SOLA INTERNATIONAL INC
Form 10-Q
August 14, 2002

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2002
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 12 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-13606

SOLA INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

DELAWARE	94-3189941
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

10590 West Ocean Air Drive, Suite 300, San Diego, CA 92130
(Address of principal executive offices)
(zip code)

(858) 509-9899
(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 such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

As of August 9, 2002, 24,543,650 shares of the registrant s common stock, par value $0.01 per share, which is the only class of common stock of the registrant, were outstanding.

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SIGNATURE

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SOLA INTERNATIONAL INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

SOLA INTERNATIONAL INC.

Consolidated Balance Sheets
(in thousands, except per share data)

	June 30, 2002 (unaudited)	March 31, 2002 (derived from audited financial statements)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 68,240	$ 68,419
Trade accounts receivable, less allowance for doubtful accounts of $8,926 and $8,395 at June 30, 2002 and March 31, 2002, respectively	120,024	114,993
Inventories, net	94,742	82,586
Deferred taxes, current	18,616	18,584
Prepaids and other current assets	20,445	15,509
Total current assets	322,067	300,091
Property, plant and equipment, net	165,002	164,465
Goodwill and other intangibles, net	194,814	190,719
Deferred taxes, long-term	33,756	33,760
Other long-term assets	23,291	24,030
Total assets	$738,930	$713,065
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable to banks	$ 206	$ 170
Current portion of long-term debt	3,486	4,140
Accounts payable	63,746	68,546
Accrued liabilities	51,946	43,470
Accrued payroll and related compensation	27,022	25,390
Other current liabilities	974	1,288
Total current liabilities	147,380	143,004
Long-term debt, less current portion	6,098	5,042
Senior notes	298,012	273,203
Deferred taxes, long-term	15,091	14,973
Other long-term liabilities	16,147	15,481
Total liabilities	482,728	451,703
Contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value; 5,000 shares authorized; no shares issued		

Common stock, $0.01 par value; 50,000 shares authorized; 24,938 shares issued as of June 30, 2002 and March 31, 2002, and 24,542 and 24,532 shares outstanding as of June 30, 2002 and March 31, 2002, respectively	249	249
Additional paid-in capital	286,190	286,169
Retained earnings	18,557	23,909
Cumulative other comprehensive loss	(46,219)	(46,329)
Common stock in treasury, at cost 396 shares and 406 shares at June 30, 2002 and March 31, 2002, respectively	(2,575)	(2,636)
Total stockholders equity	256,202	261,362
Total liabilities and stockholders equity	$738,930	$713,065

The accompanying notes are an integral part of these consolidated financial statements

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SOLA INTERNATIONAL INC.

Unaudited Consolidated Statements of Operations
(in thousands, except per share data)

	Three Months Ended June 30, 2002	Three Months Ended June 30, 2001
Net sales	$135,177	$135,956
Cost of sales	79,761	81,147
Gross profit	55,416	54,809
Research and development expenses	3,245	3,044
Selling and marketing expenses	26,021	26,787
General and administrative expenses	11,122	13,021
Operating expenses	40,388	42,852
Operating income	15,028	11,957
Interest income	486	441
Interest expense	(7,825)	(7,636)
Foreign currency gain/(loss)	(14,889)	5,088
Income/(loss) before benefit/(provision) for income taxes and minority interest	(7,200)	9,850
Benefit/(provision) for income taxes	2,160	(3,152)
Minority interest	(312)	(20)
Net income/(loss)	$ (5,352)	$ 6,678
Net income/(loss) per share basic	$ (0.22)	$ 0.28
Weighted average common shares outstanding	24,542	23,746
Net income/(loss) per share diluted	$ (0.22)	$ 0.28
Weighted average common and dilutive securities outstanding	24,542	24,176

The accompanying notes are an integral part of these consolidated financial statements

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SOLA INTERNATIONAL INC.

Unaudited Consolidated Statements of Cash Flows
(in thousands)

	Three Months Ended June 30, 2002	Three Months Ended June 30, 2001
Cash flows from operating activities:		
Net income/(loss)	$ (5,352)	$ 6,678
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:		
Minority interest in earnings	312	20
Depreciation	5,895	7,065
Amortization-goodwill and other intangibles	11	11
Amortization-debt issuance costs	757	648
Provision for excess and obsolete inventory	455	709
Provision for doubtful accounts	476	419
Tax benefit from exercise of stock options	16	306
Deferred taxes	353	593
Revaluation of senior notes	24,800	(7,698)
Loss on disposal/sale of property, plant and equipment	24	1,783
Changes in assets and liabilities, net of acquisitions:		
Trade accounts receivable	122	5,393
Inventories	(9,517)	(11,646)
Prepaids and other assets	(6,377)	(16,900)
Accounts payable trade	(8,919)	(1,517)
Accrued and other current liabilities	6,397	14,430
Other long-term liabilities	(224)	(476)
Net cash provided by/(used in) operating activities	9,229	(182)
Cash flows from investing activities:		
Purchases of businesses	(3,591)	
Investments in joint ventures	(39)	(16)
Capital expenditures	(2,630)	(4,486)
Mold expenditures	(648)	(2,252)
Other investing activities	241	43
Net cash used in investing activities	(6,667)	(6,711)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	68	545
Net receipts/(payments) under notes payable to banks	(48)	(115)
Borrowings on long-term debt	55	12,878
Payments on long-term debt	(911)	(5,679)
Issuance of senior notes		182,010
Repayment of bank debt		(159,974)
Other	(2,910)	955
Net cash provided by/(used in) financing activities	(3,746)	30,620
Effect of exchange rate changes on cash and cash equivalents	1,005	(129)

Net increase/(decrease) in cash and cash equivalents	(179)	23,598
Cash and cash equivalents at beginning of period	68,419	26,149
Cash and cash equivalents at end of period	$68,240	$ 49,747

The accompanying notes are an integral part of these consolidated financial statements

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SOLA INTERNATIONAL INC.

Notes to Consolidated Financial Statements
(unaudited)

1. Basis of Presentation

The accompanying consolidated financial statements of the Company have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to such rules and regulations. The consolidated balance sheet as of March 31, 2002 was derived from audited financial statements. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s annual report on Form 10-K for the fiscal year ended March 31, 2002.

The financial information included herein reflects all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the results for the interim period. The results of operations for the three months ended June 30, 2002 are not necessarily indicative of the results to be expected for the full year. Certain prior year items have been reclassified to conform to the current year s presentation. These reclassifications had no impact on previously reported net income/loss.

In order to continue its operations and meet its significant liquidity requirements, the Company must maintain profitable operations or obtain additional funds through equity or debt financing, bank financing, and other sources. Management believes that its existing cash balances, credit facilities, internally generated funds and other potential financing alternatives will be sufficient to meet the Company s capital, operating and debt service requirements for at least the next twelve months. If the Company is unable to generate adequate cash flow from sales of its products, the Company may need to seek additional sources of capital. There can be no assurance that the Company will be able to obtain additional debt or equity financing on terms acceptable to the Company, or at all. If adequate funds are not available, the Company could be required to delay development or commercialization of certain products, or reduce the marketing, customer support, or other resources devoted to product development. Accordingly, the failure of the Company to obtain sufficient funds on acceptable terms when needed could have a material adverse effect on the Company s business, results of operations and financial condition.

In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS 145 Rescission of FAS Nos. 4, 44, and 64, Amendment of FAS 13, and Technical Corrections. SFAS 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements, as well as FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. This Statement amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of SFAS 145 will be adopted during fiscal year 2004. The Company does not anticipate that the adoption of this statement will have a material impact on its financial position, results of operations, or cash flows.

In June 2002, the FASB issued SFAS No. 146, Accounting for Exit or Disposal Activities (SFAS 146). SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs

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Incurred in a Restructuring). The scope of SFAS 146 also includes costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002 and early application is encouraged. The Company will adopt SFAS 146 for its fiscal year beginning April 1, 2003 and does not anticipate that the adoption of this statement will have a material impact on its financial position, results of operations, or cash flows.

2. Inventories

Following is the detail of inventories:

	June 30, 2002 (in thousands)	March 31, 2002 (in thousands)
Raw Materials	$13,840	$13,104
Work In Progress	4,355	3,510
Finished Goods	76,547	65,972
	$94,742	$82,586

3. Derivative Instruments

The Company has foreign subsidiaries that operate and sell the Company s products in various global markets. In addition, the Company and foreign subsidiaries have Euro and Brazilian Real-denominated intercompany notes. As a result, the Company is exposed to changes in foreign currency exchange rates and interest rates. The Company utilizes various hedge instruments, primarily forward contracts, to manage its exposure associated with firm intercompany and third-party transactions and net asset and liability positions denominated in non-functional currencies. The Company does not hold derivative financial instruments for speculative or trading purposes.

Forward contracts are used to hedge certain cash flows denominated in non-functional currencies. The contracts outstanding at June 30, 2002 are designated as a foreign currency fair-value hedges in accordance with SFAS No. 133. Changes in the fair value of forward contracts due to changes in time value are recognized in other income and expense. For the three months ended June 30, 2002, the change in time value of the forward contracts was not significant. The Company did not record any gains or losses due to hedge ineffectiveness for the three months ended June 30, 2002.

Since July 27, 2001, the Company has transacted four foreign exchange contracts to hedge its interest expense exposure associated with the semi-annual coupon payments due September 15, 2001, March 15, 2002, September 15, 2002 and March 15, 2003 on its 205 million 11% Senior Notes. In addition, the Company has entered into other foreign exchange contracts to hedge portions of its accounts payable exposure. As of June 30, 2002, the Company has the September 15, 2002 and March 15, 2003 foreign exchange contracts, in addition to the other foreign exchange contracts, outstanding as described above.

Forward exchange contracts are also used to hedge certain foreign currency-denominated assets or liabilities. These derivatives do not qualify for SFAS No. 133 hedge accounting treatment. Accordingly, changes in the fair value of these hedges are recorded immediately in earnings to offset the changes in fair value of the assets or liabilities being hedged. The related gains and losses included in other income and expense were not significant.

