or two products on a small shelf space	16
A store offering no CHBT product whatsoever on its shelves	17
No retail at that address, or nothing at all	8
Store-within-store or kiosk (Yes our visitors politely asked)	0

1 [http://www.therealchbt.com/index.php?option=com\\_stores&view=list&Itemid=8](http://www.therealchbt.com/index.php?option=com_stores&view=list&Itemid=8)

2 This is not a rumor.

3  
4 **NO SAFE HARBOR**

5 43. The statutory safe harbor provided for certain forward-looking statements does not  
6 apply to any of the false statements alleged in this Complaint. None of the statements alleged  
7 herein are “forward-looking” statements and no such statement was identified as a “forward-  
8 looking statement” when made. Rather, the statements alleged herein to be false and misleading  
9 all relate to facts and conditions existing at the time the statements were made. Moreover,  
10 cautionary statements, if any, did not identify important factors that could cause actual results to  
11 differ materially from those in any forward-looking statements.  
12

13 44. In the alternative, to the extent that the statutory safe harbor does apply to any  
14 statement pleaded herein which is deemed to be forward-looking, the Individual Defendants are  
15 liable for such false forward-looking statements because at the time each such statement was  
16 made, the speaker actually knew and/or recklessly disregarded the fact that such forward-looking  
17 statements were materially false or misleading and/or omitted facts necessary to make statements  
18 previously made not materially false and misleading, and/or that each such statement was  
19 authorized and/or approved by a director and/or executive officer of China-Biotics who actually  
20 knew or recklessly disregarded the fact that each such statement was false and/or misleading  
21 when made. None of the historic or present tense statements made by the Individual Defendants  
22 was an assumption underlying or relating to any plan, projection, or statement of future economic  
23 performance, as they were not stated to be such an assumption underlying or relating to any  
24 projection or statement of future economic performance when made, nor were any of the  
25  
26  
27  
28

1 projections or forecasts made by the Individual Defendants expressly related to or stated to be  
2 dependent on those historic or present tense statements when made.

3 **LOSS CAUSATION/ECONOMIC LOSS**

4 45. During the Class Period, the Individual Defendants engaged in a scheme to  
5 deceive the market and a course of conduct that artificially inflated China-Biotics' securities price  
6 and operated as a fraud or deceit on purchasers of China-Biotics securities by misrepresenting the  
7 Company's financial condition and business prospects. Once the Individual Defendants'  
8 misrepresentations and fraudulent conduct were disclosed to the market, China-Biotics' securities  
9 price reacted negatively as the artificial inflation was removed from it. As a result of their  
10 purchases of China-Biotics securities during the Class Period, Plaintiff and other members of the  
11 Class suffered economic loss.  
12

13  
14 46. The Individual Defendants' false and misleading statements had the intended  
15 effect and caused China-Biotics securities to trade at artificially inflated levels throughout the  
16 Class Period.

17 47. As investors and the market became aware of China-Biotics' prior misstatements  
18 and omissions and that China-Biotics' s actual financial condition and business prospects were, in  
19 fact, not as represented, China-Biotics' securities price reacted negatively, damaging investors.  
20

21 **Applicability of Presumption of Reliance:  
22 Fraud-on-the-Market Doctrine**

23 48. At all relevant times, the market for China-Biotics' common stock was an efficient  
24 market for the following reasons, among others:

25 (a) China-Biotics' stock met the requirements for listing, and was listed and  
26 actively traded on the NASDAQ, a highly efficient and automated markets;  
27  
28

1 (b) During the class period, on average several hundreds of thousands of  
2 shares of China-Biotics' stock were traded on a weekly basis, demonstrating a very strong  
3 presumption of an efficient market;

4 (c) As a regulated issuer, China-Biotics filed with the SEC periodic public  
5 reports during the Class Period;

6 (d) China-Biotics was eligible and did file registration statements on Form S-3 with  
7 the SEC during the Class Period;

