DRAGON PHARMACEUTICALS INC
Form 10QSB
November 15, 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 September 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 September 30, 2004: 20,582,000

PART I. FINANCIAL INFORMATION

Item 1. Financial Statement

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

Index

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

	September 30, 2004	December 31, 2003
ASSETS		
Current		
Cash and short term securities	$ 2,383,072	$ 3,126,667
Accounts receivable	1,571,659	1,265,676
Inventories	1,127,597	1,090,464
Due from director	500,100	-
Prepaid and deposits	106,855	139,595
Total current assets	5,689,283	5,622,402
Fixed assets	1,829,946	2,089,352
Due from related party - Hepatitis B vaccine project	-	100
Patent rights - related party	-	500,000
Licence and permit and other assets	2,740,193	2,924,198
Total assets	$ 10,259,422	$ 11,136,052
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Current		

Accounts payable and accrued liabilities	1,341,471	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	20,582	20,462
Additional paid in capital	26,768,750	26,708,870
Accumulated other comprehensive (loss)	(32,275)	(32,007)
Accumulated deficit	(17,839,106)	(16,989,530)
Total stockholders' equity	8,917,951	9,707,795
Total liabilities and stockholders' equity	$ 10,259,422	$ 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)
(Unaudited - Prepared by Management)

	Common stock		Additional paid-in capital	Compre-hensive income (loss)	acc
	Shares	Amount			
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		$(1

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)
(Unaudited - Prepared by Management)

	Common stock		Additional paid-in	Compre-hensive income	
	Shares	Amount	capital	(loss)	acc
Balance, December 31, 2003	20,462,000	$20,462	$ 26,708,870	-	$(16
Exercise of stock options for cash	120,000	120	59,880		
Components of comprehensive income (loss)					
- foreign currency translation	-	-	-	(268)	
- net (loss) for the period	-	-	-	(849,576)	
Comprehensive (loss)				$ (849,844)	
Balance, September 30, 2004	20,582,000	$20,582	$ 26,768,750		$(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 September 30, 2004	Three Months Ended September 30, 2003
Sales	$ 1,057,254	$ 1,151,646
Cost of sales	281,536	353,998
Gross profit	775,718	797,648
Selling, general and		

administrative expenses	(810,870)	(861,160)
Depreciation of fixed assets and amortization of licence and permit	(179,612)	(186,674)
Research and development expenses	(4)	(25,884)
New market development	(1,588)	(6,577)
Provision for doubtful debts	-	(3,257)
Loan interest expense	(638)	(862)
Stock-based compensation	-	-
Operating income (loss)	(216,994)	(286,766)
Interest income	4,846	4,185
Net income (loss) for the period	(212,148)	$ (282,581)
(Loss) per share Basic and diluted	$ (0.01)	$ (0.01)
Weighted average number of common shares outstanding Basic and diluted	20,582,000	20,344,652

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

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

	2
Cash flows from (used in) operating activities	
Net (loss) for the year	$ (849,5
Adjustments to reconcile net loss to net cash used in operating activities:	
- depreciation of fixed assets and amortization of licence and permit	708,
- net write off of land-use right and fixed assets	
- provision for doubtful debts	20,
Changes in non-cash working capital items:	
- accounts receivable	(326,7
- inventories	(37,1

- prepaid expenses and deposits	32,
- accounts payable and accrued liabilities	(86,7
- management fees payable - related parties	
	(538,7
Cash flows used in investing activities	
Purchase of property and equipment	(34,6
(Increase) in other assets	(230,0
(Increase) decrease in restricted funds	
	(264,6
Cash flows from financing activities	
Loan proceeds	
Proceeds from issuance of shares	60,
	60,
Foreign exchange (gain) loss on cash held in foreign currency	(2
Decrease in cash and cash equivalents	(743,5
Cash and cash equivalents, beginning of period	3,126,
Cash and cash equivalents, end of period	$ 2,383,

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

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
September 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 September 30, 2004, and the results of operations and cash flows for the interim periods ended September 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,

(Expressed in U.S. Dollars)

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.