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4. Accrued Liabilities

Following is the detail of accrued liabilities:

	June 30, 2002 (in thousands)	March 31, 2002 (in thousands)
Liabilities associated with strategic initiatives	$ 5,305	$ 6,296
Other accrued liabilities	46,641	37,174
	$51,946	$43,470

Commencing in the third quarter of fiscal 1999, the Company implemented strategic initiatives designed to streamline manufacturing and logistics, reduce operating costs worldwide and write-off inventory SKUs that are no longer being manufactured. No special charges were recorded during the three months ended June 30, 2002 and 2001. The following table reconciles the remaining liabilities associated with the strategic initiatives from April 1, 2002 to June 30, 2002 (in thousands):

	Workforce Reductions	Facility Closures	Total
Strategic initiative liability as of April 1, 2002	$4,870	$1,426	$6,296
Fiscal 2003 Q1 cash utilized	(733)	(268)	(991)
Strategic initiative liability as of June 30, 2002	$4,147	$1,158	$5,305

The Company does not anticipate any additional special charges related to its strategic initiatives and the Company anticipates that substantially all of the accrued liabilities will be paid in fiscal 2003 and will be funded through cash provided by operations.

5. Bank Credit Agreement

On July 26, 2001, the Company entered into a three-year $45 million secured revolving credit facility maturing on July 27, 2004, as amended by Amendment No. 1 and Waiver (Amendment) dated July 19, 2002 (as so amended, the Credit Agreement). The Credit Agreement contains a number of covenants, including, among others, covenants restricting the Company and its subsidiaries with respect to the incurrence of indebtedness, the creation of liens, the making of certain investments and loans, the payment of dividends, and the ability to enter into certain transactions with affiliates. In addition, the Credit Agreement requires the Company to maintain certain interest coverage, net worth and leverage ratios and places certain restrictions on capital expenditures. The Amendment primarily increased the Company s annual Permitted Acquisitions limit, as defined in the Credit Agreement, from $15 million to $30 million, while retaining the cumulative limit of $30 million to the maturity date. As of June 30, 2002, the Company was in compliance with all covenants.

At June 30, 2002, there was no debt outstanding under this agreement and the borrowing base amounted to $45 million.

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6. Senior Notes

Following is the detail of Senior Notes:

	June 30, 2002 (in thousands)	March 31, 2002 (in thousands)
6 7/8% Senior Notes	$ 94,780	$ 94,771
11% Senior Notes	203,232	178,432
Total Senior Notes	$298,012	$273,203

Changes in exchange rates had a significant impact on the reported balance of the 11% Senior Notes as of June 30, 2002 since the notes are denominated in Euros. Using the exchange rates in effect at March 31, 2002, the 11% Senior Notes as of June 30, 2002 would have been the same as reported at March 31, 2002.

7. Cumulative Other Comprehensive Loss

Cumulative other comprehensive loss includes currency translation adjustments that are not adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries. Following is the detail of cumulative other comprehensive loss (in thousands):

Balance March 31, 2002	$(46,329)
Change in foreign currency translation adjustment	110
Balance June 30, 2002	$(46,219)

8. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share for the three months ended June 30, 2002 and 2001 (in thousands, except per share data):

	Three Months Ended June 30, 2002	Three Months Ended June 30, 2001
Numerator:		
Net income/(Loss)	$ (5,352)	$ 6,678
Denominator:		
Weighted average common shares outstanding	24,542	23,746
Effect of dilutive securities-employee stock options		430
Denominator for diluted earnings per share - Weighted average common shares and dilutive securities outstanding	24,542	24,176
Basic earnings/(loss) per share	$ (0.22)	$ 0.28

Diluted earnings/(loss) per share	$ (0.22)	$ 0.28

For the three months ended June 30, 2002, options to purchase approximately 2.4 million shares of common stock with exercise prices at a range of $4.63 to $38.38 per share were not included in the calculation of diluted net loss per share because to do so would be anti-dilutive for the period. Options to purchase approximately 1.5 million shares of common stock with exercise prices at a range of $15.00 to $41.44 per share were outstanding as of June 30, 2001 but were not included in the computation of the diluted earnings per share for the three months ended June

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2001 because the options exercise price was greater than the average market price of the common shares.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the Company s financial condition and results of operations should be read in conjunction with the Company s consolidated condensed financial statements and notes thereto included elsewhere herein. This discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may be materially different from the results we discuss in the forward-looking statements. For more information, refer to Information Relating to Forward-Looking Statements below.

Overview

We are a leading global designer, manufacturer and distributor of a broad range of plastic and glass eyeglass lenses and hold a leading manufacturing and technology position in the fast growing plastic lens segment of the global spectacle lens market. We have sales offices in 28 countries worldwide and operate in most major regions of the world. We believe that we hold a top three market position in terms of volume of plastic eyeglass lenses sold in each major region where we operate, including North America, Europe and Rest of World (consisting primarily of Australia, Asia and South America). We focus our efforts on value-added products, including products with advanced design characteristics, lens coatings and treatments and thin and light weight materials (e.g., polycarbonate). At June 30, 2002, 76.1% of our net sales were represented by value-added products.

We market our spectacle lens products globally under the brands SOLA and American Optical (AO) and distribute them globally through four primary channels: (1) direct to national retail chain, (2) direct to retail outlets, (3) wholesale distributors (e.g., independent processing laboratories), and (4) managed care organizations in the United States, a growing segment of the spectacle lens market.

Our business is organized into three primary markets: North America, Europe and Rest of World. For the quarter ended June 30, 2002, we generated approximately 45% of our net sales from North America, 36% from Europe and 19% from Rest of World.

Results of Operations

Three months ended June 30, 2002 compared to three months ended June 30, 2001

Net Sales

Our net sales were $135.2 million in the three months ended June 30, 2002 compared to net sales of $136.0 million in the same period for the prior year, a decrease of $0.8 million or 0.6%. Using constant exchange rates and on a comparable basis, net sales decreased 1.9% with North America, Europe and Rest of World decreasing 3.9%, 0.2% and 0.3%, respectively. The decrease in the North America region was due primarily to decreased sales to laboratory customers that are owned by and aligned with a principal competitor. The decrease in Europe was primarily due to a decline in our wholesale business due to short-term supply issues and reduced shipments of recently launched photochromic product. Net sales in the Rest of World region decreased due to our efforts to concentrate on higher margin value-added sales. Net sales performance by region was as follows:

North America decreased by $2.5 million or 4.0%;

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Europe increased by $2.2 million or 4.7%; and

Rest of World decreased by $0.5 million or 1.7%.

Using constant exchange rates and on a comparable basis the regional performances were as follows:

North America decreased by 3.9%;

Europe decreased by 0.2%; and

Rest of World decreased by 0.3%.

Gross Profit and Gross Margin

Our gross profit totaled $55.4 million for the three months ended June 30, 2002 compared to $54.8 million for the same period in the prior year, an increase of $0.6 million or 1.1%. Gross profit as a percentage of net sales, or gross margin, increased to 41.0% for the three months ended June 30, 2002 from 40.3% in the same period in the prior year. The increase in gross margin resulted primarily from improved overhead absorption due to our decision to selectively increase global inventory balances to improve customer service levels.

Operating Expenses

Our operating expenses in the three months ended June 30, 2002 totaled $40.4 million compared to operating expenses of $42.9 million for the same period in the prior year. Operating expenses for the three months ended June 30, 2002 and 2001 as a percentage of net sales were 29.8% and 31.5%, respectively. Research and development expenses were $3.2 million or 2.4% of net sales for the three months ended June 30, 2002 and were $3.0 million or 2.2% of net sales for the three months ended June 30, 2001. Selling and marketing expenses were $26.0 million or 19.2% of net sales for the three months ended June 30, 2002 and were $26.8 million or 19.7% of net sales for the three months ended June 30, 2001. The $0.8 million or 2.9% decrease in selling and marketing expense was due to reduced spending on certain North American sales and marketing programs. Our general and administrative expenses were $11.1 million or 8.2% of net sales for the three months ended June 30, 2002 and were $13.0 million or 9.6% of net sales for the three months ended June 30, 2001. The $1.9 million or 14.6% decrease in general and administrative expenses was the result of lower costs associated with the consolidation of our corporate functions, as well as the consolidation of our North American commercial administrative activities into one primary location.

Net Interest Expense and Foreign Currency Gain/(Loss)

Our net interest expense totaled $7.3 million for the three months ended June 30, 2002 compared to $7.2 million for the three months ended June 30, 2001, an increase of $0.1 million. For the three months ended June 30, 2002, we recorded a net foreign exchange loss of $14.9 million compared to a foreign exchange gain of $5.1 million for the same period in the prior year. Unrealized exchange losses on external and intercompany notes of $20.9 million were recorded in the first quarter of fiscal 2003 due primarily to the weakening of the U. S. Dollar to the Euro. Conversely, unrealized exchange gains on external and intercompany notes of $5.5 million were recorded in the first quarter of fiscal 2002 due primarily to the strengthening of the U. S. Dollar relative to the Euro and Brazilian Real and the impact this had on our Euro-denominated external and intercompany notes.

Provision for Income Taxes

Our combined state, federal and foreign tax rate represents an effective tax rate projected for the full fiscal 2003 year of 30.0% compared to 32.0% used for the three months ended June 30, 2001. We have net deferred tax assets on our balance sheet as of June 30, 2002 amounting to

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$35.8 million. The utilization of these deferred tax assets is dependent upon our ability to generate taxable income in the future.

Liquidity and Capital Resources

Our operating activities generated $9.2 million in cash in the three months ended June 30, 2002 compared to net cash used by operating activities for the three months ended June 30, 2001 of $0.2 million, an improvement of $9.4 million. The increase resulted primarily from an improved operating performance in the current quarter.

Our inventories as a percentage of annualized net sales for the three months ended June 30, 2002 and 2001 were 17.5% and 18.5%, respectively. In constant dollars, inventories at June 30, 2002 increased by $7.8 million when compared to the previous year end at March 31, 2002. This increase was due to our decision to selectively increase global inventory balances to improve customer service levels. Accounts receivable as a percentage of annualized net sales for the three months ended June 30, 2002 increased to 22.2% compared to 21.1% for the same period a year ago. In constant dollars, accounts receivable at June 30, 2002 decreased by $1.2 million when compared to the previous year end at March 31, 2002.

During the three months ended June 30, 2002, net cash expended on investing activities, amounted to $6.7 million. Included in this amount was $3.6 million related to the acquisition of certain assets of two businesses: Optical Electroforming, Inc., a fabricator of molds and inserts and Alice Thomsen Trading A/S, a Scandinavian distributor. The Company also incurred $2.6 million of capital expenditures and $0.7 million related to investments in molds. Net cash expended on investing activities in the three months ended June 30, 2001 amounted to $4.5 million of capital expenditures and $2.3 million related to investments in molds. We anticipate capital expenditures, including molds, of approximately $30-$35 million in fiscal year 2003.

During the three months ended June 30, 2001, our net cash provided by financing activities amounted to $30.6 million primarily as a result of the net impact of our issuance of 11% Senior Notes, the proceeds of which were used to repay our credit facility. Interest on the 11% Senior Notes is payable semi-annually on each September 15 and March 15.

