DRAGON PHARMACEUTICALS INC
Form 10QSB
August 11, 2004

U.S. Securities and Exchange
Commission Washington, D.C. 20549

Form 10-QSB

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

For the quarterly period ended June 30, 2004

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-27937

DRAGON PHARMACEUTICAL INC.
(Exact name of small business issuer as specified in its charter)

Florida	65-0142474
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1055 West Hastings Street, Suite 1900
Vancouver, British Columbia
Canada V6E 2E9
(Address of principal executive offices)

(604) 669-8817
(Issuer's telephone number)

(Former address if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 [ ]

Number of shares of common stock outstanding as of June 30, 2004: 20,582,000

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

DRAGON PHARMACEUTICAL INC.
& SUBSIDIARIES

Consolidated Financial Statements
(Unaudited - Prepared by Management)
(Expressed in U.S. Dollars)

June 30, 2004

Index

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Consolidated Balance Sheets
June 30, 2004 and December 31, 2003
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

	June 30, 2004	December 31, 2003
ASSETS		
Current		
Cash and short term securities	$ 2,608,594	$ 3,126,667
Accounts receivable	1,407,671	1,265,676
Inventories	1,130,847	1,090,464
Due from director	500,100	-
Prepaid and deposits	92,670	139,595
Total current assets	5,739,882	5,622,402
Fixed assets	1,912,249	2,089,352
Due from related party - Hepatitis B vaccine project	-	100
Patent rights - related party	-	500,000
Licence and permit and other assets	1,240,678	2,924,198
Total assets	$ 8,892,809	$ 11,136,052
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Current		
Accounts payable and accrued liabilities	1,325,780	1,428,257

Commitments (Note 12)		
Stockholders' Equity		
Share capital Authorized: 50,000,000 common shares at par value of $0.001 each Issued and outstanding: 20,582,000 common shares	20,58	20,462
Additional paid in capital	25,206,250	26,708,870
Accumulated other comprehensive (loss)	(32,845)	(32,007)
Accumulated deficit	(17,626,958)	(16,989,530)
Total stockholders' equity	7,567,029	9,707,795
Total liabilities and stockholders' equity	$ 8,892,809	$ 11,136,052

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

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
(Expressed in U.S. Dollars)

	Common stock		Additional paid-in	Compre-hensive income	
	Shares	Amount	capital	(loss)	a
Balance, December 31, 2002	20,334,000	$ 20,334	$ 26,644,998	-	$(1
Exercise of stock options for cash	128,000	128	63,872	-	
Components of comprehensive income (loss) - foreign currency translation	-	-	-	3,004	
- net (loss) for the year	-	-	-	(1,994,735)	(
Comprehensive (loss)				$(1,991,731)	
Balance, December 31, 2003	20,462,000	$ 20,462	$ 26,708,870		$(

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

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Consolidated Statements of Stockholders' Equity

(Expressed in U.S. Dollars)

	Common stock		Additional paid-in capital	Compre-hensive income (loss)	a
	Shares	Amount			
Balance, December 31, 2003	20,462,000	$20,462	$ 6,708,870	-	$(1
Exercise of stock options for cash	120,000	120	59,880		
Cancellation of 250,000 common shares allotted for in 2000	-	-	(1,562,500)		
Components of comprehensive income (loss) - foreign currency translation	-	-	-	(838)	
- net (loss) for the period	-	-	-	(637,428)	
Comprehensive (loss)				$ (638,266)	
Balance, June 30, 2004	20,582,000	$20,582	$25,206,250		$(1

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

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Consolidated Statement of Operations
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003
Sales	$908,145	$1,007,686
Cost of sales	194,755	326,988
Gross profit	713,390	680,698
Selling, general and administrative expenses	(784,051)	(723,743)

Depreciation of fixed assets and amortization of licence and permit and land-use right	(179,412)	(183,896)
Net write off of land-use right and fixed assets	-	-
Research and development expenses	(151,472)	-
New market development	(12,404)	(8,234)
Provision for doubtful debts	6,257	(10,701)
Interest expense	(747)	(929)
Stock-based compensation	-	-
Operating loss	(408,439)	(246,805)
Interest income	20,435	10,381
Net (loss) for the period	$(388,004)	$(236,424)
(Loss) per share Basic and diluted	$ (0.02)	$ (0.01)
Weighted average number of common shares outstanding Basic and diluted	20,560,022	20,334,000