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

	September 30, 2004	December 31, 2003
Trade receivables	$ 1,849,101	$ 1,524,465
Allowance for doubtful accounts	(326,968)	(298,284)
	1,522,133	1,226,181
Other receivables	49,526	39,495
	$ 1,571,659	$ 1,265,676

4. Inventories

	September 30, 2004	December 31, 2003
Raw materials	$ 86,679	$ 129,650
Finished goods	110,955	107,833
Work in progress	929,962	852,981

(Expressed in U.S. Dollars)

$ 1,127,597	$ 1,090,464

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 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 havel 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

	September 30, 2004		
	Cost	Accumulated depreciation	Net book value
Motor vehicles	$ 126,444	$ 82,818	$ 43,626
Office equipment and furniture	420,973	276,644	144,329
Leasehold improvements	1,089,231	510,393	578,838
Production and lab equipment	1,639,822	838,754	801,068
Idle equipment	555,339	293,254	262,085
	$ 3,831,809	$ 2,001,863	$ 1,829,946

6. Property and equipment (continued)

	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 nine-months ended September 30, 2004, depreciation expenses totalled $294,061 (2003 - $305,038). The majority of fixed assets are located in China.

7. Due from Related Party - Hepatitis B Vaccine Project

	September 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.

(Expressed in U.S. Dollars)

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

In April 2002, 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 chose, given the significant amount involved and the lack of security, to conservatively value the amount owing and set up a provision in fiscal 2002 for the full amount, less a nominal amount of $100. Dr. Liu defaulted on repayment in September 2003 but subsequently renegotiated repayment terms with the Company (see 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

	September 30, 2004	December 31, 2003
Original cost	$5,012,582	$5,012,582
Accumulated amortization	(2,502,389)	(2,088,384)
Licence and permit	2,510,193	2,924,198
Other assets	230,000	-
	$ 2,740,19	$ 2,924,198

Amortization expense for the licence and permit for the nine-months ended September 30, 2004 was $413,963 (2003 - $414,062).

9. Licence and permit and other assets (continued)

(Expressed in U.S. Dollars)

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

2004	(balance of the year)	$138,000
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.

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 September 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 September 30, 2004, the Company has estimated losses, for tax purposes, totalling approximately $10,518,000, 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:

	September 30, 2004	December 31, 2003
Tax losses carried forward	$ 3,576,000	$ 3,237,000

(Expressed in U.S. Dollars)

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	(4,700,400)	(4,361,400)
	$ -	$ -

A reconciliation of the federal statutory income tax to the Company's effective income tax rate, for the three months ended September 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 nine months ended September 30, 2004.

The following is a summary of the employee stock option information for the period ended September 30, 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	2,599,000	$ 2.04
Forfeited	(482,500)	$ 1.96
Exercised	(120,000)	$ 0.50
Options outstanding at September 30, 2004	1,996,500	$ 2.16

11. Stock Options and Warrants (continued)

	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	588,500	2.13	$ 0.61	563,500	$ 0.60
$1.01 - $2.00	308,000	2.57	$ 1.70	308,000	$ 1.70
$2.01 - $3.00	25,000	0.11	$ 2.50	25,000	$ 2.50
$3.01 - $4.00	1,075,000	1.12	$ 3.13	1,075,000	$ 3.13
	1,996,500	1.63	$ 2.16	1,971,500	$ 2.17

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:

	September 30, 2004	September 30, 2003
Net (loss) for the period:		
- as reported	$ (849,576)	$(1,253,034)
- pro-forma	$ (849,576)	$(1,253,034)
Basic and diluted (loss) per share:		
- as reported	$(0.04)	$(0.06)
- pro-forma	$(0.04)	$(0.06)

(b) Warrants

Share purchase warrants outstanding as at September 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
September 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:

	September 30, 2004	September 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; and

(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;

(Expressed in U.S. Dollars)

(iv) $200,000 to be provided when a new drug license for Insulin 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 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 September 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 (balance of the year)	$ 125,9011
2005	504,954
2006	509,035
2007	372,253
2008	326,205
2009	144,738
Total	$ 1,983,086

(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 September 30, 2004.

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
September 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:

	September 30, 2004	December 31,2003
ASSETS		
North America	$2,754,530	$3,156,953
China	6,963,686	7,079,241
Other	541,206	899,858
Total	$ 10,259,422	$11,136,052

	Nine months ended September 30, 2004	Nine months ended September 30, 2003
REVENUE		
North America	$ -	$ -
China	2,051,164	1,773,709
Other	792,485	1,049,945
Total	$ 2,843,669	$ 2,823,654

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 acquisition. 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 in operations: a pharmaceutical facility with a capacity of producing

1.6 billion tablets and capsules, 80 million injectables and 10 million suppositories per year and 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 290 drug approvals from the SFD&A of which about 35, mainly anti-infectious drugs, were actively marketed in China in 2003.

