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Further Irregularities on view in CSKI’s Reported 2nd Quarter Earnings.

China Sky One Medical, Inc. (NASDAQ: CSKI) released second quarter earnings on August 14th, along with its Form 10-Q. The report highlights the issues that should be of concern to its investors.

CSKI’s gross margins appear inexplicably high when compared to companies in the same industry in China. This, along with China Sky’s corporate governance and inventory and other accounting issues, should pose serious concerns for its shareholders.

CSKI reported gross margin of 75.8% for the second quarter, compared to 76.8% in the same period of 2008. Yet in its earnings release CSKI admitted that it is experiencing adverse affects from “market competition and higher raw material costs” and it still gave guidance for full year 2009 gross margin to be approximately 75%.

American Oriental Bioengineering, Inc. (NYSE: AOB) is in the same industry as CSKI: traditional Chinese medicine. For the second quarter, AOB reported gross margin of 58%, compared to 68% in the second quarter of the prior year. AOB has been a subject of asensio.com reports, focused on AOB’s disclosures to investors concerning $105 million in real estate transactions (<a href="http://asensio.com/Reports/CompleteRecordCompany.aspx?CompanyId=167&CompanyName=American+Oriental+ here to view AOB reports). Though AOB has its own issues, AOB is reporting gross margins that seem more realistic than those of CSKI.

A report previously issued by asensio.com described the irregularity surrounding CSKI's gross margin and contract sales claims. <a href="http://asensio.com/Reports/ReportView.aspx?ReportId=937&CompanyId=165&CompanyName=China+Sky+One+M here and <a href="http://asensio.com/Reports/ReportView.aspx?ReportId=951&CompanyId=165&CompanyName=China+Sky+One+M to read the report.

CSKI reported $3.6 million in research and development expense, a 176% increase from the second quarter of 2008. CSKI offered no direct explanation for the increased expenditure in its 10-Q. The summary of R&D activities included a list previously disclosed items such as the development of a “gene drug” and “the development of a biology protein chip,” among other items that appear strange for a business with operations centered on herbal, over-the-counter medicines.

A report previously issued by asensio.com raised the issue of irregularity in China Sky’s average sales prices (<a href="http://asensio.com/Reports/ReportView.aspx?ReportId=951&CompanyId=165&CompanyName=China+Sky+One+M here to view report). CSKI has since changed the way it reports revenue by product line, so that average sales prices cannot be inferred from CSKI’s disclosures. Moreover, because of the change in reporting, investors cannot verify CSKI’s comparison of product sales to the same quarter last year, particularly with the claim in CSKI’s earnings release that “patch products” accounted for 30.9% of revenue.

CSKI’s net property, plant and equipment rose from $21.1 million at December 31st to $30.6 million at June 30th. Investors should have some concern over asset inflation, considering CSKI’s sparse disclosures on how it is spending money on assets, and the importance for the amount spent relative to total assets.