In addition to our outstanding 6 7/8% Senior Notes and 11% Senior Notes, our foreign subsidiaries maintain local credit facilities to provide credit for overdraft, working capital and some fixed asset investment purposes. As of June 30, 2002, the total borrowing capacity available to our foreign subsidiaries under these local facilities was approximately $13.6 million, of which $0.2 million had been utilized. As of June 30, 2002, the Company was in compliance with all covenants.

On July 26, 2001, the Company entered into a three-year $45 million secured revolving credit facility maturing on July 27, 2004, as amended by Amendment No. 1 and Waiver (Amendment) dated July 19, 2002 (as so amended, the Credit Agreement). The Credit Agreement contains a number of covenants, including, among others, covenants restricting us and our subsidiaries with respect to the incurrence of indebtedness, the creation of liens, the making of certain investments and loans, the payment of dividends, and our ability to enter into certain transactions with affiliates. In addition, the Credit Agreement requires us to maintain certain interest coverage, net worth and leverage ratios and places certain restrictions on capital expenditures. The Amendment primarily increased the Company s annual Permitted Acquisitions limit, as defined in the Credit Agreement, from $15 million to $30 million, while retaining the cumulative limit of $30 million to the maturity date. As of June 30, 2002, there was no debt outstanding under this agreement and the borrowing base amounted to $45 million.

In order to continue our operations and meet our significant liquidity requirements, we must maintain profitable operations or obtain additional funds through equity or debt financing, bank financing, and other sources. We believe that our existing cash balances, credit facilities, internally generated funds and other potential financing alternatives will be sufficient to meet our capital, operating and debt service requirements for at least the next twelve months. If we are

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unable to generate adequate cash flow from sales of our products, we may need to seek additional sources of capital. There can be no assurance that we will be able to obtain additional debt or equity financing on terms acceptable to us, or at all. If adequate funds are not available, we could be required to delay development or commercialization of certain products, or reduce the marketing, customer support, or other resources devoted to product development. Accordingly, failure to obtain sufficient funds on acceptable terms when needed could have a material adverse effect on our business, results of operations and financial condition.

Impact of Recently Issued Accounting Standards

In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS 145 Rescission of FAS Nos. 4, 44, and 64, Amendment of FAS 13, and Technical Corrections. SFAS 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements, as well as FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. This Statement amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of SFAS 145 will be adopted during fiscal year 2004. We do not anticipate that the adoption of this statement will have a material impact on our financial position, results of operations, or cash flows.

In June 2002, the FASB issued SFAS No. 146, Accounting for Exit or Disposal Activities (SFAS 146). SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The scope of SFAS 146 also includes costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002 and early application is encouraged. We will adopt SFAS 146 for our fiscal year beginning April 1, 2003 and do not anticipate that the adoption of this statement will have a material impact on our financial position, results of operations, or cash flows.

Currency Exchange Rates

As a result of our worldwide operations, currency exchange rate fluctuations tend to affect our results of operations and financial position. The principal effect of currency exchange rates on our results of operations and financial position is the impact on our Euro-denominated debt and translation adjustments for subsidiaries where the local currency is the functional currency. Translation adjustments for functional local currencies have been recorded to stockholders equity.

Certain countries have been determined to be hyperinflationary in fiscal 2002 as defined under the provisions of Emerging Issues Task Force (EITF) Issue No. D-55, Determining a Highly Inflationary Economy under FASB Statement No. 52 and EITF Issue No. D-56, Accounting for a Change in Functional Currency and Deferred Taxes When an Economy Becomes Highly Inflationary. Accordingly, the results of our entities located in those countries are being accounted for in accordance with the provisions of these pronouncements.

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Because a portion of our debt and associated interest is non-U.S. Dollar denominated, we may hedge against certain currency fluctuations by entering into currency swaps or forward contracts. Since July 27, 2001, we have transacted four foreign exchange contracts to hedge our interest expense exposure associated with the semi-annual coupon payments due September 15, 2001, March 15, 2002, September 15, 2002 and March 15, 2003 on our 205 million 11% Notes. In addition, we have entered into other foreign exchange contracts to hedge portions of our accounts payable exposure. As of June 30, 2002, we had the September 15, 2002 and March 15, 2003 foreign exchange contracts, in addition to the other foreign exchange contracts, outstanding as described above. We do not hold derivative financial instruments for speculative or trading purposes.

Seasonality

Our business is somewhat seasonal, with fiscal third quarter results generally weaker than the other three quarters as a result of lower sales during the holiday season, and fiscal fourth quarter results generally the strongest.

Inflation

Inflation continues to affect the cost of the goods and services that we use. The competitive environment in many markets limits our ability to recover higher costs through increased selling prices, and we are subject to price erosion in many of our standard product lines. We seek to mitigate the adverse effects of inflation through cost containment and productivity and manufacturing process improvements. For a description of the effects of inflation on our reported revenues and profits and the measures taken by us in response to inflationary conditions, see Currency Exchange Rates above.

Information Relating to Forward-Looking Statements

This quarterly report, including Management s Discussion and Analysis of Financial Condition and Results of Operations and Notes to Consolidated Financial Statements , contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, including statements regarding among other items, the impact of inflation and future income tax rates and capital expenditures. These forward-looking statements reflect our current views with respect to future events and financial performance. The words may , will , could , would , believe , expect , anticipate and similar expressions identify forward-looking statements. Readers are cautioned not to place undue relianc on these forward-looking statements, which speak only as of their dates. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Actual results could differ materially from the forward-looking statements as a result of known and unknown risks, uncertainties and other factors, including those described in the Risk Factors and Business-Environmental Matters sections of our Form 10-K for the fiscal year ended March 31, 2002.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Quantitative Disclosures

We are exposed to market risks inherent in our operations, primarily related to interest rate risk and currency risk. These risks arise from transactions and operations entered into in the normal course of business.

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Interest Rate Risk. We are subject to interest rate risk on our existing long-term debt and any future financing requirements. During the first quarter of fiscal 2003, fixed rate debt consisted primarily of outstanding balances on Senior Notes.

The following table presents the future principal cash flows and weighted average interest rates expected on our existing long-term debt instruments. Fair values have been determined based on quoted market prices as of June 30, 2002:

	Expected Maturity Date (as of June 30, 2002)							
	Fiscal 2003	**Fiscal 2004**	**Fiscal 2005**	**Fiscal 2006**	**Fiscal 2007**	**Thereafter**	**Total**	**Fair Value**
	(Dollars in thousands)							
Long-term debt:								
Fixed rate debt	$2,981	$1,503	$ 902	$ 952	$ 847	$298,329	$305,514	$302,330
Weighted average interest rate	6.40%	5.74%	4.29%	4.49%	2.39%	9.66%	9.55%	
Long-term debt:								
Variable rate debt	$ 505	$ 454	$ 426	$ 389	$ 282	$ 26	$ 2,082	$ 2,082
Weighted average interest rate	4.34%	4.30%	4.30%	4.28%	4.24%	1.25%	4.26%	

Currency Rate Risk. We are exposed to currency exchange rate fluctuations on our 205 million 11% Notes, due 2008. At June 30, 2002, we had outstanding two forward exchange contracts to hedge our interest expense exposure associated with the semi-annual coupon payments due September 15, 2002 and March 15, 2003 on our 205 million 11% Senior Notes. Our subsidiaries primarily operate in foreign markets and predominantly have their local currencies as their functional currencies. These subsidiaries do not have third party borrowings in currencies other than their local currencies. Accordingly, there are no quantitative disclosures related to borrowings by our subsidiaries.

The following table presents the future principal cash flows and weighted average interest rates expected on the 205 million 11% Senior Notes, due 2008, as well as the contract amount and weighted average settlement price of the outstanding forward exchange contracts. Fair values have been determined based on quoted market prices as of June 30, 2002:

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	Expected Maturity Date (as of June 30, 2002)							
	Fiscal 2003	Fiscal 2004	Fiscal 2005	Fiscal 2006	Fiscal 2007	Thereafter	Total	Fair Value
	(Dollars in thousands)							
Long-term debt:								
Fixed rate debt						203,232	$203,232	$209,329
Weighted average interest rate						11%	11%	
Forward exchange contracts:								
Contract amounts Due 7/05/02	$20,992						$ 20,992	$ 21,423
Contract amounts Due 7/18/02	$ 7,330						$ 7,330	$ 7,192
Contract amounts Due 7/25/02	$ 420						$ 420	$ 372
Contract amounts Due 7/29/02	$ 1,177						$ 1,177	$ 1,187
Contract amounts Due 8/23/02	$ 420						$ 420	$ 372
Contract amount Due 9/15/02	$ 9,834						$ 9,834	$ 11,141
Contract amounts Due 9/25/02	$ 420						$ 420	$ 371
Contract amounts Due 10/25/02	$ 420						$ 420	$ 370
Contract amounts Due 11/25/02	$ 420						$ 420	$ 369
Contract amounts Due 12/24/02	$ 420						$ 420	$ 368
Contract amounts Due 1/14/03	$ 420						$ 420	$ 371
Contract amount Due 3/15/03	$ 9,832						$ 9,832	$ 11,057
Weighted average settlement price	1.037						1.037	

Qualitative Disclosures

Interest Rate Risk. Our primary interest rate risk exposures relate to:

Our ability to pay or refinance long-term borrowings at maturity at market rates;

The impact of interest rate movements on our ability to meet interest expense requirements and financial covenants; and

The impact of interest rate movements on our ability to obtain adequate financing to fund future operations or business acquisitions.

We manage interest rate risk on our outstanding long-term borrowings through the use of fixed rate debt. While we cannot predict our ability to refinance existing debt, or the impact interest rate movements might have on existing debt, we evaluate our financial position on an ongoing basis. Because the majority of our debt is fixed rate in nature, an increase of 10% in interest rates would not materially increase our interest expense for the next 12 months.

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Currency Rate Risk. Our primary currency rate risk exposures relate to:

- Our global operations, whereby approximately 58% of our revenues are derived from operations outside the United States, denominated in currencies other than the U.S. Dollar;

- The ability of our operations to satisfy cash flow requirements of predominantly Euro and U.S. Dollar denominated long-term debt without the need to repatriate earnings and profits, which are denominated in currencies other than the Euro and U.S. Dollar;

- Our investments in foreign subsidiaries being primarily directly from the U.S. parent, resulting in U.S. Dollar investments in foreign currency functional companies; and

- The location of our operating subsidiaries in a number of countries that have seen significant exchange rate changes against the U.S. Dollar, primarily downward in recent years, such as Brazil, Mexico, Venezuela and certain Asian countries.