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

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Consolidated Statements of Cash Flows
Six Months Ended June 30, 2004 and 2003
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

Cash flows from (used in) operating activities	
Net (loss) for the period	$ (637,
Adjustments to reconcile net loss to net cash used in operating activities:	
- depreciation of property and equipment and amortization of licence and permit	473
- provision for doubtful debts	20
Changes in non-cash working capital items:	
- accounts receivable	(162,
- inventories	(40,

- prepaid expenses and deposits	46
- accounts payable and accrued liabilities	(102,
	(401,
Cash flows used in investing activities	
Purchase of property and equipment	(20,
(Increase) in other assets	(155,
(Increase) decrease in restricted funds	
	(175,
Cash flows from financing activities	
Issuance of common shares	60
Loan proceeds	
	60
Foreign exchange (gain) loss on cash held in foreign currency	(
Decrease in cash and cash equivalents	(518,
Cash and cash equivalents, beginning of period	3,126
Cash and cash equivalents, end of period	$ 2,608

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

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

1. Basis of Presentation

The accompanying unaudited interim consolidated balance sheets, statements of operations and cash flows reflected all adjustments, consisting of normal recurring adjustments and other adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of the Company, at June 30, 2004, and the results of operations and cash flows for the interim periods ended June 30, 2004 and 2003.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instruction for Form 10-QSB pursuant to the rules and regulations of Securities and Exchange Commission and, therefore, do not include all information and notes normally provided in audited financial statements and should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2003 included in the annual report previously filed on Form 10-KSB.

(Expressed in U.S. Dollars)

The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

2. Proposed Business Combination

The Company has entered into a definitive Share Purchase Agreement with Oriental Wave Holding Ltd. ("Oriental") whereby the Company would issue its common shares in exchange for all the issued and outstanding shares of Oriental. The transaction is subject to approval by the Company's shareholders and the regulatory authorities.

If the acquisition is consummated, the former shareholders of Oriental will own 68.35% of the issued and outstanding shares of the combined Company resulting in accounting principles applicable to reverse acquisition being applied to record the transaction. Under this basis of accounting, Oriental would be the acquirer and, accordingly, the consolidated entity would be considered to be a continuation of Oriental with the net assets of the Company deemed to have been acquired and recorded at fair market value.

3. Accounts Receivable

	June 30, 2004	December 31, 2003
Trade receivables	$ 1,683,549	$ 1,524,465
Allowance for doubtful accounts	(326,967)	(298,284)
	1,356,582	1,226,181
Other receivables	51,088	39,495
	$ 1,407,670	$ 1,265,676

4. Inventories

	June 30, 2004	December 31, 2003
Raw materials	$ 112,109	$ 129,650
Finished goods	106,160	107,833
Work in progress	912,578	852,981
	$1,130,847	$ 1,090,464

(Expressed in U.S. Dollars)

5. Due from director

The Company entered into an agreement with Dr. Longbin Liu, a director of the Company, to settle the amount owing to the Company from his acquisition of the Hepatitis B Project (note 7) as well as to cancel the Patent (note 8) and Project Development (note 12) agreements between the parties. Under the terms of the settlement agreement, the G-CSF, Insulin and Hepatitis B Projects, including the rights of ownership and development obligations would revert to Dr. Liu.

In exchange, Dr Liu will pay to the Company the $3,710,000 in principal and interest owing under the Hepatitis B Project as well as reimburse the Company $1,330,000 that had been paid previously under the Patent and Project Development agreements. All amounts are due December 31, 2004 and Dr. Liu has agreed to provide 2,600,000 common shares of the Company, to be held in escrow, as security for the amounts owing, of which 2,200,000 common shares have been placed in escrow as of June 30, 2004. The warrants granted to Dr. Liu under the Patent Development agreement have been cancelled.

The carrying value of the amount due from Dr. Liu is equivalent to the previous carrying value of the Patent Rights and the Hepatitis B Project amount owing.

6. Property and equipment

	June 30, 2004	
	Cost	Accumulated depreciation
Motor vehicles	$ 126,444	$ 77,731
Office equipment and furniture	412,688	256,629
Leasehold improvements	1,088,528	479,646
Production and lab equipment	1,630,604	794,094
Idle equipment	555,339	293,254
	$3,813,603	$1,901,354

6. Property and equipment (continued)

	December 31, 2003

	Cost	Accumulated depreciation
Motor vehicles	$140,423	$ 75,996
Office equipment and furniture	414,759	221,076
Leasehold improvements	1,089,006	418,888
Production and lab equipment	1,595,450	708,841
Idle equipment	555,339	280,824
	$ 3,794,977	$ 1,705,625

For the six-months ended June 30, 2004, depreciation expenses totalled $197,589 (2003 - $201,374). The majority of fixed assets are located in China.

