

DRAGON PHARMACEUTICAL INC
Form 10-Q
August 14, 2008

U.S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2008

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.)

650 West Georgia Street, Suite 310

Vancouver, British Columbia

Canada V6B 4N9

(Address of principal executive offices)

(604) 669-8817

(Issuer's telephone number)

Not applicable

(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 a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," "non-accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$0.001 Par Value - 67,006,419 shares as of August 14, 2008.

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PART I

ITEM 1.

FINANCIAL STATEMENTS

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**CONSOLIDATED BALANCE SHEETS****AS AT JUNE 30, 2008 AND DECEMBER 31, 2007 (UNAUDITED)****Expressed in Thousands (\$'000) of US Dollars Except Share Data****(Basis of Presentation - Note 1)**

<u>ASSETS</u>	Notes	June 30, 2008 (\$'000)	December 31, 2007 (\$'000)
CURRENT ASSETS			
Cash	18	1,542	4,736
Restricted cash	10,18	2,910	-
Accounts receivable, net of allowances	2	8,344	9,921
Inventories, net	3	25,145	19,090
Prepaid expenses		5,709	3,539
Due from related parties	16	883	940
Deferred income tax assets	15	561	579
Total Current Assets		45,094	38,805
PROPERTY AND EQUIPMENT, NET			
	4,9	89,734	70,189
OTHER ASSETS			
Intangible assets, net	5	1,430	1,417
Investments □ cost		15	14
Other assets	6	3,596	3,712
Deferred income tax assets	15	294	340
Total Other Assets		5,335	5,483
TOTAL ASSETS		140,163	114,477
<u>Liabilities and Stockholders' Equity</u>			
CURRENT LIABILITIES			
Accounts payable		14,206	9,319
Other payables and accrued liabilities	8	28,672	20,243
Loans payable □ short-term	9	22,742	25,503
Notes payable	10	5,821	-
Due to related parties	16	308	106
Total Current Liabilities		71,749	55,171
LONG-TERM LIABILITIES			
Loans payable □ long-term	9	13,243	12,442
Total Long-Term Liabilities		13,243	12,442
TOTAL LIABILITIES		84,992	67,613

COMMITMENTS AND CONTINGENCIES (Note 13)

STOCKHOLDERS' EQUITY

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Authorized: 200,000,000 common shares at par value of \$0.001

each, common shares issued and outstanding

2008: 67,006,419; 2007: 66,374,507

	67	66
Additional paid-in capital	49,022	42,681
Deficit	(5,709)	(4,488)
Reserves	14	3,833
Accumulated other comprehensive income	7,958	4,796
Due from stockholders	-	(24)
Total Stockholders' Equity	55,171	46,864
<u>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</u>	140,163	114,477

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

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)

Expressed in Thousands of US Dollars (\$'000) Except Share Data

	Note	Three Months Ended June 30, 2008 (\$ '000)	Three Months Ended June 30, 2007 (\$ '000)	Six Months Ended June 30, 2008 (\$ '000)	Six Months Ended June 30, 2007 (\$ '000)
SALES	11	\$ 44,147	19,977	\$ 80,015	36,880
COST OF SALES		36,420	16,433	66,121	29,586
GROSS PROFIT		7,727	3,544	13,894	7,294
OPERATING EXPENSES					
Selling expense		1,002	542	2,119	942
General and administrative expenses		1,750	1,959	3,622	3,386
Research and development expenses		548	14	983	63
Depreciation and amortization		257	187	435	319
Total Operating Expenses		3,557	2,702	7,159	4,710
INCOME FROM OPERATIONS		4,170	842	6,735	2,584
OTHER INCOME / (EXPENSE)					
Interest expense		(807)	(624)	(1,703)	(1,343)
Other income	12	422	248	751	260
Other expense		(35)	(69)	(36)	(92)
Total other expense		(420)	(445)	(988)	(1,175)
INCOME FROM CONTINUING OPERATIONS BEFORE TAXES		3,750	397	5,747	1,409
INCOME TAX EXPENSE		(975)	(157)	(1,240)	(298)
INCOME FROM CONTINUING OPERATIONS		2,775	240	4,507	1,111
INCOME FROM DISCONTINUED OPERATIONS	7	148	214	376	193
NET INCOME		2,923	454	4,883	1,304
OTHER COMPREHENSIVE INCOME					
Foreign currency translation		1,216	589	3,162	957
COMPREHENSIVE INCOME		\$ 4,139	1,043	\$ 8,045	2,261
Earnings per share - basic					
- from continuing operations		\$ 0.04	0.00	\$ 0.07	0.02
- from discontinued operations		\$ 0.00	0.00	\$ 0.00	0.00