We manage our currency rate risks through a variety of measures. In certain limited instances, subsidiaries, after obtaining approval from our head office, will enter into forward exchange contracts in connection with inter-company purchases and sales of products. These contracts do not extend longer than one year and are immaterial to the overall operations of the group. Subsidiaries operating in high inflation environments protect margins by methods that include increasing prices monthly at a rate appropriate to cover anticipated inflation, compounding interest charges on sales invoices daily and holding cash balances in U.S. dollar denominated accounts where possible. We disclose constant exchange rate net sales performances in the aggregate, as well as by region, in Management s Discussion and Analysis of Financial Condition and Results of Operations. For more information, see Currency Exchange Rates above.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

Not applicable

Item 2. Changes in Securities and Use of Proceeds

Not applicable

Item 3. Defaults upon Senior Securities

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit Number	Description
10.1	Amendment No. 1 and Waiver dated as of July 19, 2002 to the Credit Agreement dated as of July 25, 2001 among Sola International Inc., the Lenders named therein, UBS Warburg LLC, as Sole Lead Arranger, UBS AG, Stamford Branch, as an Issuing Bank and as Administrative Agent, ABN AMRO Bank, N.V., as Syndication Agent, UBS AG, Stamford Branch, as Collateral Agent for the Lenders, and Union Bank of California, as Documentation Agent.
99.1	Certification of Chief Executive and Chief Financial Officers

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the fiscal quarter ended June 30, 2002.

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SIGNATURE

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.

Sola International Inc.
(Registrant)

Dated: August 14, 2002

By: /s/ Steven M. Neil

Steven M. Neil
Executive Vice President, Chief Financial Officer,
Secretary and Treasurer

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Exhibit Index

Exhibit Number	Description
10.1	Amendment No. 1 and Waiver dated as of July 19, 2002 to the Credit Agreement dated as of July 25, 2001 among Sola International Inc., the Lenders named therein, UBS Warburg LLC, as Sole Lead Arranger, UBS AG, Stamford Branch, as an Issuing Bank and as Administrative Agent, ABN AMRO Bank, N.V., as Syndication Agent, UBS AG, Stamford Branch, as Collateral Agent for the Lenders, and Union Bank of California, as Documentation Agent.
99.1	Certification of Chief Executive and Chief Financial Officers

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Other payables - related parties	75,741	75,741
Short-term notes payable	3,818,700	3,802,726
Total Current Liabilities	12,675,966	10,508,400
Long-term research and development commitments	-	36,565
Derivative warrant liability	1,157,640	2,523,148
Total Liabilities	13,833,606	13,068,113
Stockholders' Equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized;		
no shares issued or outstanding	-	-
Common stock, $0.001 par value; 95,000,000 shares authorized;		
43,393,644 shares and 42,308,350 shares outstanding, respectively	43,393	42,308
Additional paid-in capital	23,128,173	20,325,157
Retained earnings	72,539,089	61,602,677
Accumulated foreign currency translation adjustment	6,320,505	5,902,807
Total Stockholders' Equity	102,031,160	87,872,949
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$115,864,766	$100,941,062

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHINA PHARMA HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009 (As Restated - Note 1)	2010	2009
Revenue	$16,631,354	$13,601,355	$31,733,864	$26,593,337
Cost of revenue	9,587,417	7,681,845	18,555,719	14,745,072
Gross profit	7,043,937	5,919,510	13,178,145	11,848,265
Operating expenses:				
Selling expenses	621,580	603,924	1,204,468	1,206,684
General and administrative expenses	894,507	553,607	1,547,255	1,041,654
Bad debt expense, net of recoveries	37,615	(40,147)	108,521	734,785
Total operating expenses	1,553,702	1,117,384	2,860,244	2,983,123
Government subsidy income	465,663	-	465,663	-
Income from operations	5,955,898	4,802,126	10,783,564	8,865,142
Other income (expense):				
Interest income	5,401	10,720	12,158	21,309
Interest expense	(51,631)	(40,471)	(102,121)	(78,707)
Derivative gain (loss)	807,005	(24,278)	1,365,509	(290,075)
Net other income (expense)	760,775	(54,029)	1,275,546	(347,473)
Income before income taxes	6,716,673	4,748,097	12,059,110	8,517,669
Income tax expense	(633,419)	(486,231)	(1,122,698)	(843,953)
Net income	6,083,254	4,261,866	10,936,412	7,673,716
Other comprehensive income - foreign currency translation adjustment	403,253	5,698	417,698	93,189
Comprehensive income	$6,486,507	$4,267,564	$11,354,110	$7,766,905
Earnings per Share:				
Basic	$0.14	$0.10	$0.25	$0.18
Diluted	$0.14	$0.10	$0.25	$0.18

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHINA PHARMA HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30,	
	2010	2009
	(As Restated - Note 1)	
Cash Flows from Operating Activities:		
Net income	$10,936,412	$7,673,716
Depreciation and amortization	841,762	558,866
Stock based compensation	221,101	-
Deferred income taxes	(145,552)	(115,762)
Derivative (gain) loss	(1,365,509)	290,075
Changes in assets and liabilities:		
Trade accounts receivable	(3,402,232)	(6,798,955)
Other receivables	(25,809)	74,139
Advances to suppliers	(907,559)	703,994
Inventory	(4,994,669)	(1,716,958)
Trade accounts payable	2,404,264	2,426,525
Accrued expenses	(31,448)	3,133
Accrued taxes payable	(233,065)	(81,466)
Other payables	1,014	7,819
Advances from customers	(17,231)	36,727
Net Cash Provided by Operating Activities	3,281,479	3,061,853
Cash Flows from Investing Activities:		
Advances for purchases of property and equipment and intangible assets	(2,018,906)	(3,813,857)
Purchase of property and equipment	(108,842)	(232,624)
Purchase of intangible assets	(2,852,168)	(2,308,941)
Net Cash Used in Investing Activities	(4,979,916)	(6,355,422)
Cash Flows from Financing Activity:		
Proceeds from exercise of warrants	2,583,000	-
Net Cash Provided by Financing Activity	2,583,000	-
Effect of Exchange Rate Changes on Cash	8,799	9,221
Net Increase (Decrease) in Cash	893,362	(3,284,348)
Cash and Cash Equivalents at Beginning of Period	3,634,753	6,927,149
Cash and Cash Equivalents at End of Period	$4,528,115	$3,642,801
Supplemental Cash Flow Information:		
Cash paid for interest	$102,121	$85,429
Cash paid for income taxes	2,906,168	1,115,831

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CHINA PHARMA HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION

Organization and Nature of Operations – China Pharma Holdings, Inc., a Delaware corporation, owns 100% of Onny Investment Limited (Onny), a British Virgin Islands corporation, that in turn owns 100% of Hainan Helpson Medical & Biotechnology Co., Ltd (Helpson), which is organized under the laws of The People's Republic of China (the PRC). China Pharma Holdings, Inc. and its subsidiaries are referred to herein as the Company.

Through Helpson, the Company manufactures and markets generic and branded pharmaceutical products primarily to hospitals and private retailers located throughout the PRC. The Company has and continues to acquire well-accepted medical formulas to a diverse portfolio of Western and Chinese medicines. Helpson also manufactures biochemical products, health products and cosmetics.

Consolidation and Basis of Presentation – The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and are expressed in United States dollars. The accompanying consolidated financial statements include the accounts and operations of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Helpson’s functional currency is the Chinese Renminbi. Helpson’s revenue and expenses are translated into United States dollars at the average exchange rate for the period. Assets and liabilities are translated at the exchange rate as of the end of the reporting period. Gains or losses from translating Helpson’s financial statements are included in accumulated other comprehensive income which is a component of stockholders’ equity. Gains and losses arising from transactions denominated in a currency other than the functional currency of the entity that is party to the transaction are included in the results of operations.

Condensed Financial Statements – The accompanying unaudited condensed consolidated financial statements were prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. Management of the Company (Management) believes that the following disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

These unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of Management, are necessary to present fairly the consolidated financial position and results of operations of the Company for the periods presented. Operating results for the six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

Accounting 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 the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

CHINA PHARMA HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Basic and Diluted Earnings per Common Share - Basic earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated to give effect to potentially issuable dilutive common shares.

The following table is a reconciliation of the numerators and denominators used in the calculation of basic and diluted earnings per share:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
		(As Restated)		
Net income	$6,083,254	$4,261,866	$10,936,412	$7,673,716
Basic weighted-average common shares outstanding	43,393,644	42,278,938	43,261,567	42,278,938
Effect of dilutive securities:				
Warrants	93,793	-	280,592	-
Options	10,202	-	8,141	-
Diluted weighted-average common shares outstanding	43,497,639	42,278,938	43,550,300	42,278,938
Basic earnings per share	$0.14	$0.10	$0.25	$0.18
Diluted earnings per share	$0.14	$0.10	$0.25	$0.18

Potential common shares were not included in the compensation of diluted earnings per share as their effect would have been anti-dilutive as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
Warrants with exercise prices of $3.00 to $3.80 per share	1,822,873	2,969,607	1,668,719	2,969,607
Options with an exercise price of $3.47 per share	200,000	-	200,000	-
Total	2,022,873	2,969,607	1,868,719	2,969,607

Recently Enacted Accounting Standards - In October 2009, the FASB issued a new accounting standard which provides guidance for arrangements with multiple deliverables. The new standard requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In addition, the new standard eliminates the use of the residual method of allocation and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue for an arrangement with multiple deliverables. In October 2009, the FASB also issued a new accounting standard which changes revenue recognition for tangible products containing software and hardware elements. If certain requirements are met, revenue arrangements that contain tangible products with software elements that are essential to the functionality of the products are scoped out of the existing software revenue recognition accounting guidance and will be accounted for under the multiple-element arrangements revenue recognition guidance discussed above. Both standards will be effective for us in the first quarter of 2011. Early adoption is permitted. We do not expect the adoption of these accounting standards will have a material impact on our consolidated financial statements.

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CHINA PHARMA HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Reclassifications – The Company has reclassified certain 2009 amounts to conform to the 2010 presentation. The reclassifications had no effect on net income.

