DRAGON PHARMACEUTICALS INC
Form 10-Q
November 19, 2003

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

Form 10-Q

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

For the quarterly period ended September 30, 2003

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 [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12 b-2 of the Exchange act). Yes [ ] No [X]

Number of shares of common stock outstanding as of September 30, 2003: 20,359,000

ITEM 1. FINANCIAL INFORMATION

DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Consolidated Balance Sheets
September 30, 2003 and December 31, 2002
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

| | | Septem |
|---|---|---|
| ASSETS | | |
| Current | | |
| Cash and short term securities | $ | 3, |
| Accounts receivable | | 1, |
| Inventories | | 1, |
| Prepaid and deposits | | |
| Total current assets | | 5, |
| Fixed assets | | 2, |
| Due from related party - Hepatitis B vaccine project | | |
| Patent rights - related party | | |
| Licence and permit | | 3, |
| Total assets | $ | 11, |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Current | | |
| Bank loans | $ | |
| Accounts payable and accrued liabilities | | 1, |
| Total current liabilities | | 1, |
| Commitments (Note 13) | | |
| Stockholders' Equity | | |
| Share capital | | |
| Authorized: 50,000,000 common shares at par value of $0.001 each | | |
| Issued and outstanding: 20,359,000 common shares | | |
| Additional paid in capital | | 26, |
| Accumulated other comprehensive (loss) | | ( |
| Accumulated deficit | | (16,2 |
| Total stockholders' equity | | 10, |
| Total liabilities and stockholders' equity | $ | 11, |

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 Shares | Common stock Amount | Additional paid-in capital | Compre-hensive income (loss) | accu |
|---|---|---|---|---|---|
| Balance, December 31, 2001 | 20,331,000 | $20,331 | $26,624,741 | - | $(9, |
| Exercise of stock options for cash | 3,000 | 3 | 1,497 | - | |
| Stock based compensation | - | - | 18,760 | - | |
| Components of comprehensive income (loss) - foreign currency translation | - | - | - | (10,003) | |
| - net (loss) for the year | - | - | - | (5,250,946) | (5, |
| Comprehensive (loss) | | | | $(5,260,949) | |
| Balance, December 31, 2002 | 20,334,000 | $20,334 | $26,644,998 | | $(14, |

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 Shares | Common stock Amount | Additional paid-in capital | Compre-hensive income (loss) | c |
|---|---|---|---|---|---|
| Balance, December 31, 2002 | 20,334,000 | $20,334 | $26,644,998 | - | $(14 |

| | | | | | |
|---|---|---|---|---|---|
| Exercise of stock options for cash | 25,000 | 25 | 12,475 | | |
| Components of comprehensive income (loss) | | | | | |
| - foreign currency translation | - | - | - | 18,321 | |
| - net (loss) for the year | - | - | - | (1,253,034) | (1 |
| Comprehensive (loss) | | | | $(1,234,713) | |
| Balance, September 30, 2003 | 20,359,000 | $20,359 | $26,657,473 | | $(16 |

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

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DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES

Consolidated Statement of Operations
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

| | Three Months Ended September 30, 2003 | Three Months Ended September 30, 2002 |
|---|---|---|
| Sales | $ 1,151,646 | $ 3,777,326 |
| Cost of sales | 353,998 | 460,987 |
| Gross profit | 797,648 | 3,316,339 |
| Selling, general and administrative expenses | (861,161) | (1,157,646) |
| Depreciation of fixed assets and amortization of licence and permit and land-use right | (186,674) | (186,580) |
| Net write off of land-use right and fixed assets | - | - |
| Research expenses | (25,884) | (350,003) |
| New market development | (6,577) | (9,816) |
| Provision for doubtful debts | (3,257) | (5,533) |
| Loan interest expense | (862) | (6,586) |

| | | |
|---|---|---|
| Stock-based compensation | - | - |
| Operating income (loss) | (286,766) | 1,600,175 |
| Interest income | 4,185 | 26,224 |
| Net income (loss) for the period | $ (282,581) | $ 1,626,399 |
| (Loss) per share<br>Basic and diluted | $ (0.01) | $ 0.08 |
| Weighted average number of common shares outstanding<br>Basic and diluted | 20,344,652 | 20,334,000 |