8 (e) China-Biotics regularly communicated with public investors via  
9 established market communication mechanisms, including regular disseminations of press  
10 releases on the national circuits of major newswire services and other wide-ranging public  
11 disclosures, such as communications with the financial press and other similar reporting  
12 services;  
13

14 (f) China-Biotics was followed by several securities analysts employed  
15 by major brokerage firms who wrote reports that were distributed to the sales force and  
16 certain customers of their respective brokerage firms during the Class Period. Each of these  
17 reports was publicly available and entered the public marketplace;

18 (g) Numerous NASD member firms were active market-makers in China-  
19 Biotics securities at all times during the Class Period; and  
20

21 (h) Unexpected material news about China-Biotics was rapidly reflected in and  
22 incorporated into the Company's securities price during the Class Period.  
23

24 49. As a result of the foregoing, the market for China-Biotics' securities promptly  
25 digested current information regarding China-Biotics from all publicly available sources and  
26 reflected such information in China-Biotics' securities price. Under these circumstances, all  
27 purchasers of China-Biotics' securities during the Class Period suffered similar injury through  
28

1 their purchase of China-Biotics' securities at artificially inflated prices, and a presumption of  
2 reliance applies.

3 **FIRST CLAIM**

4 **Violation of Section 10(b) of**  
5 **The Exchange Act Against and Rule 10b-5**  
6 **Promulgated Thereunder Against All Defendants**

7 50. Plaintiff repeats and realleges each and every allegation contained above as if fully  
8 set forth herein.

9 51. This First Claim is asserted against defendants China-Biotics, and the Individual  
10 Defendants.

11 52. During the Class Period, Defendants carried out a plan, scheme and course of  
12 conduct which was intended to, and throughout the Class Period, did: (1) deceive the investing  
13 public, including Plaintiff and other Class members, as alleged herein; and (2) cause Plaintiff and  
14 other members of the Class to purchase and/or sell China-Biotics securities at artificially inflated  
15 and distorted prices. In furtherance of this unlawful scheme, plan and course of conduct,  
16 defendants, individually and as a group, took the actions set forth herein.

17 53. Defendants, individually and in concert, directly and indirectly, by the use, means  
18 or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a  
19 continuous course of conduct to conceal adverse material information about the business,  
20 operations and future prospects of China-Biotics as specified herein.

21 54. Defendants employed devices, schemes and artifices to defraud, while in  
22 possession of material adverse non-public information and engaged in acts, practices, and a  
23 course of conduct as alleged herein in an effort to assure investors of China-Biotics' value and  
24 performance and continued substantial growth, which included the making of, or the participation  
25 in the making of, untrue statements of material facts and omitting to state material facts necessary  
26  
27  
28

1 in order to make the statements made about China-Biotics and its business operations and future  
2 prospects in light of the circumstances under which they were made, not misleading, as set forth  
3 more particularly herein, and engaged in transactions, practices and a course of business that  
4 operated as a fraud and deceit upon the purchasers of China-Biotics' securities during the Class  
5 Period.  
6

7 55. Each of the Defendants' primary liability, and controlling person liability, arises  
8 from the following facts: (1) Defendants were high-level executives, directors, and/or agents at  
9 the Company during the Class Period and members of the Company's management team or had  
10 control thereof; (2) each of the Defendants, by virtue of his responsibilities and activities as a  
11 senior officer and/or director of the Company, was privy to and participated in the creation,  
12 development and reporting of the Company's financial condition; (3) each of the Defendants  
13 enjoyed significant personal contact and familiarity with the other defendants and was advised of  
14 and had access to other members of the Company's management team, internal reports, and other  
15 data and information about the Company's finances, operations, and sales at all relevant times;  
16 (4) each of the Defendants was aware of the Company's dissemination of information to the  
17 investing public that they knew or recklessly disregarded was materially false and misleading;  
18 and (5) each of the Defendants culpably participated in the wrongful conduct alleged herein.  
19  
20