Restatements of Condensed Consolidated Financial Statements – The Company previously recognized warrants issued in 2008 as permanent stockholders' equity and recognized no adjustments to their fair value through the statements of income. However, as a result of the change in accounting principle relating to the valuation and classification of warrants as a derivative warrant liability discussed in Note 8, the Company should have accounted for the 2008 warrants as a derivative liability beginning on January 1, 2009, should have recognized the change in accounting principle on January 1, 2009 and should have recognized subsequent changes in the fair value of the warrants as derivative gains or losses in the statements of income. As a result of these errors, the Company has restated its condensed consolidated balance sheets as of June 30, 2010, December 31, 2009 and June 30, 2009, its condensed consolidated statements of operations and comprehensive income for the three and six months ended June 30, 2010 and 2009, and its cash flows for the six months ended June 30, 2010 and 2009. The restatements were as follows:

Balance Sheet Amounts	As Previously Reported	Restatement	As Restated
June 30, 2010			
Derivative warrant liability	$-	$1,157,640	$1,157,640
Total liabilities	12,675,966	1,157,640	13,833,606
Additional paid-in capital	23,981,130	(852,957)	23,128,173
Retained earnings	72,843,772	(304,683)	72,539,089
Total stockholders' equity	103,188,800	(1,157,640)	102,031,160
December 31, 2009			
Derivative warrant liability	$-	$2,523,148	$2,523,148
Total liabilities	10,544,965	2,523,148	13,068,113
Additional paid-in capital	21,178,114	(852,957)	20,325,157
Retained earnings	63,272,868	(1,670,191)	61,602,677
Total stockholders' equity	90,396,097	(2,523,148)	87,872,949
June 30, 2009			
Current assets	$64,372,150	$-	$64,372,150
Total assets	85,928,588	-	85,928,588
Current liabilities	7,967,030	-	7,967,030
Research and development commitments	36,524	-	36,524
Derivative warrant liability	-	553,952	553,952
Total liabilities	12,675,966	553,952	13,229,918
Common stock	42,279	-	42,279
Additional paid-in capital	21,066,338	(852,957)	20,213,381
Retained earnings	51,003,610	299,005	51,302,615
Foreign currency translation adjustment	5,812,807	-	5,812,807
Total stockholders' equity	77,925,034	(553,952)	77,371,082
Total liabilities and stockholders' equity	85,928,588	-	85,928,588

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CHINA PHARMA HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Statements of Operations and Comprehensive Income Amounts	As Previously Reported	Restatement	As Restated
For the Three Months Ended June 30, 2010			
Derivative gain	$-	$807,005	$807,005
Net other income (expense)	(46,230)	807,005	760,775
Income before income taxes	5,909,668	807,005	6,716,673
Net income	5,276,249	807,005	6,083,254
Comprehensive income	5,679,502	807,005	6,486,507
Basic and diluted earnings per share	$0.12	$0.02	$0.14
For the Three Months Ended June 30, 2009			
Derivative loss	$-	$(24,278)	$(24,278)
Net other expense	(29,751)	(24,278)	(54,029)
Income before income taxes	4,772,375	(24,278)	4,748,097
Net income	4,286,144	(24,278)	4,261,866
Comprehensive income	4,291,842	(24,278)	4,267,564
Basic earnings per share	$0.10	$-	$0.10

Statements of Operations and Comprehensive Income Amounts	As Previously Reported	Restatement	As Restated
For the Six Months Ended June 30, 2010			
Derivative gain	$-	$1,365,509	$1,365,509
Net other income (expense)	(89,963)	1,365,509	1,275,546
Income before income taxes	10,693,601	1,365,509	12,059,110
Net income	9,570,903	1,365,509	10,936,412
Comprehensive income	9,988,601	1,365,509	11,354,110
Basic and diluted earnings per share	$0.22	$0.03	$0.25
For the Six Months Ended June 30, 2009			
Derivative loss	$-	$(290,075)	$(290,075)
Net other expense	(57,398)	(290,075)	(347,473)
Income before income taxes	8,807,744	(290,075)	8,517,669
Net income	7,963,791	(290,075)	7,673,716
Comprehensive income	8,056,980	(290,075)	7,766,905
Basic and diluted earnings per share	$0.19	$(0.01)	$0.18

Statements of Cash Flows Amounts	As Previously Reported	Restatement	As Restated
For the six months ended June 30, 2010			
Net income	$9,570,903	$1,365,509	$10,936,412
Derivative gain	-	(1,365,509)	(1,365,509)

For the six months ended June 30, 2009			
Net income	$7,963,791	$(290,075)	$7,673,716
Derivative loss	-	290,075	290,075

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(Unaudited)

NOTE 2 - INVENTORY

Inventory consisted of the following:

	June 30, 2010	December 31, 2009
Raw materials	$ 10,135,138	$ 9,353,076
Finished goods	9,171,568	4,879,997
Total Inventory	$ 19,306,706	$ 14,233,073

NOTE 3 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	June 30, 2010	December 31, 2009
Permit of land use	$ 413,694	$ 411,963
Building	2,238,807	2,229,442
Plant, machinery and equipment	5,477,397	5,223,872
Motor vehicle	135,695	135,127
Office equipment	122,061	109,440
Construction in progress	439,954	616,491
Total	8,827,608	8,726,335
Less: accumulated depreciation	(2,418,184)	(2,020,462)
Property and Equipment, net	$ 6,409,424	$ 6,705,873

Construction in progress consists of machinery and construction supplies that have been paid for, but are not yet completed and placed into production. Once the machinery is working or the facility is in use, it is moved into plant, machinery and equipment and depreciated. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets as follows:

Asset	Life - years
Permit of land use	40 - 70
Building	20 - 35
Plant, machinery and equipment	10
Motor vehicle	5 - 10
Office equipment	5

For the six months ended June 30, 2010 and 2009, depreciation expense was $388,668 and $224,615, respectively.

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CHINA PHARMA HOLDINGS, INC.
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NOTE 4 - INTANGIBLE ASSETS

Intangible assets represent the costs of patents, trademarks, licenses, techniques and medical formulas. Medical formulas are amortized over the expected life of the related medicine once production and sales commence. Amortization expense relating to intangible assets was $454,016 and $334,250 for the six months ended June 30, 2010 and 2009, respectively.

NOTE 5 – ADVANCES FOR PURCHASES OF INTANGIBLE ASSSETS AND PROPERTY AND EQUIPMENT

In order to expand the number of medicines manufactured and marketed by the Company, the Company has entered into purchase contracts with independent and university laboratories. The contracts are for the purchase of established medical formulas for which the related patents have expired (generic medicines). Prior to entering into the contracts, the independent laboratories typically have completed all required research and development to determine the medical formula for and the method of production of the generic medicine. If the Company enters into a contract prior to the determination of the medical formula for a medicine, contract costs incurred to establish the medical formula are recognized as research and development expense. The contracts with the laboratories are primarily for certification of the manufacturing process and authorization by the State Food and Drug Administration (the SFDA) to sell the generic medicines. Under the terms of each contract, the Company is required to make progress payments to the laboratory; however, the payments are fully refundable in the event that the laboratory fails to obtain SFDA certification of the generic medicine under the contract. Payments made prior to the completion of the related process are recorded as advances for purchases of intangible assets.

The Company is also increasing production capabilities with new machinery and facilities. As is common in the PRC, the Company prepays for much of the machinery and construction supplies. The prepayments are capitalized as advances for purchases of property and equipment until the construction begins or the machinery is delivered to the Company.

NOTE 6 – SHORT-TERM NOTES PAYABLE

On July 2, 2009 the Company entered into revolving line of credit with a bank, with the related note payable bearing interest at an annual rate of 5.31% and collateralized by certain land use rights, buildings, machinery and equipment. The revolving line of credit expired on June 30, 2010, but the amounts outstanding on the line are due beginning August 13, 2010 to September 8, 2010. The outstanding balance due under the revolving line of credit was $3,818,700 at June 30, 2010. There are no additional amounts available to the Company under this line of credit.

NOTE 7 - INCOME TAXES

Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax laws or rates is recognized in income in the period that includes the enactment date.

Undistributed earnings of Helpson, the Company’s foreign subsidiary, since its acquisition, amounted to approximately $71.8 million at June 30, 2010. Those earnings, as well as the investment in Helpson of approximately $21.0 million are considered to be indefinitely reinvested and, accordingly, no U.S. federal or state income taxes have been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to

U.S. federal and state income taxes (net of an adjustment for foreign tax credits) and withholding taxes payable to the PRC. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credits may be available to reduce a portion of the U.S. tax liability.

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Under current tax law in China, the Company is and will be subject to the following enterprise income tax rates:

Year	Enterprise Income Tax Rate
2010	11%
2011	24%
2012 and after	25%

Deferred tax assets arising in the United States related primarily to the derivative warrant liability and net operating loss carry forwards have been fully valued against. The provision for income taxes consisted of the following:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
Current	$ 706,632	$ 479,027	$ 1,268,250	$ 959,715
Deferred	(73,213)	7,204	(145,552)	(115,762)
Net Income Tax Expense	$ 633,419	$ 486,231	$ 1,122,698	$ 843,953

The Company has also incurred various other taxes, comprised primarily of business taxes, value-added taxes, urban construction taxes, education surcharges and others. Any unpaid amounts are reflected on the balance sheets as accrued taxes payable. During the three months ended June 30, 2010 the Company received an incentive payment from the taxing authority of the Hainan provincial government in the PRC totaling $465,663 which has been recorded in other income on the accompanying statement of operations for the three and six months ended June 30, 2010.

NOTE 8 – DERIVATIVE WARRANT LIABILITY

On May 27, 2008 and on May 30, 2008, the Company issued warrants to purchase 1,250,000 shares of common stock at $2.80 per share and warrants to purchase 300,000 shares of common stock at $2.98 per share, respectively, exercisable for a period of three years. If the Company issues shares of common stock or common stock equivalents at a price per share less than the exercise price, then, the exercise price will be multiplied by a fraction, the numerator of which is the number of shares of common stock outstanding immediately prior to the such issuance plus the number of shares of common stock which the offering price for such shares of common stock or common stock equivalents would purchase at the closing price of the common stock on that date, and the denominator of which is the sum of the number of shares of common stock outstanding immediately prior to such issuance plus the number of shares of common stock so issued or issuable. Simultaneously with any adjustment to the exercise price, the number of shares of common stock that may be purchased upon exercise of the warrants is increased or decreased proportionately, so that after such adjustment the aggregate exercise price payable for the adjusted number of shares is the same as the aggregate exercise price in effect immediately prior to such adjustment.

The Company was not required to account for the warrants as a derivative liability until January 1, 2009. On January 1, 2009, the Company applied the guidance of ASC Topic 815-40, Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock, and it was determined that the potential adjustment to the number of shares of common stock that could be purchased upon exercise of the warrants caused the warrants to be a derivative liability. The application of the new guidance on January 1, 2009 resulted in the fair value of the warrants being reclassified as a derivative liability and adjusted to their fair value at each reporting date, with the changes in the fair value recognized as a noncash expense or income.