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

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DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2003 and 2002
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

| | 2 |
|---|---|
| Cash flows from (used in) operating activities | |
| Net (loss) for the year | $ (1,253, |
| Adjustments to reconcile net loss to net cash used in operating activities: | |
| - depreciation of fixed assets and amortization of licence and permit | 719, |
| - net write off of land-use right and fixed assets | |
| - provision for doubtful debts | 44, |
| Changes in non-cash working capital items: | |
| - accounts receivable | (383, |
| - inventories | 114, |
| - prepaid expenses and deposits | (35, |
| - accounts payable and accrued liabilities | (157, |
| - management fees payable - related parties | |
| | (951, |
| Cash flows used in investing activities | |
| Purchase of fixed assets | (123, |
| (Increase) decrease in restricted funds | 510, |

| | | |
|---|---|---|
| Acquisition of Patent rights | | |
| Acquisition of balance of Huaxin | | |
| Refundable investment deposits | | |
| Recovery from Hepatitis B Vaccine Project | | |
| | | 386, |
| Cash flows from financing activities | | |
| Loan proceeds | | (483, |
| Proceeds from issuance of shares | | 12, |
| | | (470, |
| Foreign exchange (gain) loss on cash held in foreign currency | | 17, |
| Decrease in cash and cash equivalents | | (1,018, |
| Cash and cash equivalents, beginning of period | | 4,425, |
| Cash and cash equivalents, end of period | $ | 3,407, |

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

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DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2003
(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 , 2003, and the results of operations and cash flows for the interim periods ended June 30, 2003 and 2002.

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, 2002 included in the annual report previously filed on Form10-K.

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

2. Restricted Funds

| | September 30, 2003 |
|---|---|
| Cash and cash equivalents | $ 3,407,581 |
| Term deposits held as collateral against bank loans | - |
| Cash and short term securities | $ 3,407,581 |

3. Accounts Receivable

| | September 30, 2003 |
|---|---|
| Trade receivables | $ 1,526,776 |
| Allowance for doubtful accounts | (323,694) |
| | 1,203,082 |
| Other receivables | 84,327 |
| | $ 1,287,409 |

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DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2003
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

4. Inventories

| | September 30, 2003 |
|---|---|

(Expressed in U.S. Dollars)

| | |
|---|---|
| Raw materials | $ 163,076 |
| Finished goods | 35,406 |
| Work in progress | 895,570 |
| | $ 1,094,053 |

5. Fixed Assets

| | September 30, 2003 | |
|---|---|---|
| | Cost | Accumulated depreciation |
| Motor vehicles | $ 140,406 | $ 69,668 |
| Office equipment and furniture | 414,240 | 202,353 |
| Leasehold improvements | 1,066,884 | 425,792 |
| Production and lab equipment | 2,148,949 | 833,358 |
| | $ 3,770,479 | $ 1,531,171 |

| | December 31, 2002 | |
|---|---|---|
| | Cost | Accumulated depreciation |
| Motor vehicles | $ 140,388 | $ 50,103 |
| Office equipment and furniture | 385,462 | 144,199 |
| Leasehold improvements | 1,065,313 | 336,503 |
| Production and lab equipment | 2,052,260 | 692,005 |
| | $ 3,643,423 | $ 1,222,810 |

For the nine months ended September 30, 2003, depreciation expenses totalled $305,038(2002 - $277,260). The majority of fixed assets are located in China.

(Expressed in U.S. Dollars)

6. Due from Related Party - Hepatitis B Vaccine Project

| | September 30, 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 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.

(Expressed in U.S. Dollars)

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.

8. Licence and permit

| | September 30, 2003 | December 31, 2002 |
|---|---|---|
| Original cost | $,5,012,582 | $5,012,582 |
| Accumulated amortization | 1,950,568 | 1,536,842 |
| | $ 3,062,014 | $3,475,740 |

Amortization expense for the licence and permit for the nine months ended September 30, 2003 was $414,062 (2002 - $414,024)

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

| | | |
|---|---|---|
| 2003 | (balance of the year) | $138,000 |
| 2004 | | $552,000 |
| 2005 | | $552,000 |
| 2006 | | $552,000 |
| 2007 | | $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. Bank Loans

| | September 30, 2003 |
|---|---|
| RMB 4,000,000, bearing interest at 3.394% per annum and due on February 26, 2003. The loan was secured by the term deposit. $ - $ 483,162 | |
| Total | $ - |

The weighted average interest rate was 3.394% and 5.265% for the nine months ended September 30, 2003 and 2002.