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- net income	\$ 0.04	0.01	\$ 0.07	0.02
Earnings per share - diluted				
- from continuing operations	0.04	0.00	0.07	0.02
- from discontinued operations	0.00	0.00	0.00	0.00
- net income	0.04	0.01	0.07	0.02
Weighted average number of shares outstanding during the period				
- basic	66,992,531	62,878,004	66,683,519	62,878,004
- diluted *	68,891,910	62,878,004	68,531,398	62,878,004

* For the three months ended June 30, 2008 and 2007, diluted weighted average number of shares outstanding include the dilutive effect of stock options of 7,870,000 and nil, respectively, and exclude the antidilutive effect of stock options of 1,990,000 and 9,975,000, respectively. For the six months ended June 30, 2008, diluted weighted average number of shares outstanding include the dilutive effect of stock options of 7,870,000 and nil, respectively, and exclude the antidilutive effect of stock options of 1,990,000 and 9,975,000 respectively.

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

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY****FOR THE SIX MONTHS ENDED JUNE 30, 2008 (UNAUDITED)****Expressed in Thousands (\$'000) of US Dollars Except Share Data**

	Common Stock		Additional			Accumulated		Total
	Shares	Amount	Paid-In	Deficit	Reserves	other	Due from	
		(\$'000)	Capital	(\$'000)	(\$'000)	compre-	Stockholders	(\$'000)
			(\$'000)			hensive	(\$'000)	(\$'000)
						income		
						(\$'000)		
Balance, December 31, 2007	66,374,507	\$ 66	\$ 42,681	\$ (4,488)	\$ 3,833	\$ 4,796		(24) \$ 46,864
Stock options exercised (Note 14 (B))	631,912	1	135					136
Other comprehensive income								
- foreign currency translation						3,162		3,162
Stock-based compensation			102					102
Transfer from retained earnings to:								
- additional Paid-in Capital: (Note 13 (C))			6,104	(6,104)				-
Repayment from stockholders							24	24
Net income for the period				4,883				4,883
Balance, June 30, 2008	67,006,419	\$ 67	\$ 49,022	\$ (5,709)	\$ 3,833	\$ 7,958		- \$ 55,171

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

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2008 (UNAUDITED)

Expressed in Thousands (\$'000) of US Dollars

	2008 (\$'000)	2007* (\$'000)
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES:		
Income from continuing operations	4,507	1,111
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,651	2,577
Stock-based compensation expense	102	1,020
Accreted interest on long term payable	42	386
Loss on disposal of assets	-	41
Deferred income tax expense	121	-
Changes in operating assets and liabilities		
Accounts receivable	1,409	(4,704)
Inventories	(5,102)	1,145
Prepaid expenses	(1,887)	(481)
Accounts payable	4,166	571
Notes payable	5,656	-
Restricted cash	(2,828)	-
Amount due from related parties	258	(452)
Other payables and accrued liabilities	783	(298)
Cash provided by continuing operations	10,878	916
Cash provided by discontinued operations	540	551
Net Cash provided by Operating Activities	11,418	1,467
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES:		
Purchase of property and equipment	(18,087)	(3,979)
Government grants received in advance	-	1,295
Land deposit received in advance	4,665	-
Deposit for land and construction	(787)	-
Recovery of land deposit	1,131	-
Cash used in continuing operations	(13,078)	(2,684)
Cash provided by (used in) discontinued operations	1,555	(20)
Net Cash used in Investing Activities	(11,523)	(2,704)
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES:		

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Due from shareholder	24	-
Repayment of long-term accounts payable	(251)	(2,986)
Repayment of non-interest bearing demand loans	(2,900)	-
Proceeds from non-interest bearing demand loans	3,910	1,300
Proceeds from loans payable	509	6,422
Repayment of loans	(4,786)	(3,391)
Proceeds from exercise of stock options	136	-
Net Cash provided by (used in) Financing Activities	(3,358)	1,345
EFFECT OF EXCHANGE RATE CHANGES ON CASH	269	4
NET INCREASE (DECREASE) IN CASH	(3,194)	112
CASH AT BEGINNING OF THE PERIOD	4,736	1,079
CASH AT END OF THE PERIOD	1,542	1,191
Cash paid during the period for interest expense, net of capitalized interest	1,661	855
Cash paid during the period for income taxes	646	249

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

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)

Expressed in US Dollars

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

The Company capitalized interest of \$0 and \$26,000 during the six months ended June 30, 2008 and 2007, respectively.