7. Due from Related Party - Hepatitis B Vaccine Project

	June 30, 2004	December 31, 2003
Hepatitis B Vaccine Project	$ -	$4,000,000
Less : Repayment	-	(500,000)
Valuation allowance	-	(3,499,900)
	$ -	$ 100

(a) Pursuant to an agreement dated October 6, 2000, the Company paid $4,000,000 for the acquisition of certain assets and technology relating to the production of Hepatitis B vaccine. The vendor of the transaction was a company named Alphatech Bioengineering Limited, incorporated in Hong Kong, with two shareholders who are both directors of the Company.

(b) Pursuant to an amended agreement dated June 5, 2001, in the event that the Company failed to find a joint venture partner, establish a production facility for the vaccine project or sell the project to a third party within nine months from the date of the amended agreement, Dr. Longbin Liu, a director of the Company (and President and CEO of the Company at the time of the transaction) and one of the shareholders of Alphatech, demanded to repurchase the project from the Company. The repurchase price of $4.0 million is payable as follows:

(i) $500,000 at the date of repurchase; and

(ii) the balance to be paid within eighteen (18) months of the date of repurchase with interest at 6% per annum. The interest will be accrued from six months after the date of repurchase.

Notes to Consolidated Financial Statements
June 30, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

7. Due from Related Party - Hepatitis B Vaccine Project (continued)

The Company decided not to pursue the project and Dr. Liu has repurchased the project on the agreed terms.

The amount owing by Dr. Liu to the Company was unsecured. The Company has chosen, given the significant amount involved and the lack of security, to conservatively value the amount owing and has set up a provision for the full amount, less a nominal amount of $100. The Company has reached settlement with Dr. Liu on this amount owing and other projects (note 5).

8. Patent Rights - Related Party

Pursuant to an agreement dated January 14, 2002, the Company entered into a Patent Development Agreement with the Dr. Longbin Liu, a director of the Company (and President and CEO of the Company at the time of the transaction) and a company controlled by the Dr. Liu entitling the Company to acquire one patent filed in the United States related to the discovery of a new gene or protein. Consideration for the right to acquire the patent was payment of $500,000 (paid) and the issuance of warrants to acquire 1,000,000 common shares of the Company at a price of $2.50 per share for a period of five years. The patent may be acquired prior to January 14, 2005 at no additional cost other than the reasonable legal costs of obtaining the patent.

The issuance and exercise of the warrants to acquire 1,000,000 common stock of the Company is contingent upon the success of the patent applications. The $500,000 will be refunded to the Company if no patent applications have been filed by January 14, 2005. The Company has reached settlement with Dr. Liu on this and other projects (note 5) and the warrants have been cancelled.

9. Licence and permit and other assets

	June 30, 2004	December 31, 2003
Original cost	$5,012,582	$5,012,582
Cancellation of allotted shares	(1,562,500)	-
Accumulated amortization	(2,364,404)	(2,088,384)
Licence and permit	1,085,678	2,924,198
Other assets	155,000	-
	$1,240,678	$ 2,924,198

Amortization expense for the licence and permit for the six-months ended June 30, 2004 was $275,975 (2003 - $275,956)

June 30, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

9. Licence and permit and other assets (continued)

The estimated amortization expense for each of the five succeeding fiscal years is as follows:

2004	(balance of the year)	$175,000
2005		$350,000
2006		$350,000
2007		$211,000

The above amortization expense forecast is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, changes in foreign currency exchange rates, impairment of intangible assets, accelerated amortization of licence and permit, and other events.

10. Income Taxes

(a) Kailong and Huaxin are subject to income taxes in China on its taxable income as reported in its statutory accounts at a tax rate in accordance with the relevant income tax laws.

Allwin and Biotrade are not subject to income taxes. As at June 30, 2004, $3.9 million of unremitted earnings attributable to international companies were considered to be indefinitely invested. No provision has been made for taxes that might be payable if these earnings were remitted to the United States. The Company's intention is to reinvest these earnings permanently or to repatriate the earnings when it is tax effective to do so. It is not practicable to determine the amount of incremental taxes that might arise were these earnings to be remitted.