21 56. Defendants had actual knowledge of the misrepresentations and omissions of  
22 material facts set forth herein, or acted with reckless disregard for the truth in that they failed to  
23 ascertain and to disclose such facts, even though such facts were available to them. Such  
24 defendants' material misrepresentations and/or omissions were done knowingly or recklessly and  
25 for the purpose and effect of concealing China-Biotics' financial condition and future business  
26 prospects from the investing public and supporting the artificially inflated or distorted price of its  
27 securities. As demonstrated by defendants' overstatements and misstatements of the Company's  
28

1 financial condition and business prospects throughout the Class Period, defendants, if they did not  
2 have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing  
3 to obtain such knowledge by deliberately refraining from taking those steps necessary to discover  
4 whether those statements were false or misleading.

5  
6 57. As a result of the dissemination of the materially false and misleading information  
7 and failure to disclose material facts, as set forth above, the market price for China-Biotics'  
8 securities was artificially inflated during the Class Period. In ignorance of the fact that market  
9 prices of China-Biotics' publicly-traded securities were artificially inflated or distorted, and  
10 relying directly or indirectly on the false and misleading statements made by defendants, or upon  
11 the integrity of the market in which the Company's securities trade, and/or on the absence of  
12 material adverse information that was known to or recklessly disregarded by defendants but not  
13 disclosed in public statements by defendants during the Class Period, Plaintiff and the other  
14 members of the Class acquired and/or sold China-Biotics securities during the Class Period at  
15 artificially high prices and were damaged thereby.

16  
17 58. At the time of said misrepresentations and omissions, Plaintiff and other members  
18 of the Class were ignorant of their falsity, and believed them to be true. Had Plaintiff and the  
19 other members of the Class and the marketplace known the truth regarding China-Biotics'  
20 financial results, which were not disclosed by defendants, Plaintiff and other members of the  
21 Class would not have purchased or otherwise acquired China-Biotics securities, or, if they had  
22 acquired such securities during the Class Period, they would not have done so at the artificially  
23 inflated prices or distorted prices at which they did.

24  
25 59. By virtue of the foregoing, the Defendants have violated Section 10(b) of the  
26 Exchange Act, and Rule 10b-5 promulgated thereunder.

27  
28



1 control or influence the particular transactions giving rise to the securities violations as alleged  
2 herein, and exercised the same.

3 66. As set forth above, China-Biotics violated Section 10(b) and Rule 10b-5. By  
4 virtue of their positions as controlling persons, the Individual Defendants are liable pursuant to  
5 Section 20(a) of the Exchange Act as they culpably participated in the fraud alleged herein. As a  
6 direct and proximate result of defendants' wrongful conduct, Plaintiff and other members of the  
7 Class suffered damages in connection with their purchases of the Company's securities during the  
8 Class Period.  
9

10 67. This action was filed within two years of discovery of the fraud and within five  
11 years of each plaintiff's purchases of securities giving rise to the cause of action.

12 **WHEREFORE**, Plaintiff prays for relief and judgment, as follows:

13 (a) Determining that this action is a proper class action, designating Plaintiff as  
14 class representative under Rule 23 of the Federal Rules of Civil Procedure and Plaintiff's counsel  
15 as Class Counsel;  
16

17 (b) Awarding compensatory damages in favor of Plaintiff and the other Class  
18 members against all defendants, jointly and severally, for all damages sustained as a result of  
19 defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;  
20

21 (c) Awarding Plaintiff and the Class their reasonable costs and expenses  
22 incurred in this action, including counsel fees and expert fees; and

23 (d) Such other and further relief as the Court may deem just and proper.  
24  
25  
26  
27  
28

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**JURY TRIAL DEMANDED**

Plaintiff hereby demands a trial by jury.

Dated: September 17, 2010

Respectfully submitted,