DRAGON PHARMACEUTICALS INC
Form 10QSB
May 13, 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 March 31, 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 March 31, 2004: 20,462,000

PART I.

Item 1. Financial Documents

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

	March 31, 2004	December 31, 2003
ASSETS		
Current		
Cash and short term securities	$ 3,015,951	$ 3,126,667
Accounts receivable	1,262,137	1,265,676
Inventories	1,126,767	1,090,464
Prepaid and deposits	103,326	139,595
Total current assets	5,508,181	5,622,402
Fixed assets	2,005,689	2,089,352
Due from related party - Hepatitis B vaccine project	100	100
Patent rights - related party	500,000	500,000
Licence and permit	2,786,163	2,924,198
Total assets	$ 10,800,133	$ 11,136,052
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Current		
Accounts payable and accrued liabilities	1,342,567	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: 20,462,000 common shares	20,462	20,462
Additional paid in capital	26,708,870	26,708,870
Accumulated other comprehensive (loss)	(32,813)	(32,007)
Accumulated deficit	(17,238,953)	(16,989,530)
Total stockholders' equity	9,457,566	9,707,795
Total liabilities and stockholders' equity	$ 10,800,133	$ 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 Shares	Common stock Amount	Additional paid-in capital	Comprehensive income (loss)	acc
Balance, December 31, 2002	20,334,000	$ 20,334	$26,644,998	-	$(14,
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)	(1,
Comprehensive (loss)				$(1,991,731)	
Balance, December 31, 2003	20,462,000	$ 20,462	$26,708,870		$(16

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 Shares	Common stock Amount	Additional paid-in capital	Comprehensive income (loss)	acc
Balance, December 31, 2003	20,462,000	$20,462	$26,708,870	-	$ 16,
Components of comprehensive income (loss) - foreign currency translation	-	-	-	(806)	
- net (loss) for the period	-	-	-	(249,423)	(2

Comprehensive (loss)				$(250,229)	
Balance, March 31, 2004	20,462,000	$20,462	$26,708,870		$(17

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

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

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Sales	$ 878,270	$ 664,322
Cost of sales	246,741	201,282
Gross profit	631,529	463,040
Selling, general and administrative expenses	(678,887)	(968,559)
Depreciation of property and equipment and amortization of licence and permit	(179,442)	(185,299)
Research and development expenses	(535)	-
New market development	-	(15,479)
Provision for doubtful debts	(27,073)	(30,710)
Interest expense	(769)	(3,460)
Stock-based compensation	-	-
Operating loss	(255,177)	(740,467)
Interest and other income	5,754	6,440
Net (loss) for the period	$ (249,423)	$ (734,027)
(Loss) per share Basic and diluted	$ (0.01)	$ (0.04)

Weighted average number of

common shares outstanding		
Basic and diluted	20,462,000	20,334,000

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

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

	Three Mo Ended Ma 20
Cash flows from (used in) operating activities	
Net (loss) for the period	$ (249,
Adjustments to reconcile net loss to net cash used in operating activities:	
- depreciation of property and equipment and amortization of licence and permit	231
- provision for doubtful debts	27
Changes in non-cash working capital items:	
- accounts receivable	(23,
- inventories	(36,
- prepaid expenses and deposits	36
- accounts payable and accrued liabilities	(85,
	(100,
Cash flows used in investing activities	
Purchase of property and equipment	(10,
(Increase) decrease in restricted funds	
	(10,
Cash flows from financing activities	
Loan proceeds	
Foreign exchange (gain) loss on cash held in foreign currency	(
Decrease in cash and cash equivalents	(110,
Cash and cash equivalents, beginning of period	3,126
Cash and cash equivalents, end of period	$ 3,015

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

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Statements of Cash Flows

March 31, 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 March 31, 2004, and the results of operations and cash flows for the interim periods ended March 31, 2004 and 2003.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instruction for Form 10-Q 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 Form10-KSB.

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 an letter of intent with Oriental Wave Holding Ltd. ("Oriental") whereby the Company would issued common shares in exchange for all the issued and outstanding shares of Oriental. The transaction is subject to the parties agreeing on a definitive agreement and approval by shareholders and the regulatory authorities.

The transaction will result in the former shareholders of Oriental owning 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

	March 31, 2004	December 31, 2003
Trade receivables	$ 1,542,580	$ 1,524,465
Allowance for doubtful accounts	(333,245)	(298,284)
	1,209,335	1,226,181
Other receivables	52,802	39,495
	$ 1,262,137	$ 1,265,676

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Statements of Cash Flows
March 31, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

4. Inventories

	March 31, 2004	December 31, 2003
Raw materials	$ 144,021	$ 129,650
Finished goods	88,453	107,833
Work in progress	894,293	852,981
	1,126,767	$ 1,090,464

5. Property and equipment

	March 31, 2004		
	Cost	Accumulated depreciation	Net book value
Motor vehicles	$ 126,444	$ 72,041	$ 54,403
Office equipment and furniture	414,512	239,413	175,099
Leasehold improvements	1088,803	449,290	639,513
Production and lab equipment	1,619,647	745,058	874,589
Idle equipment	555,339	293,254	262,085
	$3,804,745	$1,799,055	$2,005,689