As at June 30, 2004, the Company has estimated losses, for tax purposes, totalling approximately $10,100,000, which may be applied against future taxable income. The potential tax benefits arising from these losses have not been recorded in the financial statements. The Company evaluates its valuation allowance requirements on an annual basis based on projected future operations. When circumstances change and this causes a change in management's judgement about the realizability of deferred tax assets, the impact of the change on the valuation allowance is generally reflected in current income.

10. Income Taxes (continued)

(b) The tax effect of temporary differences that give rise to the Company's deferred tax asset (liability) are as follows:

	June 30,	December 31,

(Expressed in U.S. Dollars)

	2004	2003
	$ 3,451,000	$ 3,237,000
Tax losses carried forward		
Stock-based compensation	6,400	6,400
Provision for amount owing from Hepatitis B Vaccine Project	1,118,000	1,118,000
Less: valuation allowance	(4,575,400)	(4,361,400)
	$ -	$ -

A reconciliation of the federal statutory income tax to the Company's effective income tax rate, for the three months ended June 30, 2004 and 2003 are as follows:

	2004	2003
Federal statutory income tax rate	34%	34%
Benefit of loss carry forward	(34%)	(34%)
Effective income tax rate	-	-

11. Stock Options and Warrants

(a) Stock Options Plans

There were no options granted during the six months ended June 30, 2004.

The following is a summary of the employee stock option information for the period ended June 30, 2004:

	Shares	Weight Exer
Options outstanding at December 31, 2002	3,288,000	$
Granted	500,000	$
Forfeited	(1,061,000)	$
Exercised	(128,000)	$
Options outstanding at December 31, 2003	2,599,000	$
Forfeited	(482,500)	$
Exercised	(120,000)	$
Options outstanding at June 30, 2004	1,996,500	$

11. Stock Options and Warrants (continued)

Options Outstanding				Options Exercisa	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weigh Avera Exerc Pric
$0.01 - $1.00	588,500	2.39	$ 0.61	563,500	$ 0.
$1.01 - $2.00	308,000	2.82	$ 1.70	308,000	$ 1.
$2.01 - $3.00	25,000	0.361	$ 2.50	25,000	$ 2.
$3.01 - $4.00	1,075,000	1.372	$ 3.13	1,075,000	$ 3.
	1,996,500	1.88	$ 2.16	1,971,500	$ 2.

The Company accounts for its stock-based compensation plan in accordance with APB Opinion No. 25, under which no compensation is recognized in connection with options granted to employees except if options are granted with a strike price below fair value of the underlying stock. The Company adopted the disclosure requirements SFAS No. 123, Accounting for Stock-Based Compensation. Accordingly, the Company is required to calculate and present the pro forma effect of all awards granted. For disclosure purposes, the fair value of each option granted to an employee has been estimated as of the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 5.5%, dividend yield 0%, volatility of 90%, and expected lives of approximately 0 to 5 years. Based on the computed option values and the number of the options issued, had the Company recognized compensation expense, the following would have been its effect on the Company's net loss:

	June 30, 2004	June 30, 2003
Net (loss) for the period:		
- as reported	$(663,616)	$ (970,452)
- pro-forma	$(663,616)	$ (970,452)
Basic and diluted (loss) per share:		
- as reported	$(0.03)	$(0.05)
- pro-forma	$(0.03)	$(0.05)

(b) Warrants

Share purchase warrants outstanding as at June 30, 2004:

Number of Warrants	Underlying Shares	Exercise Price Per Share	Expiry Date
50,000	50,000	$1.70	November 15, 2004

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

12. Related Party Transactions

(a) The Company incurred the following expenses to a director of the Company:

	June 30, 2004	June 30, 2003
Management fees	$-	$40,000

(b) Pursuant to an agreement dated January 14, 2002, the Company entered into a Project Development Agreement with Dr. Longbin Liu ("Dr. Liu"), a director of the Company (and President and CEO of the Company at the time of the transaction) to continue the research and development of G-CSF and Insulin for the Company. The Company will make payment for the development of G-CSF as follows:

(i) 500,000 to be provided at the commencement of the research in the G-CSF Project (paid);

(ii) $500,000 to be provided when cell-line and related technology is established and animal experimentation commences in the G-CSF Project;

(iii) $300,000 to be provided when a permit for clinical trials for G-CSF has been issued by the State Drug Administration of China ("SDA");

(iv) $200,000 to be provided when a new drug license for G-CSF is issued to Dragon by the SDA; and

(v) $500,000 to be paid as a bonus if the SDA issues the new drug license for G-CSF to Dragon before January 14, 2005.

