



American Oriental Bioengineering (AMEX: AOB)

Institutional Research Report

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Rating: BUY/4
Price Target (12/06): \$6.00

Symbol (AMEX):	AOB
Close Price: (05/24/06)	\$5.18
AOB Avg. Daily Vol. (3-Mo.):	1,055,090
Industry	Pharmaceuticals
Price Target (12/06):	\$6.00
Market Capitalization: USD	\$317.5 Mn
Shares O/S: 03/31/06	61.3 Mn
Cash & Equiv: 03/31/06	\$80.9 Mn
Net Working Capital: 03/31/06	\$96.9 Mn

ANALYST 1QFY06 REVIEW & RATIONALE

We reiterate our BUY/4 rating and 12/31/06 \$6.00 Price Target on American Oriental Bioengineering (AMEX: AOB). We will not revisit our price target until there is greater visibility of the GLP transaction on AOB's business.

AOB's first quarter March 31, 2006 (Q1FY06) comparable revenue growth of almost 100% year-over-year was purely organic, while the comparative Q1FY05 included the HSPL acquisition. We also note that the 3.5% sequential Q1FY06 decline relative to the previous Q4FY05 quarter was emblematic of the seasonal business, characterized by calendar year-end strength in the fourth quarter. On a sequential basis, PBP revenue increased by 0.4% while PBN revenue decreased by 9.6%.

Turning to profit metrics, operating margins expand to 33.4%, an improvement of over 2.0% versus Q1FY05, helped by a 3.48% increase in gross margins to 65.9% in Q1FY06. Meanwhile, Q1FY06 earnings per share increased 60% \$0.08 to compared to the previous quarter last year ending March 31, 2005 of \$0.05 in the throws of a year-over-year 43.6% dilution increase.

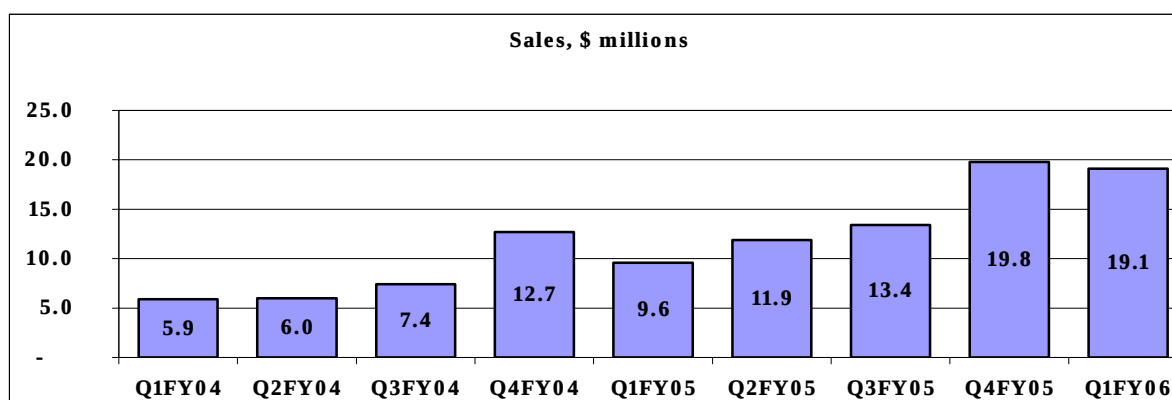
In 1QFY06, the Company completed the second round of the \$60 million private placement tranche for \$25 million. \$20 million in cash is to be directed for the GLP acquisition and AOB had \$80.9 million in the coffer at quarter-end. Given AOB's core competency of integrating manufacturing and marketing platforms of target acquisitions, we would anticipate further cash outlays for transactions. Indeed, AOB has a universe of 97 candidates for acquisitions of which AOB is still undertaking due diligence with seven (7) target companies.