* Cash flow for the six months ended June 30, 2007 was reclassified to reflect the results of discontinued operations. (See Note 7)

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)

Expressed in US Dollars

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION

(A) Basis of presentation and accounting policies

The unaudited interim consolidated financial statements have been prepared in conformity with United States generally accepted accounting principles. They include the accounts of Dragon Pharmaceutical Inc., which is incorporated under the laws of the State of Florida, United States, and its wholly-owned or controlled subsidiaries (collectively, the Company). Certain information and footnote disclosures required by United States generally accepted accounting principles for complete annual financial statements have been omitted and, therefore, these consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2007. In the opinion of management, these consolidated financial statements reflect all adjustments, of a normal recurring nature, necessary to present fairly, in all material respects, the Company's consolidated financial position, results of operations, and cash flows for the interim periods presented. The results of operations for the three and six months ended June 30, 2008 are not necessarily indicative of those for a full fiscal year.

The accompanying unaudited interim consolidated financial statements contemplate continuation of the Company as a going concern. The Company has a working capital deficiency of \$26.66 million as at June 30, 2008. However, the Company has developed and is implementing a plan to decrease its debt and increase its working capital which will allow the Company to continue operations as discussed below.

The Company plans to seek additional equity through the conversion of some of its liabilities and expects to raise funds through private placements in order to support existing operations and expand the range and scope of its business. The Company has also significantly increased production levels to generate additional cash flow under contracted supply agreements. In addition, the Company intends to continue to renegotiate and extend loans, as required, when they become due, as has been done in the past. There is no assurance that such additional funds will be available for the Company on acceptable terms, if at all, or that the Company will be able to negotiate and extend the loans. If adequate funds are not available or not available on acceptable terms or the Company is unable to negotiate

or extend its loans, the Company may be required to scale back or abandon some activities. Management believes that actions presently taken provide the opportunity for the Company to continue as a going concern. The Company's ability to achieve these objectives cannot be determined at this time. These conditions raise substantial doubt about the Company's ability to continue as a going concern. These financial statements do not include any adjustments that might result from this uncertainty.

(B) Recent Accounting Pronouncements

Effective January 1, 2008, the Company adopted, on a prospective basis, SFAS No. 157, Fair Value Measurements (SFAS 157) as amended by FASB Staff Position SFAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 (FSP FAS 157-1) and FASB Staff Position SFAS 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and provides for expanded disclosure about fair value measurements. SFAS 157 applies prospectively to all other accounting pronouncements that require or permit fair value measurements. FSP FAS 157-1 amends SFAS 157 to exclude from the scope of SFAS 157 certain leasing transactions accounted for under SFAS No. 13, Accounting for Leases. FSP FAS 157-2 amends SFAS 157 to defer the effective date of SFAS 157 for all non-financial assets and non-financial liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008.

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)****Expressed in US Dollars**

The adoption of SFAS 157 did not have a material impact on the Company's unaudited interim consolidated financial statements. Management is evaluating the impact that SFAS 157 will have on its non-financial assets and non-financial liabilities since the application of SFAS 157 for such items was deferred to January 1, 2009. The Company believes that the impact of these items will not be material to its consolidated financial statements.

Effective January 1, 2008, the Company adopted, on a prospective basis, SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of the guidance is to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company did not elect to apply the fair value option for any of its eligible financial instruments or other items on the January 1, 2008 effective date.

NOTE 2**ACCOUNTS RECEIVABLE**

Accounts receivable at June 30, 2008 and December 31, 2007 consisted of the following:

	June 30, 2008 (\$□000)	December 31, 2007 (\$□000)
Trade receivables	7,373	8,203
Amount due from sale of biotech division (Note 7)	-	1,613
Other receivables	1,756	813
Less: allowance for doubtful accounts	(785)	(708)
Accounts receivable, net	8,344	9,921

For the three months ended June 30, 2008 and 2007, the Company recorded a provision for doubtful accounts of \$16,000 and \$24,000 in the Consolidated Statements of Operations, respectively. For the six months ended June 30, 2008 and 2007, the Company recorded a provision for doubtful accounts of \$30,000 and \$52,000 in the Consolidated Statements of Operations, respectively.

NOTE 3

INVENTORIES

Inventories at June 30, 2008 and December 31, 2007 consisted of the following:

	June 30, 2008 (\$□000)	December 31, 2007 (\$□000)
Raw materials	11,347	6,864
Work-in-progress	7,185	7,642
Finished goods	6,902	5,492
	25,434	19,998
Less: provision	(289)	(908)
	25,145	19,090

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)****Expressed in US Dollars**

As at June 30, 2008 and 2007, the Company recorded an inventory valuation provision for lower of net realizable value or cost of \$289,000 and \$161,000 in the Consolidated Statements of Operations, respectively. As at March 31, 2008 and 2007, the Company recorded an inventory valuation provision for lower of net realizable value or cost of \$589,000 and \$157,000 in the Consolidated Statements of Operations, respectively.