The Company will make payment for the development of Insulin as follows:

(i) $750,000 to be provided by at the commencement of the research in the Insulin Project (paid);

(ii) $750,000 to be provided when cell-line and related technology is established and animal experimentation commences in the Insulin Project (paid);

(iii) $300,000 to be provided when a permit for clinical trials for Insulin has been issued by the SDA;

(iv) $200,000 to be provided when a new drug license for Insulin is issued to Dragon by the SDA; and

(Expressed in U.S. Dollars)

(v) $500,000 to be paid as a bonus if the SDA issues the new drug license for Insulin to Dragon before January 14, 2005.

12. Related Party Transactions (continued)

For both the G-CSF and Insulin Projects:

(i) if the Company elects to cease development of the project it will forfeit any payments made and lose ownership of the Project, but it will not be obligated to make any further payments toward the Project;

(ii) if an application for permit for clinical trials is not submitted within three years with respect to the G-CSF Project or four years with respect to the Insulin Project or if the SDA rejects the Projects for technical or scientific reasons or If development of the Project is terminated by Dr. Liu, then Dr. Liu will refund to the Company all amounts paid, without interest or deduction, with respect to the Project within six months.

As at June 30, 2004, the Company has paid a total of $1,500,000 and $500,000 towards the Insulin and G-CSF Projects, respectively. The Company has paid an additional $100,000 to a company controlled by Dr. Liu to produce Insulin samples for drug registration purposes. The Company has reached settlement with Dr. Liu on this and other projects (note 5).

(c) see Notes 5, 6, and 7 also.

13. Commitments

(a)The Company has entered into operating lease agreements with respect to Huaxin's production plant in Nanjing, China for an amount of $326,200 (RMB 2,700,000) per annum until June 11, 2009, and the Company's administrative offices in Vancouver for an amount escalating from $136,000 to $157,000 (CDN$200,000 to CDN$230,000) per annum until March 31, 2007. Minimum payments required under the agreements are as follows:

2004	$ 246,782
2005	494,835
2006	498,684
2007	369,646
2008	326,205
2009	144,738
Total	$ 2,080,889

(b) The Company has contracted with a European Institute of Biotechnology, which may develop a high yield proprietary cell line and production process technology for the Company. Product from this most advanced technology will be used by the Company to enter the European market, once certain competitor's patents expire. The total cost of development will be $609,000

(EUROS 500,000) of which $365,000 (EUROS 300,000) remains unpaid at June 30, 2004.

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

14. Segmented Information

The Company operates exclusively in the biotech sector. The Company's assets and revenues are distributed as follows:

	June 30, 2004	December 31,2003
ASSETS		
North America	$ 2,932,489	$3,156,953
China	5,434,407	7,079,241
Other	525,913	899,858
Total	$ 8,892,809	$11,136,052

	Six months ended June 30, 2004	Six months ended June 30, 2003
REVENUE		
North America	$ -	$ -
China	1,359,515	1,031,242
Other	429,490	640,767
Total	$1,786,415	$ 1,672,009

15. Comparative Figures

Certain 2003 comparative figures have been reclassified to conform to the financial statement presentation adopted for 2004.

Item 2. Management's Discussion and Analysis and Plan of Operations

The following discusses the Company's financial condition and results of operations based upon the Company's consolidated financial statements which have been prepared in accordance with generally accepted accounting principles. It should be read in conjunction with the Company's financial statements and the notes thereto and other financial information included in the Company's Form 10-KSB for the fiscal year ended December 31, 2003.

Overview

The Company (or "Dragon") was formed on August 22, 1989, under the name First Geneva Investment Inc. First Geneva Investment's business was to evaluate businesses for possible acquisition. On July 28, 1998, First Geneva Investment entered into a share exchange agreement with Allwin Newtech. Allwin Newtech was formed in 1998 for the purpose of developing and marketing pharmaceutical drugs

for sale in China. Prior to the acquisition of Allwin Newtech, First Geneva Investment had no operations. On September 21, 1998, First Geneva Investment changed its name to Dragon Pharmaceutical Inc.