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, 2003, $3.7 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, 2003, the company has estimated losses, for tax purposes, totalling approximately $8,200,000, 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:

| | September 30, 2003 | D |
|---|---|---|
| Tax losses carried forward | $ 2,790,000 | |
| Stock-based compensation | 6,400 | |
| Provision for amount owing from Hepatitis B Vaccine Project | 1,118,000 | |
| Less: valuation allowance | (3,914,400) | |

| | | |
|---|---|---|
| | $ - | $ |



DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2003
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

10. Income Taxes (continued)

A reconciliation of the federal statutory income tax to the Company's effective income tax rate, for the three months ended September 30, 2003 and 2002 are as follows:

| | 2003 | 2002 |
|---|---|---|
| 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

During the six months ended June 30, 2003 the Company granted options to purchase 500,000 shares at a price of $0.68 per share, at a time when the market price was $0.48 per share.

The following is a summary of the employee stock option information for the period ended September 30, 2003:

| | Shares | Weighted Exercis |
|---|---|---|
| Options outstanding at December 31, 2001 | 2,969,500 | $ |
| Granted | 920,000 | $ |
| Forfeited | (598,500) | $ |
| Exercised | (3,000) | $ |
| Options outstanding at December 31, 2002 | 3,288,000 | $ |
| Granted | 500,000 | $ |
| Forfeited | (296,000) | $ |
| Exercised | (25,000) | $ |

| | | |
|---|---|---|
| Options outstanding at September 30, 2003 | 3,467,000 | $ |



DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2003
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

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 | Weighte Average Exercis Price |
| $0.01 - $1.00 | 1,716,500 | 1.69 | $ 0.55 | 1,566,500 | $ 0.5 |
| $1.01 - $2.00 | 440,500 | 3.57 | $ 1.70 | 440,500 | $ 1.7 |
| $2.01 - $3.00 | 60,000 | 1.11 | $ 2.50 | 60,000 | $ 2.5 |
| $3.01 - $4.00 | 1,275,000 | 2.12 | $ 3.13 | 1,275,000 | $ 3.1 |
| | 3,467,000 | 2.08 | $ 1.68 | 3,342,000 | $ 1.7 |

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, 2003 | S |
|---|---|---|
| Net (loss) for the period: | | |
| - as reported | $(1,253,034) | |
| - pro-forma | $(1,253,034) | |
| Basic and diluted (loss) per share: | | |
| - as reported | $(0.06) | |
| - pro-forma | $(0.06) | |

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DRAGON PHARMACEUTICAL INC. & SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2003
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

11. Stock Options and Warrants (continued)

(b) Warrants

Share purchase warrants outstanding as at September 30, 2003:

| 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 Note 7

12. Related Party Transactions

(a) The Company incurred the following expenses to a director (2002: two directors) of the Company:

| | September 30, 2003 | September 30, 2002 |
|---|---|---|
| Management fees | $ 40,000 | $172,500 |

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

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

(iii) 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

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

(v) 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.





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12. Related Party Transactions (continued)

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

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

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

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

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

(v) 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:

(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.

(Expressed in U.S. Dollars)

As at June 30, 2003, 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.

(c) see Notes 6 and 7 also.





13. Commitments

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:

| | |
|---|---|
| 2003 | $ 117,733 |
| 2004 | 487,813 |
| 2005 | 489,053 |
| 2006 | 492,771 |
| 2007 | 368,136 |
| 2008 - 2009 | 470,904 |
| Total | $2,426,410 |

14. Segmented Information

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

| | September 30, 2003 | December 31,2002 |
|---|---|---|
| ASSETS | | |
| North America | $3,225,045 | $4,144,668 |
| China | 7,624,810 | 9,020,882 |
| Others | 930,876 | 478,542 |
| Total | $11,780,731 | $13,644,092 |

| | Nine months ended September 30, 2003 | Nine months ended September 30, 2002 |
|---|---|---|
| REVENUE | | |
| North America | $ - | $ - |
| China | 1,773,709 | 2,097,292 |

| | | |
|---|---|---|
| Others | 1,049,945 | 4,079,000 |
| Total | $ 2,823,654 | $ 6,176,292 |

15. Comparative Figures

Certain 2002 comparative figures have been reclassified to conform to the financial statement presentation adopted for 2003.



ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS 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-K for the fiscal year ended December 31, 2002.

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.

During the third quarter, the Company reviewed all facets of its EPO production and decided not to continue with the EPO production using bioreactors. As a result of our review, the Company doubled the capacity of the EPO production using roller bottle in order to fulfill demand in China and the developing countries. In addition, the Company has undertaken to obtain more data on the EPO cell line using roller bottle in accordance with the legislated requirements in Europe and the United States. This will upgrade our registration documents and positively differentiate Dragon from other low price EPO producers in developing countries where the Company, through its licensees, meets tough competition. These developing countries requires more documentation regarding the safety of the 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.



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 September 30, 2003 was $1,151,646 compared to $3,777,326 for the three-month period ending September 30, 2002. Sales in and outside of China were $742,467 and $409,179, respectively during the three-month period ending September 30, 2003. Sales during the three-month period ending September 30, 2002 were $745,326 in China and $3,032,000 outside of China. The overseas sales during the three-month period ending September 30, 2002 included delivery of a $3,000,000 bulk order to be used by the purchaser for new drug research and development. Cost of sales for the three-months ended September 30, 2003 of $353,998 is attributed to the production costs of the pharmaceutical products. The cost of sales for the three-months ended September 30, 2002 was $460,987. The gross profit margin was 69% for the three-month period ending September 30, 2003 and 88% for the three-month period ended September 30, 2002. The profit margin decreased during the three months ended September 30, 2003 because the Company decided to sell and sold some product with short-term expiry dates at a reduced price and because there was not a large bulk order in the current periodRevenue for the nine-month period ending September 30, 2003 was $2,823,654 compared to $6,176,292 for the nine-month period ending September 30, 2002. Sales in and outside of China were $1,773,708 and $1,049,946, respectively during the nine-month period ending September 30, 2003. Sales during the nine-month period ending September 30, 2002 were $2,097,292 in China and $4,079,000 outside of China. The overseas sales during the nine-month period ending September 30, 2002 included delivery of a $3,700,000 bulk order to be used by the purchaser for new drug research and development. 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 September 30, 2003 was $4,185 compared to $26,224 for the three-month period ended September 30, 2002. Interest income for the nine-months period ended September 30, 2003 was $21,004 compared to $76,126 for the nine-month period ended September 30, 2002.

Interest income has decreased as interest rates have declined and as the cash balance has decreased to fund the Company's operations.

EXPENSES. Total operating expenses for the three-months ended September 30, 2003 were $1,084,414. The major expenses incurred in the third quarter of 2003 were selling expenses of $368,380 representing 34% of total expenses. The remaining major expense items are represented by administrative expenses.

Significant operating expenses for the three-months ended September 30, 2003 included rent of $68,680, salaries and benefits of $204,960, $42,964 in travel costs and legal fees of $47,620. No management fees were paid to directors for services during the third quarter of 2003.

Other significant expenses for the third quarter include the depreciation of fixed assets and amortization of license and permit of $186,674.

Comparatively, total operating expenses for the three-months ended September 30, 2002 were $1,716,164. The major expenses incurred in the third quarter of 2002 were research and development expenses of $350,000 and the selling expenses of $459,199 representing 20% and 27% of total expenses, respectively.

Administrative expenses represent the remaining major expense items.



Significant operating expenses for the three-months ended September 30, 2002 included consulting fees of $130,535, loan interest of $6,586, rent of $121,375, salaries and benefits of $143,278, $90,017 in travel costs and management fees of $76,451. Management fees include $57,500 incurred to two directors for services during the third quarter of 2002.

Other significant expenses for the third quarter of 2002 include the depreciation of fixed assets and amortization of license and permit and land-use rights of $186,580.

Total operating expenses for the nine-months ended September 30, 2003 were $3,215,425. The major expense incurred in the nine-months ended September 30, 2003 was selling expense of $1,161,719 representing 36% of total expenses. The remaining expense items are primarily administrative expenses.

Significant operating expenses for the nine-months ended September 30, 2003 included rent of $280,796, salaries and benefits of $594,938, $143,357 in travel costs and a bad debts provision of $44,668. Management fees of $40,000 were paid to a director for services during the nine-months ended September 30, 2003.

Other significant expenses for the nine-months ended September 30, 2003 include the depreciation of fixed assets and amortization of license and permit of $555,869.