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Upon adoption, a cumulative effect adjustment was recorded based on the amounts that would have been recognized if this guidance had been applied from the issuance date of the warrants. The following table illustrates the changes to the Company's consolidated balance sheet on January 1, 2009:

	December 31, 2008	Cumulative Effect Adjustment	January 1, 2009 As Restated
Derivative warrant liability	$ -	$ 263,577	$ 263,577
Additional paid-in capital	21,066,338	(852,957)	20,213,381
Retained earnings	43,039,819	589,380	43,629,199

The Company uses the Black-Scholes valuation model to measure the fair value of the warrants, and based on the following assumptions, the fair values were as follows:

	May 27, 2008		January 1, 2009		June 30, 2009		December 31, 2009		June 30, 2010	
Risk free interest rate	2.93	%	2.93	%	1.64	%	2.93	%	1.00	%
Expected life, in years	3.00		2.41		1.91		1.41		0.91	
Expected dividend rate	0	%	0	%	0	%	0	%	0	%
Volatility	67.21	%	67.21	%	80.24	%	67.21	%	74.99	%
Fair value	$852,957		$263,577		$553,952		$2,523,148		$1,157,639	

Changes to the derivative warrant liability are recognized in the results of operations and resulted in derivative losses of $24,278 and $290,075 for the three and six months ended June 30, 2009 and derivative gains of $807,005 and $1,365,509 for the three and six months ended June 30, 2010.

Fair Value Measurements – Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. To measure fair value, a hierarchy has been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows: Level 1 – Quoted prices in active markets for identical assets or liabilities. Level 2 – Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data. Level 3 – Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Company uses fair value to measure the derivative warrant liability on a recurring basis because fair value is the primary measure for accounting. The derivative warrant liability is a level 3 measurement measured using a valuation model as explained above.

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CHINA PHARMA HOLDINGS, INC.
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NOTE 9 - STOCKHOLDERS' EQUITY

During the first quarter of 2010, the Company received proceeds of $2,583,000 pursuant to the exercise of warrants to purchase 1,085,294 shares of common stock at an exercise price of $2.38 per share. The warrants were issued in conjunction with the Company's February 1, 2007 Unit Offering. On February 1, 2010, warrants to purchase 88,235 shares of common stock at an exercise price of $2.38 per share expired unexercised.

On May 17, 2010 the Company issued three-year warrants to purchase 150,000 shares of common stock to a consultant for services rendered. The exercise price is $3.00 per share for 75,000 shares and $3.80 per share for the remaining 75,000 shares. The value of the warrants of $116,993 was recorded as general and administrative expense in the accompanying financial statements as of the date of issuance. The fair value of the warrants issued was determined using the Black-Scholes Option Pricing Model, using the following assumptions: risk free interest rate of 1.30%, expected dividend yield of 0%, expected volatility of 67.0% and an expected life of 3 years. The exercise price of the warrants exceeded the market price of the stock on the dates of grant.

As of June 30, 2010, the Company has outstanding warrants to purchase an aggregate of 1,916,666 shares of Company's common stock at exercise prices ranging from $2.80 to $3.80 per share, which expire from May 29, 2011 through May 16, 2013.

On September 2, 2009, the board of directors of the Company adopted the 2009 Stock Option Plan, under which a total of 1,000,000 shares of the Company's common stock are available for issuance to directors, officers, employees, and eligible consultants.

On April 28, 2010 the Company issued three-year options to purchase 200,000 shares of common stock under the 2009 Stock Option Plan to an executive officer of the Company. The exercise price is $3.47 per share based on the closing market price for the Company's common stock as of that date. A total of 50,000 options will vest upon the achievement of certain performance milestones, and the remaining 150,000 options will vest ratably over one year from the date of grant. The fair value of the options of $226,560 was determined using the Black-Scholes Option Pricing Model, using the following assumptions: risk free interest rate of 1.61%, expected dividend yield of 0%, expected volatility of 67.6% and an expected life of 1.5 years.

During the six months ended June 30, 2010, the Company recognized $104,108 of compensation expense as general and administrative expenses related to the above mentioned options and the 100,000 stock options to purchase common stock at $2.75 per share that were granted in 2009. The total remaining unrecognized compensation expense related to these options is $158,609. A total of $56,640 will be recognized upon the achievement of the performance goals stated in the option. The remaining $158,609 is anticipated to be recognized ratably over the remaining vesting periods in the amount of $103,675 and $54,934 during fiscal 2010 and 2011, respectively. As of June 30, 2010, the aggregate intrinsic value of the options was $0.

On June 23, 2010 the Company amended its articles of incorporation which increased the total number of authorized common shares from 60,000,000 to 95,000,000, and authorized 5,000,000 shares of preferred stock. The preferred stock may be issued in series with such designations, preferences, stated values, rights, qualifications or limitations as determined solely by the Company's board of directors.

NOTE 10 – CONTINGENCIES

Economic environment - Significantly all of the Company's operations are conducted in the PRC, and therefore the Company is subject to special considerations and significant risks not typically associated with companies operating in the United States of America. These risks include, among others, the political, economic and legal environments and fluctuations in the foreign currency exchange rate. The Company's results from operations may be adversely affected by changes in the political and social conditions in the PRC, and by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things. The unfavorable changes in global macroeconomic factors may also adversely affect the Company’s operations.

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In addition, all of the Company's revenue is denominated in the PRC's currency of Renminbi (RMB), which must be converted into other currencies before remittance out of the PRC. Both the conversion of RMB into foreign currencies and the remittance of foreign currencies abroad require approval of the PRC government.

NOTE 11 – CONCENTRATIONS

At June 30, 2010, one customer accounted for 23.1% of accounts receivable. At December 31, 2009, one customer accounted for 15.0% of accounts receivable.

For the six months ended June 30, 2010, two customers accounted for 36% and 11% of sales, respectively. For the six months ended June 30, 2009, three customers accounted for 23.6%, 18.1% and 12.6% of sales, respectively.

For the six months ended June 30, 2010, purchases from three suppliers accounted for 46.2%, 15.7% and 12.5% of raw material purchases, respectively. For the six months ended June 30, 2009, purchases from three suppliers accounted for 35.1%, 32.1% and 23.7% of raw material purchases, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Disclosure Regarding Forward-Looking Statements

The statements contained in this report with respect to our financial condition, results of operations and business that are not historical facts are forward-looking statements. Forward-looking statements can be identified by the use of forward-looking terminology, such as "anticipate", "believe", "expect", "plan", "intend", "seek", "estimate", "project", "could", "may" or the negative thereof or other variations thereon, or by discussions of strategy that involve risks and uncertainties. Management wishes to caution the reader of the forward-looking statements that any such statements that are contained in this report reflect our current beliefs with respect to future events and involve known and unknown risks, uncertainties and other factors, including, but not limited to, economic, competitive, regulatory, technological, key employee, and general business factors affecting our operations, markets, growth, services, products, licenses and other factors, some of which are described in this report and in "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009 and some of which are discussed in our other filings with the Securities and Exchange Commission. These forward-looking statements are only estimates or predictions. No assurances can be given regarding the achievement of future results, as actual results may differ materially as a result of risks facing our company, and actual events may differ from the assumptions underlying the statements that have been made regarding anticipated events.

These risk factors should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. All written and oral forward-looking statements made in connection with this report that are attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Given these uncertainties, we caution investors not to unduly rely on our forward-looking statements. We do not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by applicable law or regulation.

Business Overview

We are principally engaged in the development, manufacture, packaging, marketing and distribution of generic and branded pharmaceutical products for a wide range of high incidence and high mortality conditions in The People's Republic of China (the "PRC"). All of our operations are conducted in the PRC, where our 8,000-square-meter manufacturing facilities are located. With eight different production lines, we have the capability to manufacture pharmaceutical products in the form of dry powder injectables, liquid injectables, tablets, capsules, oral solutions and granules. Over 90% of our pharmaceutical products are sold on a prescription basis and have been approved for at least one or more therapeutic indications by the Chinese State Food and Drug Administration (the "SFDA") based upon demonstrated safety and efficacy.

At June 30, 2010, we manufactured 20 pharmaceutical products for a wide variety of diseases and medical indications, each of which may be classified into one of three general categories: a basic generic drug, which is a common drug in the PRC marketplace for which there is a very large market, a "super" or "first to market" generic drug, which is a generic Western drug that is new to the PRC marketplace, and a modern Traditional Chinese Medicine, which generally is a non-synthetic, plant-based medicinal compound of the type that has been widely used in the PRC for thousands of years, to which we apply modern production techniques to produce a pharmaceutical product in different formulations, such as tablets, capsules or powders. In choosing generic drugs to develop and manufacture, we consider several factors, including the number of other manufacturers currently producing the particular drug, the size of the market, the proposed or required method of distribution, the existing and expected pricing for the particular

drug in the marketplace, the costs of manufacturing that drug, and the costs of acquiring or developing the formula for that drug. We believe we have historically selected generic drugs to manufacture that very large addressable markets and higher profit margins relative to other drugs being manufactured and distributed in the PRC.

In 2002, we built, and we currently own and operate, an approximately 8,000-square-meter manufacturing facility in Haikou, Hainan Province that supports eight modern, scalable production lines. We implement quality control procedures in compliance with standards for Good Manufacturing Practice, or GMP standards, and applicable SFDA regulations to ensure consistent quality in our products.

We market and sell our products through 16 sales offices covering all major cities and provinces in China. To comply with applicable Chinese law relating to sales of prescription drugs to certain hospitals and clinics, we also use a distribution system comprised of approximately 1,250 independent regional distributors. We have grown significantly in recent years, with our net revenues increasing from $8.7 million in 2005 to $61.7 million in 2009, representing a compound annual growth rate, or CAGR, of 63% during this period. Our net revenues increased by $5.1 million, or by 19%, to $31.7 million in the first six months of 2010 as compared to the comparable period of 2009. Our net income increased from $3.8 million in 2005 to $20.2 million in 2009, representing a CAGR of 52% during this period. Our net income increased by $1.6 million, or by 20%, to $9.6 million in the first six months of 2010 as compared to the comparable period of 2009.

We often have seasonal pattern in our sales revenues throughout the year for a variety of reasons, including 1) the higher rates of occurrence of cerebral/cardio diseases and flu in the winter season and 2) Chinese New Year being in the first quarter. As a result, our fourth quarter revenues tend to be higher and first quarter revenues tend to be lower.

We have a strong focus on bringing new and first-to-market generic medicines to market through the purchase of medical formulas from research institutions as well as our own in-house research and development activities. As of June 30, 2010, in addition to our portfolio of 20 commercialized products, we had nine drugs at different stages of SFDA registration progress, including three which had passed SFDA technical analysis and entered clinical trials (including a new anti-drug-resistance antibiotic product), as follows:

- We completed the clinical trials earlier this year for Candesartan, a front-line drug therapy for the treatment of hypertension. Since then, we have completed all testing procedures for this new product, and we are currently waiting for the final production approval from SFDA.