On July 27, 1999, Dragon acquired a 75% interest in Nanjing Huaxin Bio-pharmaceutical Co. Ltd. ("Huaxin"), which manufactures EPO in China. The Company increased the efficiencies in the production of EPO and successfully achieved commercial production during the last quarter of calendar 1999. In January 2002 the Company purchased the balance of Huaxin for $1,400,000.

On September 6, 2000, Dragon incorporated Allwin Biotrade Inc. ("Biotrade"). Biotrade was incorporated for the purpose of marketing and distributing biopharmaceutical products outside China. On September 15, 2000, Dragon incorporated Dragon Pharmaceutical (Canada) Inc. ("Dragon Canada"). Dragon Canada was incorporated for the purpose of researching and developing new biopharmaceutical products.

The Company has contracted with a European Institute of Biotechnology that may develop a high yield proprietary cell line and production process technology for the Company. Product from this most advanced technology available today will be used by the Company to enter the European market, once certain competitor's patents expire.

Recent Events

Agreement to Acquire Oriental Wave Holding Ltd. On March 24, 2004, we announced that we entered into a letter of intent to acquire Oriental Wave Holding Ltd. in a transaction in which we will be the survivor company. On June 14, 2004 we announced that the parties had signed a definitive Share Purchase Agreement setting forth the terms of the merger. If the proposed acquisition is consummated, the resulting ownership of the combined company will be approximately 31.65% for Dragon shareholders and approximately 68.35% for Oriental Wave shareholders.

Oriental Wave Holding Ltd, incorporated in the British Virgin Islands, is a holding company of a China-based pharmaceutical company engaged in the production of chemical intermediates and active pharmaceutical ingredients and formulation, marketing and sale of generic drugs. Based on its 2003 audited financial statements, Oriental Wave Group had revenues of $26 million and earnings of $7.5 million.

Oriental Wave Group currently has two Chinese State Food and Drug administration ("SFD&A") certified GMP production facilities on stream: a pharmaceutical facility with a capacity of producing 1.6 billion tablets and capsules, 80 million injectables and 10 million suppositories per year as well as a chemical plant producing clavulanic acid by a fermentation process. A third facility for the production, by fermentation, of 7-ACA, an intermediate for Cephalosporin antibiotics started pilot production on July 1, 2004. Oriental Wave Group has a total of approximately 280 drug approvals from the SFD&A of which about 35, mainly anti-infectious drugs, were actively exploited in China in 2003.

On consumation of the acquisition, the combined company will be reorganized into three major divisions: a Pharmaceutical division for prescription and over-the-counter generic drugs; a Chemical division for bulk pharmaceutical chemicals such as Clavulanic Acid, 7-ACA and sterilized bulk drugs and a Biotech division for EPO and in-licensed G-CSF.

Completion of the proposed acquisition is subject to a number of conditions including required regulatory and shareholder approvals.

Settlement agreement with Dr. Liu. In view of the slow progress in developing new drugs, the availability of alternative drugs, the desire to avoid conflict of interest issues in the future and, in some cases, the high investment costs associated with bringing the drugs into production, the Company has reached a settlement with its research partners to discontinue further development of the drugs under development and recover some of the development costs paid to date. On April 4, 2004, the Company entered into an agreement with Dr. Longbin Liu and his affiliate to settle the amount owing to the Company from his acquisition of the Hepatitis B Vaccine Project as well as cancellation of the Patent and Project Development agreements between the parties. Under the terms of the settlement agreement, the G-CSF, Insulin and Hepatitis B Projects, including the rights of ownership and development obligations would revert to Dr. Liu.

In exchange, Dr Liu will pay to the Company the $3,710,000 in principal and interest owing under the Hepatitis B Project as well as reimburse the Company $1,330,000 that had been paid previously under the Patent and Project Development agreements. All amounts are due on December 31, 2004 and the warrants granted to Dr. Liu under the Patent Development agreement have been cancelled. Dr. Liu has agreed to provide 2,600,000 common shares of the Company, to be held in escrow, as security for the amounts owing of which 2,200,000 common shares of the Company have been placed in escrow as of June 30, 2004.