NOTE 4**PROPERTY AND EQUIPMENT**

The following is a summary of property and equipment at June 30, 2008 and December 31, 2007:

	Cost (\$□000)	June 30, 2008 Accumulated Depreciation (\$□000)	Net Book Value (\$□000)
Plant and equipment	70,288	19,750	50,538
Land use rights and buildings	20,029	1,381	18,648
Motor vehicles	886	298	588
Furniture and office equipment	3,174	1,864	1,310
Construction in progress	18,650	-	18,650
	113,027	23,293	89,734
	Cost (\$□000)	December 31, 2007 Accumulated Depreciation (\$□000)	Net Book Value (\$□000)
Plant and equipment	63,268	15,573	47,695
Land use rights and buildings	17,918	1,132	16,786
Motor vehicles	794	232	562

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Furniture and office equipment	2,866	1,498	1,368
Construction in progress	3,778	-	3,778
	88,624	18,435	70,189

Depreciation expense for the three months ended June 30, 2008 and 2007 was \$1,862,000 and \$1,288,000 respectively. Depreciation expense for the six months ended June 30, 2008 and 2007 was \$3,576,000 and \$2,571,000 respectively. Land use rights and equipment with a net book value of \$29.2 million are pledged as collateral for \$8.6 million in loans payable (Note 9).

The balance of construction in progress as at June 30, 2008 represents capital expenditures in expansion of the formulation drugs and 7-ACA production lines. These projects are expected to be completed in the current fiscal year.

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)****Expressed in US Dollars****NOTE 5****INTANGIBLE ASSETS**

Intangible assets consisted of the following as of June 30, 2008 and December 31, 2007:

	June 30, 2008 (\$'000)	December 31, 2007 (\$'000)
Product licenses	1,552	1,458
Less: accumulated amortization	(122)	(41)
	1,430	1,417

Amortization expense for the three months ended June 30, 2008 and 2007 was \$38,000 and \$3,000 respectively. Amortization expense for the six months ended June 30, 2008 and 2007 was \$75,000 and \$6,000 respectively.

NOTE 6**OTHER ASSETS**

	June 30, 2008 (\$'000)	December 31, 2007 (\$'000)
Deposit for land and constructions costs	3,596	3,712

The Company is actively exploring additional business opportunities which may involve an investment in a new production campus. In this regard, the Company paid the deposits to the land bureau and various contractors for possible land and construction costs. According to the respective agreements, which were revised in June 2008, the Company will notify the contractors of the final decision of the project by April 1, 2009 and such deposits are refundable.

NOTE 7 **DISCONTINUED OPERATIONS**

The Company signed an agreement on November 5, 2007 with a non-affiliated third party to sell the assets of its former biotech operation excluding finished goods on hand. According to the agreement, the buyer agreed to pay the Company before June 2008 a total of US\$ 2.14 million (or RMB 15.6 million), in exchange for certain fixed assets and certain net working capital as at October 31, 2007 of the biotech business. As at June 30, 2008, the Company has received the full amount of US\$2.14 million from the buyer. The loss on disposal of the biotech division was as follows:

	\$□000
Accounts receivable	567
Inventory -raw materials & work-in-progress	249
Value added tax for sales of inventories	42
Total current assets	858
Property and equipment	1,516
Less: accounts payable and accrued liabilities	(770)
Net assets for sale	1,604
Selling price	2,138
Gain on sale of fixed assets and working capital	534
Less: write-off of intangible assets and goodwill	(3,112)
Loss on disposal of biotech division	(2,578)

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)****Expressed in US Dollars**

The operations of the former biotech division have been reclassified and are presented in the consolidated financial statements as a discontinued operation. A summary of such discontinued operation is as follows:

	Three months ended June 30, 2008 (\$'000)	Three months ended June 30, 2007 (\$'000)	Six months ended June 30, 2008 (\$'000)	Six months ended June 30, 2007 (\$'000)
Net sales	432	573	966	998
Cost of sales	232	139	413	251
Gross profit	200	434	553	747
Operating and other expenses	(2)	(168)	(52)	(478)
Income before taxes	198	266	501	269
Income tax expense	(50)	(52)	(125)	(76)
Profit from discontinued operation	148	214	376	193

The net sales for the three and six months ended June 30, 2008 represent sales of the finished goods retained by the Company at the date of sale of the division. As at June 30, 2008, the finished goods remaining on hand were \$367,000 and are expected to be sold by the end of the year.