- We continue to receive positive feedback from patients during our clinical trial of Rosuvastatin, a generic form of Crestor. The majority of the patients in the clinical trial have completed the treatment cycle.

- The clinical trial for our anti-drug-resistant antibiotic combination drug is also progressing on schedule, and the Phase I part of the trial is nearly completed.

In addition to the products mentioned above, we have several other products pending SFDA technical review and plan to initiate clinical trials in 2010 that focus on our main therapeutic areas. We are also evaluating additional opportunities on an ongoing basis, directed by the organic growth and market demands of China's pharmaceutical market. We are working closely with several pharmaceutical research institutions and remain focused on creating a steady increase in new products and, in turn, revenue. We remain focused on improving our product portfolio and increasing our internal growth, maintaining and developing new marketing channels, and using our existing retail network in the expanding markets in the PRC to raise our overall market share. The organic growth of the Chinese pharmaceutical market has had a positive affect on, and will continue to direct, our company's development.

The growth of China's pharmaceutical market is driven by China's rapid economic growth. Increased healthcare spending by the Chinese government to reform the healthcare system has already greatly improved the accessibility to and desire for medical care. Important additional factors include: the aging of the population and the resulting increase in age-related disorders; the urban migration of the population; and improved awareness of self-health care.

The Healthcare Reform program announced last year by the Chinese government is now in its implementation stage. After the official announcement of the Essential Drugs List ("EDL") in late 2009, we have seen gradual but meaningful and notable increases in demand for the EDL products. Furthermore, EDL product pricing (set by the government) has been relatively benign as compared to the pricing levels the market had anticipated. While the Healthcare Reform is unquestionably moving forward, the pace of implementation varies significantly from province to province. As a result, the effect of the pricing regulations also have varied significantly from province to province.

We continue to believe that the regulators in the PRC want to see prices of the essential drugs affordable, on the one hand, but permit drug companies a fair profit on the other hand. We think we are well positioned in the current environment. As our product portfolio is well diversified, pricing or volume changes of one single product should not have a material impact on our overall profitability. Furthermore, our management team has been in the Chinese pharmaceutical market for more than 15 years, and it is very experienced at adapting to changes. We will seek to remain flexible with our product mix to achieve our profitability goals.

Results of Operations

The following table presents our results of operations for the three-month and six-month periods ended June 30, 2010 and 2009.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2010 (as restated)	2009 (as restated)	% Chg	2010 (as restated)	2009 (as restated)	% Chg
Revenue	$ 16,631,354	$ 13,601,355	22 %	$ 31,733,864	$ 26,593,337	19 %
Cost of Revenue	9,587,417	7,681,845	25 %	18,555,719	14,745,072	26 %
Gross Profit	7,043,937	5,919,510	19 %	13,178,145	11,848,265	11 %
Selling Expenses	621,580	603,924	3 %	1,204,468	1,206,684	0 %
General and Admin Expenses	894,507	553,607	62 %	1,547,255	1,041,654	49 %
Bad Debt Expense (Benefit)	37,615	(40,147)		108,521	734,785	
Income from Operations	5,955,898	4,802,126	24 %	10,783,564	8,865,142	22 %
Derivative Gains (Loss)	807,005	(24,278)		1,365,509	(290,075)	
Income Tax Expense	(633,419)	(486,231)	30 %	(1,122,698)	(843,953)	33 %
Net Income	$ 6,083,254	$ 4,261,866	43 %	$ 10,936,412	$ 7,673,716	43 %
Basic Net Income per Share	$ 0.14	$ 0.10	39 %	$ 0.25	$ 0.18	38 %
Basic Weighted Average Shares Outstanding	43,393,644	42,278,938		43,261,567	42,278,938	
Diluted Net Income per Share	$ 0.14	$ 0.10	39 %	$ 0.25	$ 0.18	38 %
Diluted Weighted Average Shares Outstanding	43,497,639	42,278,938		43,550,300	42,278,938	

Three Months Ended June 30, 2010 and 2009

Revenue

For the three months ended June 30, 2010, our revenues increased by $3.0 million, or 22%, to $16.6 million from the $13.6 million we generated in the corresponding period of 2009.

Set forth below are our revenues in millions USD for each of the three months ended June 30, 2009 and 2010 by product category.

Product Category	Three Months Ended June 30		Net Change	% Change
	2010	2009		
CNS Cerebral & Cardio Vascular	$ 4.9	$ 5.1	-$ 0.2	-5%
Anti-Viro/ Infection & Respiratory	$ 6.3	$ 5.2	$ 1.1	21%
Digestive Diseases	$ 2.3	$ 1.0	$ 1.3	129%
Other	$ 3.2	$ 2.3	$ 0.9	40%

On a year over year basis, we continued to experience healthy revenue growth during the quarter ended June 30, 2010. We saw strong performance in the “Digestive Diseases” category stemming primarily from an increase in sales of Omeprazole, the generic gastroesophageal reflux disease (GERD drug we launched in the fourth quarter of 2009. Sales of Omeprazole during the quarter ended June 30, 2010 was approximately $0.94 million. The strong growth in our “Other” category came from higher sales of Vitamin B6, one of the two products we produce that is on the National EDL. We are starting to see rising demand in EDL-related products and also limited pressure on pricing. We continue to be opportunistic on our ability to capture new markets and also to carefully manage our product mix. Revenues derived from our products in our “Anti-Viro/Infection & Respiratory” category grew 21%, while the revenues of our “CNS Cerebral and Cardio Vascular” category declined by 5%.

Cost of Revenue

For the three months ended June 30, 2010, our cost of revenue was $9.6 million, or 58% of total revenue, compared to $7.7 million, or 56% of total revenue during the comparable period of 2009. The increase in cost of revenue during the second quarter of 2010 period was primarily due to higher revenue for the 2010 period.

Gross Profit

Gross profit for the three months ended June 30, 2010 was $7.0 million, which was approximately 19% higher compared to the $5.9 million for the second quarter of 2009. Gross profit margin for the second quarter of 2010 was 42.4%, compared to 43.5% in the corresponding quarter of 2009. The lower gross profit margin in the second quarter of 2010 was mainly due to higher volume of lower-margin products sold compared to the same period a year ago.

Selling Expenses

Our selling expenses for the three months ended June 30, 2010 were $0.62 million, an increase of approximately $18,000, or 3%, compared to $0.60 million for the three months ended June 30, 2009. Selling expenses were approximately 3.7% of revenue in the second quarter of 2010 compared to 4.4% a year ago.

General Administrative Expenses

Our general and administrative expenses for the three months ended June 30, 2010 was $0.89 million, an increase of $0.34 million, or 62%, compared to $0.55 million for the same period in 2009. The increase in our general and administrative expense was in part due to the increase of share-based compensation expense and amortization expenses for our drug formulas during the quarter ended June 30, 2010 compared to the same quarter a year ago.

Bad Debt Expense

Due to the peculiarity of the Chinese pharmaceutical market environment, deferred payments to pharmaceutical companies by state-owned hospitals and local medicine distributors are a normal phenomenon. Over 90% of our drugs are sold to state-owned hospitals and local medicine distributors, which creates slow collections of our trade receivables. Since most hospitals in China are backed by the government, management believes the deferred payments from hospitals are secure and will eventually be collected. Historically, we have not written-off any receivables in our 15-year history of doing business with hospitals.

As of June 30, 2010, our bad debt allowance for accounts receivable was $2.83 million compared to $2.78 million as of March 31, 2010. The increase of $37,615 in our bad debt allowance represented a corresponding increase in our bad debt expense for the quarter ending June 30, 2010.

Income from Operations

Our operating income for the three months ended June 30, 2010 was approximately $6.0 million, compared to $4.8 million for the same period in 2009, which represented an increase of $1.2 million, or 24%. The principal reason for our higher operating income in the second quarter of 2010 was the higher gross profit in the quarter. We also received a one-time incentive cash payment from the government of Hainan in the amount of $0.47 million.

Derivative Gains (Losses)

Changes to the derivative warrant liability are recognized in the results of operations and resulted in a derivative gain of $0.81 million during three months ended June 30, 2010 and a derivative loss of $0.02 million in the corresponding period a year ago. (Please see Note 8 to our consolidated financial statements contained in this report.)

Income Tax Expense

Income tax expense for the three months ended June 30, 2010 was $0.63 million, compared with $0.49 million in the same quarter a year ago. The corporate tax rate for our operating subsidiary in China was 11%, which will remain the same through the end of this year.

Net Income

Our net income for the three months ended June 30, 2010 increased by $1.82 million, or approximately 43%, to $6.1 million from $4.3 million for the three months ended June 30, 2009. Net income for the period ended June 30, 2010 included the effect of a one-time incentive cash payment from the provincial taxing authority (see "Other Income" subsection), but was partially offset by a one-time expense for share-based compensation paid to a consultant to our company.

Excluding the effect of derivative gains and losses, our net income for the three months ended June 30, 2010 was approximately $5.3 million, an increase of approximately $1.0 million, or 23%, from approximately $4.3 million for the three months ended June 30, 2009. Please see the table below for a reconciliation of these non-GAAP financial measures.

China Pharma Holdings, Inc.
Reconciliation of Non-GAAP Adjusted Net Income and Diluted EPS
(Unaudited, $ in thousand except share and per share data)

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2010		2009		2010		2009	
	Net income	EPS	Net income	EPS	Net income	EPS	Net income	EPS
Adjusted net income, excluding approximate after-tax impact of derivative gain(loss)	$5,276	$0.12	$4,286	$0.10	$9,570	$0.22	$7,964	$0.19
Add: Derivate Gain (Loss) (a)	807	0.02	(24)	0.00	1,366	0.03	(290)	(0.01)
Net income as reported (GAAP)	$6,083	$0.14	$4,262	$0.10	$10,936	$0.25	$7,674	$0.18

(a) Represents the approximate amount that net income or EPS of the corresponding periods would have decreased by if derivative reclassification had not been made.

Six Months Ended June 30, 2010 and 2009

Revenue

For the six months ended June 30, 2010, our revenues increased by $5.1 million, or 19%, to $31.7 million from the $26.6 million we generated in the corresponding period of 2009.

Set forth below are our revenues in millions of USD for each of the six months ended June 30, 2009 and 2010 by product category.