Results of Operations

Revenues. Revenues are generated from the sale of EPO in China by Huaxin and throughout the developing world by Biotrade. Sales for the three-month period ending June 30, 2004 were $908,145 compared to $1,007,686 for the three-month

period ending June 30, 2003. Sales in and outside of China were $657,645 and $250,500, respectively during the three-month period ending June 30, 2004. Sales during the three-month period ending June 30, 2003 were $576,894 in China and $430,792 outside of China. Cost of sales for the three-months ended June 30, 2004 of $194,755 is attributed to the production costs of the pharmaceutical products. The cost of sales for the three-months ended June 30, 2003 was $326,988. The gross profit margin was 79% for the three-month period ending June 30, 2004 and 68% for the three-month period ended June 30, 2003. The profit margin was lower during the three months ended June 30, 2003 because the Company decided to sell and sold some product with short-term expiry dates at a reduced price.

Sales for the six-month period ending June 30, 2004 were $1,786,415 compared to $1,672,009 for the six-month period ending June 30, 2003. Sales in and outside of China were $1,359,515 and $426,900, respectively during the six-month period ending June 30, 2004. Sales during the six-month period ending June 30, 2003 were $1,031,242 in China and $640,767 outside of China.

Interest income is related primarily to interest earned on cash received from the private placement of common stock received during the third quarter of 2001. Interest income for the three-months period ended June 30, 2004 was $20,435 compared to $10,381 for the three-month period ended June 30, 2003. Interest income for the six-months period ended June 30, 2004 was $26,189 compared to $16,819 for the six-month period ended June 30, 2003.

Expenses. Total operating expenses for the three-months ended June 30, 2004 were $1,121,830. The major expenses incurred in the second quarter of 2004 were selling expenses of $364,877 and research and development expenses of $151,472 representing 33% and 14% of total expenses, respectively. The remaining major expense items are represented by administrative expenses.

Significant operating expenses for the three-months ended June 30, 2004 included

rent of $84,074, salaries and benefits of $208,566, $53,197 in travel costs and legal expenses of $13,543. During 2004, the Company ceased paying management fees to certain directors for consulting services.

Other significant expenses for the second quarter include the depreciation of fixed assets and amortization of license and permit of $179,412.

Comparatively, total operating expenses for the three-months ended June 30, 2003 was $927,504. The major expense incurred in the second quarter of 2003 was selling expenses of $287,667 representing 31% of total expenses. Administrative expenses represent the remaining major expense items.

Significant operating expenses for the three-months ended June 30, 2003 included rent of $123,912, salaries and benefits of $198,586, $34,055 in travel costs and a bad debts provision of $10,701. Management fees of $20,000 were paid to a director for consulting services during the second quarter of 2003.

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Other significant expenses for the second quarter of 2003 include the depreciation of fixed assets and amortization of license and permit and land-use rights of $183,896.

Total operating expenses for the six-months ended June 30, 2004 were $2,008,535. The major expense incurred in the first half of 2004 was selling expense of $628,330 representing 31% of total expenses. The remaining expense items are primarily administrative expenses.

Significant operating expenses for the six-months ended June 30, 2004 included rent of $168,101, salaries and benefits of $390,471, $83,883 in travel costs, legal expenses of $38,718 and research and development expenses of $152,007. There were no management fees paid to directors during the first half of 2004.

Other significant expenses for the first half of the year include the depreciation of fixed assets and amortization of license and permit of $358,854.

Comparatively, total operating expenses for the six-months ended June 30, 2003, were $2,131,011. The major expense incurred in the first half of 2003 was selling expenses of $793,339 representing 37% of total expenses. Administrative expenses represent the remaining expense items.

Significant operating expenses for the six-months ended June 30, 2003 included bad debt write offs of $41,412, rent of $212,111, salaries and benefits of $389,978 and $100,393 in travel costs. Management fees of $40,000 were paid to a director for services during the six-months ended June 30, 2003.

Other significant expenses for the second half of 2003 include the depreciation of fixed assets of and amortization of license and permit and land-use rights of $369,195.

Net and Comprehensive Loss. Dragon had a net loss and a comprehensive loss of $388,004 for the three-month period ending June 30, 2004 compared to $236,424 for the same period last year. The primary reason for the increase was that the Company paid in excess of $150,000 in development expense in the three months ended June 30, 2004.

The Company's net and comprehensive loss of $637,427 for the six-month period ending June 30, 2004 compared to $970,452 for the same period last year.