	December 31, 2003		
	Cost	Accumulated depreciation	Net book value
Motor vehicles	$140,423	$ 75,996	$ 64,427
Office equipment and furniture	414,759	221,076	193,683
Leasehold improvements	1,089,006	418,888	670,118
Production and lab equipment	1,595,450	708,841	886,609
Idle equipment	555,339	280,824	274,515
	$ 3,794,977	$1,705,625	$ 2,089,352

For the three-months ended March 31, 2004, depreciation expenses totalled $94,112 (2003 - $100,987). The majority of fixed assets are located in China.

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Statements of Cash Flows
March 31, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

6. Due from Related Party - Hepatitis B Vaccine Project

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

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 is 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 amount owing was not repaid on the due date and the Company is pursuing collection. See note 15 also.

9

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Statements of Cash Flows
March 31, 2004
(Expressed in U.S. Dollars)

(Expressed in U.S. Dollars)

(Unaudited - Prepared by Management)

7. 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 US$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 US$500,000 will be refunded to the Company if no patent applications have been filed by January 14, 2005. See note 15 also.

8. Licence and permit

	March 31, 2004	December 31, 2003
Original cost	$5,012,582	$5,012,582
Accumulated amortization	(2,226,419)	(2,088,384)
	$2,786,163	$ 2,924,198

Amortization expense for the licence and permit for the three months ended March 31, 2004 was $137,456 (2003 - $138,021)

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

2004	(balance of the year)	$414,000
2005		$552,000
2006		$552,000
2007		$552,000
2008		$552,000

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.

9. 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 March 31, 2004, $3.8 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 March 31, 2004, the company has estimated losses, for tax purposes, totalling approximately $8,500,000, 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.

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

	March 31, 2004	December 31, 2003
Tax losses carried forward	$ 3,345,000	$ 3,237,000
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	(4,469,000)	(4,361,400)
	$ -	$ -

A reconciliation of the federal statutory income tax to the Company's effective income tax rate, for the three months ended March 31, 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	-	-

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Statements of Cash Flows
March 31, 2004

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

10. Stock Options and Warrants

(a) Stock Options Plans

There were no options granted during the three months ended March 31, 2004.

The following is a summary of the employee stock option information for the period ended March 31, 2004:

	Shares	Weighted Average Exercise Price
Options outstanding at December 31, 2002	3,288,000	$ 1.82
Granted	500,000	$ 0.68
Forfeited	(1,061,000)	$ 0.90
Exercised	(128,000)	$ 0.50
Options outstanding at December 31, 2003 and March 31, 2004	2,599,000	$ 2.04

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.01 - $1.00	888,500	2.52	$ 0.60	763,500	$ 0.59
$1.01 - $2.00	375,500	3.07	$ 1.70	375,500	$ 1.70
$2.01 - $3.00	60,000	0.61	$ 2.50	60,000	$ 2.50
$3.01 - $4.00	1,275,000	1.62	$ 3.13	1,275,000	$ 3.13
	2,599,000	2.12	$ 2.04	2,474,000	$ 2.11

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

(Expressed in U.S. Dollars)

10. Stock Options and Warrants (continued)

compensation expense, the following would have been its effect on the Company's net loss:

	March 31, 2004	March 31, 2003
Net (loss) for the period:		
- as reported	$(249,423)	$(734,027)
- pro-forma	$(249,423)	$(734,027)
Basic and diluted (loss) per share:		
- as reported	$(0.01)	$(0.04)
- pro-forma	$(0.01)	$(0.04)

(b) Warrants

Share purchase warrants outstanding as at March 31, 2004:

Number of Warrants	Underlying Shares	Exercise Price Per Share	Expiry Date
50,000	50,000	$1.70	November 15, 2004
1,000,000*	1,000,000	$2.50	January 14, 2007

* See Notes 7 and 15

11. Related Party Transactions

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

	March 31, 2004	March 31, 2003
Management fees	$-	$20,000

(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:

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

---

11. Related Party Transactions (continued)

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

(v) US$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"); and

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

(vii) US$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:

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

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

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

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

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

For both the G-CSF and Insulin Projects:

(xiii) 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;

(xiv) 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 March 31, 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.

14

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Statements of Cash Flows
March 31, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

---

11. Related Party Transactions (continued)

(c) see Notes 6, 7 and 15 also.

12. Commitments

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

2004	$ 373,105
2005	502,727
2006	370,664
2007	326,205
2008	326,205
2009	144,738
Total	$ 2,043,644

(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 $615,000 (EUROS 500,000) of which $492,000 (EUROS 400,000) remains unpaid at March 31, 2004.

