

AMERICAN ORIENTAL BIOENGINEERING, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
As Of September 30, 2008
(UNAUDITED)

NOTE 7 – INVENTORIES

	<u>September 30,</u> <u>2008</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2007</u>
Raw materials	\$ 8,411,496	\$ 7,509,497
Work-in-progress	3,880,041	2,685,053
Finished goods	5,120,606	2,307,413
	<u>17,412,143</u>	<u>12,501,963</u>
Less: provision for slow moving inventories	(161,138)	(237,427)
Inventories, net	<u>\$ 17,251,005</u>	<u>\$ 12,264,536</u>

NOTE 8 – LAND USE RIGHTS

According to the law of the PRC, the government owns all the land in the PRC. Companies are authorized to possess and use land through land use rights granted by the Chinese government. Land use rights are being amortized using the straight-line method over the lease term of 40 to 50 years. Land use rights consist of the following as of September 30, 2008 and December 31, 2007:

	<u>September 30,</u> <u>2008</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2007</u>
Cost of land use rights	\$ 66,715,285	\$ 48,177,647
Less: Accumulated amortization	(2,831,978)	(1,867,407)
Land use rights, net	<u>\$ 63,883,307</u>	<u>\$ 46,310,240</u>

Amortization expense for the three months ended September 30, 2008 and 2007 was \$279,504 and \$201,888, respectively. Amortization expense for the nine months ended September 30, 2008 and 2007 was \$823,270 and \$573,097, respectively. During the nine months ended at September 30, 2008, \$15,311,785 had been transferred from deposits for long term assets, relating to Beijing Yizhuang Project. The land certificate of Beijing Yizhuang facilities which amount to \$15,311,785 was in the process of issuance as of September 30, 2008. As of September 30, 2008, the net book value of land use rights pledged as collateral was \$26,272,455. See Notes 12 and 13.

NOTE 9 – OTHER INTANGIBLE ASSETS, NET

Other intangible assets include product licenses, trademarks, patents, proprietary technology and software. The cost of the product licenses are amortized over their estimated useful lives of 10 to 12 years; the cost of trademarks are amortized over their registered useful lives of 4 to 10 years; the cost of patents are amortized over their protection period of 7 to 8 years; the cost of proprietary technology are amortized over their protection period of 10 years and the cost of software are amortized over their estimated useful life of 10 years. Other intangible assets are summarized as follows:

	<u>September 30,</u> <u>2008</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2007</u>
At cost:		
Product licenses	\$ 15,483,906	\$ 14,512,205
Trademarks	10,557,274	9,894,747
Patents	4,795,549	4,494,602
Proprietary technology	281,627	263,954
Software	62,758	—
	<u>31,181,114</u>	<u>29,165,508</u>
Less: Accumulated amortization	(6,212,821)	(2,193,342)
Other intangible assets, net	<u>\$ 24,968,293</u>	<u>\$ 26,972,166</u>

Amortization expense for the three months ended September 30, 2008 and 2007 was \$1,290,173 and \$109,091, respectively. Amortization expense for the nine months ended September 30, 2008 and 2007 was \$3,797,628 and \$157,687, respectively.

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NOTE 10 – PLANT AND EQUIPMENT

Plant and equipment consist of the following:

	<u>September 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>
	<u>(Unaudited)</u>	
At cost:		
Buildings	\$ 63,363,092	\$ 41,017,380
Machinery and equipment	19,788,893	17,949,890
Motor vehicles	1,542,252	1,320,091
Office equipment	1,348,995	1,137,140
Other equipment	582,829	446,326
Leasehold improvement	115,603	108,348
	<u>86,741,664</u>	<u>61,979,175</u>
Less : Accumulated depreciation		
Buildings	(4,360,004)	(3,305,219)
Machinery and equipment	(10,383,711)	(8,774,745)
Motor vehicles	(934,894)	(694,256)
Office equipment	(707,154)	(510,926)
Other equipment	(176,056)	(118,528)
Leasehold improvement	(97,784)	(78,741)
	<u>(16,659,603)</u>	<u>(13,482,415)</u>
Plant and equipment, net	<u>\$ 70,082,061</u>	<u>\$ 48,496,760</u>

Depreciation expense for the three months ended September 30, 2008 and 2007 was \$823,996 and \$598,682, respectively. Depreciation expense for the nine months ended September 30, 2008 and 2007 was \$2,414,154 and \$1,695,820, respectively. As of September 30, 2008, the net book value of plant and equipment pledged as collateral for a bank loan was \$13,416,656. During the nine months ended at September 30, 2008, \$19,648,215 had been transferred from deposits for long term assets relating to Beijing Yizhuang Project. The property certificate of Beijing Yizhuang facilities which amount to \$19,648,215 was in the process of issuance as of September 30, 2008. See notes 12 and 13.