Basic and Diluted Net Loss Per Share

The Company's net loss per share has been computed by dividing the net loss for

the period by the weighted average number of shares outstanding during the three and six month periods ended June 30, 2004. The loss per share for the three-month period ended June 30, 2004 was $0.02 and $0.03 for the six-month period ended June 30, 2004. Common stock issuable upon the exercise of common stock options and common stock warrants have been excluded from the net loss per share calculations as their inclusion would be anti-dilutive.

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Liquidity and Capital Resources

Dragon is a development stage pharmaceutical and biotechnological company that has commenced the manufacture and marketing of pharmaceutical products in China through its 100% equity interest in Nanjing Huaxin Bio-pharmaceuticals Ltd. Previously, the Company has raised funds through equity financings to fund its operations and to provide working capital. The Company may finance future operations through additional equity financings.

As of June 30, 2004, the Company had $2,608,594 in cash available. This cash, the $1,407,671 in accounts receivable and anticipated sales will be used to fund the ongoing operations and research and development. Working capital was $4,414,102 at June 30, 2004. The Company does not anticipate significant capital requirements in the near future.

During the six-months June 30, 2004, the Company incurred losses of $637,427 and the Company will continue to incur losses until sales for its products increase or the contemplated merger with Oriental Wave is completed. The Company will continue to fund its operations through working capital.

Item 3. Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined by Exchange Act Rule 13a-15(e)) as of the end of our second fiscal quarter pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in our internal control over financial reporting identified in connection with our evaluation as of the end of the first fiscal quarter that occurred during such quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Dragon Pharmaceutical Inc. v. Longbin Liu, Supreme Court of British Columbia, Canada, No. S036057, filed November 10, 2003. On November 2003, we filed a complaint against our Director and former Chairman for payment of $3,500,000, plus interest calculated at 6% per annum, due on September 5, 2003, pursuant to the terms of the Acquisition Agreement related to Hepatitis B Vaccine Project entered into by the Company and the defendant on October 6, 2000, as amended on June 5, 2001. The Company has served the complaint against the defendant but has suspended the action pursuant to the terms of a Settlement Agreement entered into on April 4, 2004. See Item 2, Management's Discussion and Analysis and Plan

of Operations, Recent Events - Settlement Agreement with Dr. Liu.

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Item 2. Changes in Securities.

None

Item 3. Defaults Upon Senior Securities.

None

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

None

Item 5. Other Information.

None

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

Exhibit No.

31.1 Certification by the Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act

31.2 Certification by the Principal Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act

32 Certification by the Principal Executive and Financial Officers Pursuant to Section 906 of the Sarbanes-Oxley Act

(b) Reports on Form 8-K.

Form 8-K for April 22, 2004 reporting announcing 2003 year end results.

Form 8-K for May 13, 2004 announcing first quarter results.

Form 8-K for June 11, 2004 reporting entering into a Share Purchase Agreement with Oriental Wave Holdings Ltd.

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Signatures

In accordance with 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.

DRAGON PHARMACEUTICAL INC.
(registrant)

Dated: August 5, 2004

/s/ Matthew Kavanagh

Matthew Kavanagh
Director of Finance and Corporate
Compliance and Corporate Secretary
(Duly authorized Officer and

Principal Financial Officer)

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EXHIBIT 31.1

Section 302 Certification of Principal Executive Officer

I, Alexander Wick, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Dragon Pharmaceutical Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) Omitted

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 5, 2004 /s/ Alexander Wick

Alexander Wick, President and
Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

Section 302 Certification of Principal Financial Officer

I, Matthew Kavanagh, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Dragon Pharmaceutical Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) Omitted

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 5, 2004 /s/ Matthew Kavanagh

Matthew Kavanagh,
Principal Financial Officer

EXHIBIT 32

CERTIFICATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(SUBSECTIONS (a) AND (b) OF SECTION 1350, CHAPTER 63 OF
TITLE 18, UNITED STATES CODE)

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of Title 18, United States Code), each of the undersigned officers of Dragon Pharmaceutical Inc., a Florida corporation (the "Company"), does hereby certify with respect to the Quarterly Report of the Company on Form 10-QSB for the quarter ended June 30, 2004 as filed with the Securities and Exchange Commission (the "Form 10-QSB") that, to the best of their knowledge:

(1) the Form 10-QSB fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Form 10-QSB fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 5, 2004 /s/ Alexander Wick

Alexander Wick
President and Chief Executive Officer

Dated: August 5, 2004 /s/ Matthew Kavanagh

Matthew Kavanagh
Principal Financial Officer