15

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Statements of Cash Flows
March 31, 2004
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

---

13. Segmented Information

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

	March 31, 2004	December 31,2003
ASSETS		
North America	$ 3,286,891	$3,156,953
China	7,087,715	7,079,241
Others	425,527	899,858
Total	$ 10,800,133	$11,136,052

	Three months ended March 31, 2004	Three months ended March 31, 2003
REVENUE		
North America	$ -	$ -
China	701,870	454,347
Others	176,400	209,975
Total	$ 878,270	$ 664,322

14. Comparative Figures

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

15. Subsequent Event

The Company has entered into an agreement with Dr. Longbin Liu to settle the amount owing to the Company from his acquisition of the Hepatitis B Project (note 8) as well as cancel 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 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. The warrants granted to Dr. Liu under the Patent Development agreement will be cancelled. It is a condition of the agreement that 2,200,000 common shares of the Company be placed in escrow by June 30, 2004.

16

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

Letter of Intent 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 merger in which we will be the survivor company. If the proposed merger 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 chemical generic drugs. Based on its 2003 audited financial statements, Oriental Wave Group had revenues of $26 million and earnings of $7.5 million.

17

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 is under construction for the production, by fermentation, of 7-ACA, an intermediate for Cephalosporin antibiotics. 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 completion of the proposed merger, the combined company will be reorganized into three major divisions: a Chemical Drug division, a Chemical Intermediate division and a Biotech division

Completion of the proposed merger is subject to a number of conditions including entering into a definitive agreement and all 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 bearing 1% 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 the warrants granted to Dr. Liu under the Patent Development agreement will be 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. It is a condition of the agreement that 2,200,000 common shares of the Company be placed in escrow by June 30, 2004.

Results of Operations

Revenues. Revenue is generated from the sale of EPO in China by Huaxin and throughout the developing world by Biotrade. Revenue for the three-month period ending March 31, 2004 was $878,270 compared to $664,322 for the three-month period ending March 31, 2003. Sales in and outside of China were $701,870 and $176,400, respectively during the three-month period ending March 31, 2004. Sales during the three-month period ending March 31, 2003 were $454,347 in China and $209,975 outside of China. Cost of sales for the three-months ended March 31, 2004 of $246,741 is attributed to the production costs of the pharmaceutical products. The cost of sales for the three-months ended March 31, 2003 was $201,282. The gross profit margin was 72% for the three-month period ending March 31, 2004 and 70% for the three-month period ended March 31, 2003.

18

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 and cash from operations received since. Interest and other income for the three-month period ended March 31, 2004 was $5,754 compared to $6,439 for the three-month period ended March 31, 2003.

Interest income has decreased as interest rates have declined and as the cash balance has decreased through the funding of operations.

Expenses. Total operating expenses for the three-months ended March 31, 2004 were $886,706. The major expenses incurred in the first quarter of 2003 was selling expenses of $263,453 representing 30% of total expenses. The remaining major expense items are represented by administrative expenses.

Significant operating expenses for the three-months ended March 31, 2004 included rent of $84,027, legal fees of $25,175, salaries and benefits of $181,905, $30,685 in travel costs, insurance of $14,315 and a bad debts provision of $27,073. There were no management fees of $20,000 were paid to directors for services during the first quarter of 2004.

Other significant expenses for the first quarter include the depreciation of fixed assets and amortization of license and permit of $179,442.

Comparatively, total operating expenses for the three-months ended March 31, 2003 were $1,203,507. The major expenses incurred in the first quarter of 2003 were selling expenses of $505,672 representing 42% of total expenses. The remaining major expense items are represented by administrative expenses.

Significant operating expenses for the three-months ended March 31, 2003 included rent of $88,199, salaries and benefits of $191,393, $66,338 in travel costs, insurance of $30,166 and a bad debts provision of $30,710. Management fees of $20,000 were paid to a director for services during the first quarter of 2003.

Other significant expenses for the first quarter of 2003 include the depreciation of fixed assets and amortization of license and permit and land-use rights of $185,299.

Overall, expenditures have decreased in 2004 from 2003 levels as the Company has streamlined operations, closed its Beijing and Hong Kong representative offices and diligently pursued cutting costs in all areas, where practical.

Net and Comprehensive Loss. Dragon had a net loss and a comprehensive loss of $249,423 for the three-month period ending March 31, 2004.

The Company's net and comprehensive loss for the three-month period ended March 31, 2003 was $734,027.

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-month period ended March 31,

19

2004. The loss per share for the three-month period ended March 31, 2004 was $0.01. 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.

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 March 31, 2004, the Company had $3,015,951 in cash available. This cash, the $1,262,137 in accounts receivable and anticipated sales will be used to fund the ongoing operations and research and development. Working capital was $4,165,614 at March 31, 2004.

During the three-months ended March 31, 2004, the Company incurred losses of $249,423 and the Company will continue to incur losses until sales for its products increase. 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 first 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

20

the action, pursuant to the terms of Settlement Agreement. See Part I. Item 2. Recent Events - Settlement Agreement with Dr. Liu for more details.

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 March 24, 2004 reporting entering into a Letter of Intent with Oriental Wave Holdings Ltd.

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

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: May 6, 2004

/s/ Matthew Kavanagh

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