Upon the consummation 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 2,231,000 common shares of the Company have been placed in escrow as of September 30, 2004.

Results of Operations

Sales. Sales are generated from the sale of EPO in China by our subsidiary, Nanjing Huaxin, and throughout the developing world by our subsidiary, Allwin Biotrade. Revenues for the three-month period ending September 30, 2004 were $1,057,254 compared to $1,151,646 for the three-month period ending September 30, 2003. Sales in and outside of China were $691,669 and $365,585, respectively during the three-month period ending September 30, 2004. Sales during the three-month period ending September 30, 2003 were $742,467 in China and $409,179 outside of China. Sales for the nine-month period ended September 30, 2004 were $2,843,669 compared to $2,823,654 for the nine-month period ended September 30, 2003. Sales in and outside of China were $2,051,184 and $792,485, respectively, during the nine-month period ended September 30, 2004. Sales during the nine-month period ended September 30, 2003 were $1,773,708 in China and $1,049,946 outside of China. Sales in China increased during the nine-month period ended September 30, 2004 due to our implementing a more commission-based sales compensation plan during the latter part of the year ended December 31, 2003. During the first part of the nine months ended September 30, 2003, our compensation structure was more salary-based which did not provide sufficient incentives to our sales force. During the nine months ended September 30, 2004, sales outside of China decreased compared to the same period of the prior year.

19

During the nine months ended September 30, 2003, because the shelf-life of certain of our EPO product inventory was about to expire, we decreased the price of this product in order to encourage sales. Although sales increased during the nine months ended September 30, 2003, the price reduction reduced our profit margin.

Cost of sales for the three-months ended September 30, 2004 of $281,536 is attributed to the production costs of the pharmaceutical products. The cost of sales for the three-months ended September 30, 2003 was $353,998. The gross profit margin was 73% for the three-month period ending September 30, 2004 and 68% for the three-month period ended September 30, 2003. Cost of sales for the nine-months ended September 30, 2004 and September 30, 2003 were $723,033 and $882,267. The gross profit margin was 75% for the nine-month period ended September 30, 2004 and 69% for the nine-month period ended September 30, 2003. The lower profit margin during the nine month period ended September 30, 2003 reflects price reductions in sales price for certain of our products that we were required to sell due to the anticipated expiration dates of such products reducing the gross margin to 69% from the normal overall gross margin of 75%-80%.

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 subsequent sales. Interest income for the three-month period ended September 30, 2004 was $4,846 compared to $4,185 for the three-month period ended September 30, 2003. Interest income for the nine-month period ended September 30, 2004 was $31,035 compared to $21,004 for the nine-month period ended September 30, 2003. Interest income increased during the nine months ended September 30, 2004 as compared to the same period for the prior year primarily due to a marginally increase in interest rates.

Expenses. Total operating expenses for the three-month period ended September 30, 2004 were $992,712 consisting of selling, general and administrative expenses of $810,870, depreciation and amortization of $179,612, research expenses of $4, new market development of $1,588, and interest expense of $638. Total operating expenses for the nine-month period ended September 30, 2004 were $3,001,246, consisting of selling, general and administrative expenses of $2,273,807, depreciation and amortization of $538,466, research expenses of $152,011, new market development of $13,993, provision for bad debt of $20,816 and interest expense of $2,154.

Comparatively, total operating expenses for the three-month period ended September 30, 2003 were $1,084,414 consisting of selling, general and administrative expenses of $861,160, depreciation and amortization of $186,674, research expenses of $25,884, new market development of $6,577, provision for bad debt of $3,257 and interest expense of $862. Total operating expenses for the nine-month period ended September 30, 2003 were $3,215,425 consisting of selling, general and administrative expenses of $2,553,462, depreciation and amortization of $555,869, research expenses of $25,884, new market development of $30,291, provision for bad debt of $44,668 and interest expense of $5,251.