Comparatively, total operating expenses for the nine-months ended September 30, 2002, were $6,562,788. The major expenses incurred in the nine-months ended September 30, 2002 were research and development expenses of $2,121,370 and the selling expenses of $1,410,306 representing 32% and 21% of total expenses, respectively. Administrative expenses represent the remaining expense items.

Significant operating expenses for the nine-months ended September 30, 2002 included bad debt write offs of $86,082, consulting fees of $441,815, loan interest of $62,601, rent of $292,767, salaries and benefits of $409,234, $352,507 in travel costs and management fees of $1,209,087. Management fees include $172,500 paid to two directors for services during the nine-months ended September 30, 2002.

Other significant expenses for the second half of 2002 include the depreciation of fixed assets of and amortization of license and permit and land-use rights of $548,687 and new market development of $172,139.

Overall, expenditures have decreased in 2003 from 2002 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 $282,581 for the three-month period ending September 30, 2003 compared to income of $1,626,399 for the same period last year.

The Company's net and comprehensive loss of $1,253,034 for the nine-month period ending September 30, 2003 compared to $1,136,347 for the same period last year.

DUE FROM RELATED PARTY - HEPATITIS B VACCINE PROJECT. Dr. Longbin Liu exercised his right to repurchase the Hepatitis B vaccine project from the Company for the original purchase price of $4 million, of which $500,000 has been paid and the balance of $3.5 million, plus interest accruing at 6% per annum from September 2002, was due September 5, 2003. Dr. Liu paid $500,000 at the time of the repurchase but did not pay the balance of $3.5 million plus accrued interest, due September 5, 2003.

The Company fully intends to pursue collection of the full amount owing and has commenced legal action. The Board of Directors has removed Dr. Liu as Chairman of the Board of Directors and has demanded that he step down as a Director of the Company. Dr. Liu has declined to step down as a Director at this time.

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 three-month and nine-month periods ended September 30, 2003. The loss per share for the three-month period ended September 30, 2003 was $0.01 and the loss per share for the nine-month period ended September 30, 2003 was $0.06. 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 September 30, 2003, the Company had $3,407,581 in cash available. This cash, the $1,287,409 in accounts receivable and anticipated sales will be used to fund the ongoing operations and research and development. Working capital was $4,611,892 at September 30, 2003.

During the nine-months ended September 30, 2003, the Company incurred losses of $1,253,034 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. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company is exposed to market risk, primarily related to foreign exchange. The Company maintains its accounting records in their functional currencies (i.e., U.S. dollars, Renminbi Yuan, and Canadian dollars respectively). They translate foreign currency transactions into their functional currency in the following manner.

At the transaction date, each asset, liability, revenue and expense is translated into the functional currency by the use of the exchange rate in effect at that date. At the period end, monetary assets and liabilities are translated into the functional currency by using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in operations.

The following table sets forth the percentage of the Company's administrative expense by currency for the years ended December 31, 2001 and 2002 and the nine-months ended September 30, 2003 and 2002.

By Currency

| | December 31, 2001 | December 31, 2002 |
|---|---|---|
| U.S. Dollar | 31% | 27% |
| Canadian Dollar | 12% | 46% |
| Renminbi Yuan | 57% | 27% |
| Total | 100% | 100% |

| | September 30, 2002 | September 30, 2003 |
|---|---|---|
| U.S. Dollar | 26% | 12% |
| Canadian Dollar | 47% | 64% |
| Renminbi Yuan | 27% | 24% |
| Total | 100% | 100% |

Such administrative expense by currency may change from time to time. Further, the Company incurred expenses in China of $1,867,597 and $1,983,450 for the nine-months ended September 30, 2003 and 2002, respectively, all of which were paid in RMB.

The Company has not entered into any material foreign exchange contracts to minimize or mitigate the effects of foreign exchange fluctuations on the Company's operations. The Company exchanges Canadian dollars to fund its Chinese operations. Based on prior years, the Company does not believe that it is subject to material foreign exchange fluctuations. However, no assurance can be given that this will not occur in the future.

ITEM 4. 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 is currently in the process of serving the complaint against the defendant.

ITEM 2. CHANGES IN 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 AND REPORTS ON FROM 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 8K.



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 14, 2003

/S/ Matthew Kavanagh
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Matthew Kavanagh
Director of Finance and Corporate
Compliance and Corporate Secretary
(duly authorized Officer and
Principal Financial Officer)