Product Category	Six Months Ended June 30		Net Change	% Change
	2010	2009		
CNS Cerebral & Cardio Vascular	$ 10.2	$ 10.4	-$ 0.2	-2%
Anti-Viro/ Infection & Respiratory	$ 11.6	$ 9.3	$ 2.4	26%
Digestive Diseases	$ 4.0	$ 1.4	$ 2.6	179%
Other	$ 5.9	$ 5.5	$ 0.4	8%

On a year over year basis, we continued to experience healthy revenue growth during the first half of 2010. We saw strong performance from the “Digestive Disease” category as sales of both Tiopronin and Omeprazole, the two products we launched in the second and fourth quarters of 2009, began to rise. The sales increase in our “Other” category came from higher sales of Vitamin B6, one of the two products that we produce that is on the National EDL (Essential Drug List), starting in the second quarter of 2010. Sales of products in our anti-infection category grew 26% for the six months ending June 30, 2010, while sales of our CNS Cerebral and Cardio Vascular category declined slightly compared to 2009.

Cost of Revenue

For the six months ended June 30, 2010, Cost of revenue was $18.6 million, or 58% of total revenue, compared to $14.7 million, or 55% of total revenue during the comparable period of 2009. The increase in cost revenues during the 2010 period was primarily due to higher revenue for the 2010 period.

Gross Profit

Gross profit for the six months ended June 30, 2010 was $13.2 million, which was approximately 11% higher compared to the $11.8 million for the first half of 2009. Gross profit margin for the first half of 2010 was 41.5%, compared to 44.6% in the first half of 2009. The lower gross profit margin in the first half of 2010 was mainly due to a higher volume of lower-margin products sold compared to the same period a year ago.

Selling Expenses

Our selling expenses for the six months ended June 30, 2010 were approximately $1.20 million, as compared to $1.21 million for the six months ended June 30, 2009. Selling expenses were approximately 3.8% of revenue in the first half of 2010 compared to 4.5% a year ago primarily due to the increased revenues during the 2010 period.

General Administrative Expenses

Our general and administrative expenses for the six months ended June 30, 2010 was $1.55 million, an increase of $0.51 million, or 49%, compared to $1.04 million for the same period in 2009. The increased in our general and administrative expense was in part due to the increase of share-based compensation expense and amortization expenses for our drug formulas during the first half of 2010 compared to the same period a year ago.

Bad Debt Expense

Our bad debt expense for the six months ended June 30, 2010 was $0.11 million, compared to 0.73 million in the first half of 2009.

During 2009, we reviewed and changed our bad debt allowance estimate to align our estimates to be more in line with our experience and industry collection standards.

The lower bad debt expense for the first half of 2010 reflects the change in our bad debt allowance estimate and also improved receivable collection for our company.

Income from Operations

Our operating income for the six months ended June 30, 2010 was approximately $10.8 million, compared to $8.9 million for the same period in 2009, an increase of $1.9 million, or 22%. The principal reason for our higher operating income in the first half of 2010 was our increased sales revenue in the 2010 period. We also received a one-time incentive cash payment from the government of Hainan in the amount of $0.47 million.

Derivative Gains (Losses)

Changes to the derivative warrant liability are recognized in the results of operations and resulted in a derivative gain of $1.37 million during six months ended June 30, 2010 and a derivative loss of $0.29 million in the corresponding period a year ago. (Please see Note 8 to our consolidated financial statements contained in this report.)

Income Tax Expense

Income Tax expense for the six months ended June 30, 2010 is $1.12 million, compared to $0.84 million in the same period a year ago.

Net Income

Our net income for the six months ended June 30, 2010 was approximately $10.9 million, an increase of $3.3 million, or approximately 43%, from approximately $7.7 million for the six months ended June 30, 2009.

Excluding the effect of derivative gains and losses, our net income for the six months ended June 30, 2010 was approximately $9.6 million, an increase of $1.8 million, or 20%, from approximately $8.0 million for the six months ended June 30, 2009. Please see the table entitled "Reconciliation of Non-GAAP Adjusted Net Income and Basic and Diluted EPS" contained in the previous Net Income section (for the three month periods ended June 30, 2010 and 2009) for a reconciliation of these non-GAAP measures.

Liquidity and Capital Resources

Our principal sources of liquidity are cash generated from operations and short-term bank loans. As of June 30, 2010, cash and cash equivalents outstanding was $4.53 million, an increase of $0.90 million from $3.63 million as of December 31, 2009. As of June 30, 2010, we had a balance of $3.8 million in short-term bank loans.

During the first half of 2010, we continued our vigorous collection efforts from our customers and achieved good results. While we have made progress, improving accounts receivable collection continues to be a focus of the management team and we expect to make further progress in the quarters to come.

Based on our current operating plan, management believes that our cash provided by operations plus the proceeds from our existing bank loans will be sufficient to meet our working capital needs and our anticipated capital expenditures, including expenditures for new formula acquisitions, for the next 12 months. However, if events or circumstances occur and we do not meet our operating plan as expected, we may be required to seek additional capital and/or reduce certain discretionary spending, which could have a material adverse effect on our ability to achieve our business objectives. Notwithstanding the foregoing, we may seek additional financing for expansion purposes, which may include debt and/or equity financing. There can be no assurance that any additional financing will be available on acceptable terms, if at all. Any equity financing may result in dilution to existing stockholders and any debt financing may include restrictive covenants.

	Six Months Ended June 30	
	2010	2009
Net Cash Provided by Operating Activities	$3,281,479	$3,061,853
Net Cash Used in Investing Activities	(4,979,916)	(6,355,422)
Net Cash Provided by Financing Activities	2,583,000	-
Effect of Exchange Rate change on Cash	8,799	9,221
Cash & Equivalent Beginning Balance	3,634,753	6,927,149
Cash & Equivalent Ending Balance	$4,528,115	$3,642,801

Operating Activities:

Net cash provided by operating activities was $3.28 million in the six-month period ended June 30, 2010 compared to $3.06 million in the same period in 2009. We have improved our receivable collection performance compared to a year ago. Cash used by trade receivables was $3.4 million in the first half of 2010 compared to $6.8 million in the corresponding period a year ago, even as sales revenue grew by 19%. Cash usage on inventory increased in the six months ended June 30, 2010 because of an increase in finished goods inventory. This increase was due to an anticipated production line interruption during July of 2010 because of equipment maintenance. As of the end of July, the maintenance operation has been completed and management expects the inventory level to revert to normal levels in coming months.

Investing Activities:

Net cash used in investing activities in the six months ended June 30, 2010 was $5.0 million. The majority of the cash was used for our investments in new drug formulas during the period. This was a decrease of $1.4 million compared to the same period in 2009 of $6.4 million.

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Financing Activities:

During the first half of 2010, we issued approximately 1.1 million shares of common stock for total proceeds of $2.58 million from the exercise of warrants that were issued in our 2007 offering of equity units. During the comparable six-month period a year ago, we had no cash flow from financing activities.

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements during the six months ended June 30, 2010.

Commitments

At June 30, 2010, we had no material commitments except for those expenditures incurred in the ordinary course of business.

Critical Accounting Policies and Estimates

Please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our Annual Report on Form 10-K for the year ended December 31, 2009, for disclosures regarding our critical accounting policies and estimates. The interim financial statements follow the same accounting policies and methods of computations as those for the year ended December 31, 2009. There were no new accounting policies and estimates during the period ended June 30, 2010 that affected our company.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

As a "smaller reporting company" as defined by Item 10 of Regulation S-K, we are not required to provide information required by this item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2010. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act are accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as described above. Based on this evaluation, in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2010 as originally filed with the SEC on August 9, 2010, our management, including our chief executive officer and chief financial officer, concluded that, as of June 30, 2010, our disclosure controls and procedures were effective at a reasonable assurance level.

However, for the reasons stated in Note 1 to our consolidated financial statements included in this report, we determined that a restatement was required for our financial statements for the year ended December 31, 2009 and our financial statements for the three and six months ended June 30, 2010 and 2009 contained in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2010. As a result of the foregoing, management determined that a material weakness existed with respect to our reporting of complex, non-routine transactions. This weakness was a result of our failure to apply new guidance in ASC Topic 815-40, Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock with respect to certain warrants issued in 2008. The proper application of this guidance caused the warrants to be a classified as a derivative liability, which required the restatement of our financial statements as of and for year ended December 31, 2009 and the three and six months ended June 30, 2010 and 2009.

As result of the material weakness identified with respect to our reporting of complex, non-routine transactions, our chief executive officer and chief financial officer have reevaluated our disclosure controls and procedures and, on March 11, 2011, concluded that our disclosure controls and procedures were not effective as of June 30, 2010. As of the date of this report, we are undertaking steps to augment the technical resources available to us.

A system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the system will meet its objectives. The design of a control system is based, in part, upon the benefits of the control system relative to its costs. Control systems can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. In addition, the design of any control system is based in part upon assumptions about the likelihood of future events.

Changes in Internal Control Over Financial Reporting

In our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, our chief executive officer and chief financial officer concluded that under the framework set forth in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, our internal control over financial reporting was effective. However, due to the restatement of our financial statements for the year ended December 31, 2009 and for three and six months ended June 30, 2010 and 2009 as described above, our chief executive officer and chief financial officer reassessed that conclusion and determined that there existed a material weakness in our internal controls over financial reporting as of December 31, 2009 and 2010. Management has determined that the design and operation of internal control over financial reporting for complex and non-recurring financing transactions that we had in place during 2009 and 2010 were not effective to allow our management, employees and consultants, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely and reasonable basis. That material weakness was the lack of the needed level of technical resources available to us to evaluate the proper accounting for non-routine complex financial instruments and other highly complex accounting issues.

Because we were not aware of this material weakness during the quarter ended June 30, 2010, there was no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. As of the date of this report, we are undertaking steps to augment the technical resources available to us.

PART II OTHER INFORMATION

Item 6. Exhibits

The exhibits required by this item are set forth in the Exhibit Index attached hereto.

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 PHARMA HOLDINGS, INC.

Date: March 15, 2011

By: /s/ Zhilin Li
Name: Zhilin Li
Title: President and Chief Executive Officer
(principal executive officer)

Date: March 15, 2011

By: /s/ Frank Waung
Name: Frank Waung
Title: Chief Financial Officer
(principal financial officer and principal accounting officer)

EXHIBIT INDEX

No. Description

3.1* – Amended and Restated Certificate of Incorporation

10.1* – Employment Agreement by and between the Company and Frank Waung, Chief Financial Officer dated as of April 28, 2010

10.2* – Option Grant Agreement by and between the Company and Frank Waung, Chief Financial Officer dated as of April 28, 2010

31.1 – Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 – Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 – Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 – Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Incorporated by reference to the Company's Quarterly Report on Form 10-Q for quarter ended June 30, 2010, filed with the SEC on August 9, 2010.