Selling, general and administrative expenses for the three months ended September 30, 2004 primarily consisted of $369,093 in selling expenses, rent of $85,775, salaries and benefits of $209,541, travel costs of $50,051, insurance of $10,927 and legal fees of $17,808. Selling, general and administrative expenses for the nine months ended September 30, 2004 primarily consisted of $997,423 in selling expenses, rent of $253,876, salaries and benefits of $600,012, travel costs of $133,934, insurance of $34,832 and legal fees of $56,526.

Comparatively, selling, general and administrative expenses for the three months ended September 30, 2003 primarily consisted of $368,380 in selling expenses, rent of $68,680, salaries and benefits of $204,960, travel costs of $42,964, insurance of $12,293 and legal fees of $47,620. Selling,

general and administrative expenses for the nine months ended September 30, 2003 primarily consisted of $1,161,719 in selling expenses, rent of $280,796,

salaries and benefits of $594,938, travel costs of $143,377, insurance of $50,001 and legal fees of $59,268. Included in selling, general and administrative expenses were management fees of $40,000 paid to a director for services. No similar payment was made during the nine months ended September 30, 2004.

Overall, selling, general and administrative expenses decreased by $164,296 during the nine months ended September 30, 2004 as compared for the nine months ended September 30, 2003. Selling expenses decreased as a result of sales staff reductions and implementation of a commission-based compensation structure. Other reductions occurred in administrative salaries as our personnel levels have decreased as we streamlined operations, rent through the closure of our Beijing and Hong Kong representative offices and diligently pursued cutting costs in all areas where practical. In addition, during the nine months ended September 30, 2003 we incurred fees for management services to related parties. No management fees were paid to directors for services during the first nine months of 2004.

Depreciation and fixed assets and amortization of license and permit of $538,466 for the nine months ended September 30, 2004 compared to $555,869 for the nine months ended September 30, 2003 remained relatively the same as we did not acquired significant assets or licenses during the nine months ended September 30, 2004. Further during the nine months ended September 30, 2004, we incurred research expenses of $152,011 related to our proposed EPO product to be offered in Europe. The majority of the research expense was incurred during the first part of 2004. In general, it is our policy to expense research expenses. No significant research expense was incurred during the same period for the prior year.

New market development expense decrease by $16,298 from $30,291 for the nine months ended September 30, 2003 compared to $13,993 for the nine months ended September 30, 2004. The decrease was due to fewer new EPO dosages or indications being introduced in 2004. In addition, the provision for doubtful debts decreased by $23,852 from $44,668 for the nine months ended September 30, 2003 compared to $20,816 for the nine months ended September 30, 2004 due to our tightening of our credit policy in China. Finally, interest expense decreased by $3,097 from $5,251 for the nine months ended September 30, 2003 compared to $2,154 for the nine months ended September 30, 2004 due to the payoff of certain loans in early 2003.

Expenses, Net and Comprehensive Loss. Dragon had a net loss and a comprehensive loss of $212,148 for the three-month period ending September 30, 2004 compared to $282,581 for the same period last year.

The Company's net and comprehensive loss of $849,576 for the nine-month period ending September 30, 2004 compared to $1,253,034 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 nine month periods ended September 30, 2004. The loss per share for the three-month period ended September 30, 2004 was $0.01 and $0.04 for the nine-month period ended September 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.

Liquidity and Capital Resources

Dragon is a pharmaceutical and biotechnological company that has commenced the manufacture and marketing of pharmaceutical products in China through its indirect ownership in Nanjing Huaxin Bio-pharmaceuticals Ltd. Previously, the Company has raised funds through equity financings to fund its operations and to provide working capital.

As of September 30, 2004, the Company had $2,283,072 in cash available. This cash, the $1,571,659 in accounts receivable and anticipated sales will be used to fund the ongoing operations and research and development. Working capital was $4,347,812 at September 30, 2004. The Company does not anticipate significant capital requirements in the near future.

During the nine-months September 30, 2004, the Company incurred losses of $849,576 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 in the near future 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 third 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

The Company is not currently involved in any legal proceedings.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

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.

(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.

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: November 10, 2004

/s/ Matthew Kavanagh

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

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: November 10, 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: November 10, 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 September 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: November 10, 2004

/s/ Alexander Wick

Alexander Wick
President and Chief Executive Officer

Dated: November 10, 2004

/s/ Matthew Kavanagh

Matthew Kavanagh
Principal Financial Officer