AOB has a unique ability to identify, access and complete the due diligence on these deals and possesses the necessary expertise to leverage these opportunities with savvy operational business integration. Specifically related to GLP, the Company is positioned to capitalize on their under-utilized product portfolio. According to Mr. Liu, AOB CEO, “we believe we can significantly grow GLP revenues by improving the execution of sales and marketing programs.” We must be mindful that the HSPL transaction was a \$3M revenue transaction with 39% gross margin before the acquisition and now yields over \$16M with 61% gross margin. Applying this model to GLP, we are keenly aware that AOB quadrupled sales of HSPL in 1.5 years with a 50% absolute increase in gross margins, and given GLP is considered underutilized at \$10M revenue and positive net income, we believe the prospects remain equally promising. Further, inasmuch GLP has solid infrastructure with a 100,000 distribution network, 70 products and the ‘Good Manufacturing Practices’ certification at the production facilities, we think there is immense potential in the Jinji Series of drugs. Indeed, with AOB existing expansive distribution network and the complementary AOB Cease Enuresis product line, we anticipate material sales traction in a sharply augmented women’s health sub-category, specifically targeting bedwetting and nighttime urination (primarily pregnant and post-pregnant women).

FINANCIAL OVERVIEW

Income statement

Though AOB is following an active acquisition-driven growth strategy, Q1FY06 did not include any new acquisitions. For the first quarter, the Company reported revenues of \$19.1 million, an increase of 97.7 percent compared to the \$9.7 million reported in the first quarter last year and down 3.5 percent compared to the \$19.8 million reported in the fourth quarter of 2005. However, the Company's 3.5 percent sequential revenue decline in the first quarter of 2006 compares favorably to the 23.6 percent sequential decline in the first quarter of 2005.



Source: SEC filings

The increase in revenue as compared to the first quarter of last year is attributable to growth in both the Company's Plant-based Pharmaceutical (PBP) and Plant-based Nutraceutical (PBN) products. During the first quarter of 2006, sales of PBP products increased approximately \$6.2 million, or 102.8 percent compared to the same period in 2005. PBP revenues were driven by a 137.9 percent increase in Cease Enuresis Soft Gel and Patch sales and a 101.6 percent increase in Shuanghuanlian Injection Powder sales. PBP revenue growth was also driven by continued

strength in Double Ginseng Grain product sales, which increased 57.6 percent from the same period of last year. During the first quarter of 2006, PBN sales increased by \$3.3 million or 89.4 percent compared to the same period last year as the Company continued to improve its marketing efforts geared towards educating consumers about the benefits of soy-based peptide products. PBN revenues were driven by a 122.9 percent increase in Soy Peptide Tablets and a 116.2 percent increase in Vitamate Oral Liquid sales.

Key Financial Indicators (All numbers in thousands, except per-share amounts in USD)			
	<u>Q1 2006</u>	<u>Q1 2005</u>	<u>Percentage Change</u>
Revenues	\$ 19,087	\$ 9,653	97.7%
Cost of goods sold	\$ 6,509	\$ 3,628	79.4%
Gross Profit	\$ 12,577	\$ 6,025	108.8%
Total Operating Expenses	\$ 6,194	\$ 3,000	106.5%
Income from operations	\$ 6,383	\$ 3,025	111.0%
Net Income	\$ 4,917	\$ 2,183	125.2%
EPS -- Fully Diluted	\$ 0.08	\$ 0.05	60.0%
Diluted Shares	61.3M	42.7M	43.6%

Balance Sheet

The Company completed the quarter with \$80.9 million in cash and cash equivalents. Cash and cash equivalents increased from \$57.5 million during the fourth quarter of 2005 primarily as a result of \$3.9 million in positive cash flow from operations and the receipt on January 23, 2006, of the second tranche of net cash proceeds of \$25.0 million in connection with the \$60.0 million private placement effected in December 2005. Short-term debt totaled \$3.7 million and was down \$1.4 million versus the year-ago period and unchanged from the fourth quarter of last year. Inventory increased 4.5 percent and 64.5 percent from the first quarter of 2005 and fourth quarter of 2005 respectively to \$8.1 million. The increase in inventory was below that of overall sales growth for the first quarter with the increase necessary to support the Company's future growth. The Company continues to have excellent quality receivables with overall Days Sales Outstanding (DSO) unchanged from last year at 45 days. As of March 31, 2006, the Company had a current ratio of 11.24 to 1 as compared to a current ratio of 2.68 to 1 on March 31, 2005.

<u>\$'000s</u>	<u>12/31/05</u>	<u>03/31/06</u>
Cash & Equiv.	57,532	80,915
Inventories	4,916	8,086
Net Working Capital	66,813	96,897
Plant and Equipment, net	13,386	13,860
Total Assets	99,422	130,540
Debt	3,717	3,742
Shareholders' Equity	90,604	120,800

Source: SEC filings

Analyst's Statement: "I have prepared this report, and the content within it, including all opinions, are solely my own."

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