NOTE 8**OTHER PAYABLES AND ACCRUED LIABILITIES**

Other payables and accrued liabilities at June 30, 2008 and December 31, 2007 consisted of the following:

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	June 30, 2008 (\$'000)	December 31, 2007 (\$'000)
Machinery and equipment payable	7,205	6,680
Non-interest bearing demand loans	5,330	3,088
Current portion of long term accounts payable	1,918	2,004
Advance of Government grants *	2,328	2,187
Advance of land reservation	4,801	-
Accrued expenses	3,068	3,204
Income taxes payable	1,949	1,252
Other taxes payable	725	1,107
Deposits received from customers	1,348	721
	28,672	20,243

* The government grants are related to the construction of a water treatment facility. Upon receipt of final approval of the completed project, the amount of \$2,328,000 will be reclassified as deferred revenue and recognized on a straight-line basis as the asset is depreciated.

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)****Expressed in US Dollars****NOTE 9****LOANS PAYABLE**

The loans payable, denominated in Renminbi Yuan (RMB), are as follows:

	June 30, 2008 (\$'000)	December 31, 2007 (\$'000)
RMB 20 million loan payable to a bank, interest rate of 7.956% per annum, collateralized by property and equipment with a net book value of \$9,004,000, due January 2008	-	2,735
RMB 6.68 million loan payable to a bank, interest rate of 8.748% per annum, collateralized by land use right and buildings with a net book value of \$5,375,000, due September 2008	972	913
RMB 3.85 million loan payable to a bank, interest rate of 9.072% per annum, guaranteed by an unrelated third party, due April 2008	-	526
RMB 3.6 million loan payable to a bank, interest rate of 9.198% per annum, guaranteed by an unrelated third party, due October 2008	524	-
RMB 52.3 million loan payable to a bank, interest rate of		

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9.711% per annum, collateralized by plant and building with a net book value of \$23,823,000, due December 2008	7,611	7,151
RMB 55.00 million loan payable to a bank, interest rate of 9.36% per annum, guaranteed by an unrelated third party, due September 2009	8,004	7,520
RMB 89.60 million loan payable to a unrelated third party, non-interest bearing and uncollateralized, due October 2008	13,040	12,252
RMB 4.09 million loan payable to a unrelated third party, non-interest bearing and uncollateralized, due September 2008	595	559
RMB 10.00 million loan payable to a bank, interest rate of 6.732% per annum, collateralized by property and equipment with a net book value of \$7,627,000, due February 2008	-	1,367
RMB 36.00 million loan payable to a bank, interest rate of 10.458% per annum, guaranteed by an unrelated third party, due October 2010	5,239	4,922
	35,985	37,945
Less: current maturities	22,742	25,503
	13,243	12,442

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)****Expressed in US Dollars**

Maturities are as follows:

Fiscal year ended December 31,	
2008 (Remainder of the year)	22,742
2009	8,004
2010	5,239
	35,985

NOTE 10**NOTES PAYABLE**

The Company has a banking facility whereby the Company has issued several non-interest bearing notes payables to two vendors totalling \$2,910,000 (RMB 20 million) as at June 30, 2008. These notes are due on August 4, 2008, and are collateralized by \$2,910,000 of bank deposits that may only be used to repay the notes. The notes payable were paid in August 2008. On August 7, 2008, the Company issued several non-interest bearing notes payables to vendors totalling \$1,455,000 (RMB10 million). These notes are due on February 7, 2009.

The Company also entered into an agreement with a bank providing a facility of up to \$4,272,000 (RMB 30 million) pursuant to which the company may issue promissory notes that are guaranteed by the bank and which can be provided to suppliers to guarantee payment for purchases. This facility is for one year and expires on February 2, 2009. The bank will charge a fee of 0.05% on the total amount of each letter of credit provided. The facility is collateralized by equipment with a net book value of \$6,982,000. As at June 30, 2008, the Company issued several non-interest bearing notes under this facility to vendors totalling \$2,911,000. These notes are due on August 19, 2008.

NOTE 11**SEGMENTS**

Beginning with the first quarter of fiscal year 2008, the Company has changed the structure of its internal organization and realigned its business segments into two divisions: Cephalosporin and Penicillin. Cephalosporin Division operates the production and sales of 7-ACA, active pharmaceutical ingredient (API) and formulation drugs. In addition to 7-ACA, an intermediate for cephalosporin antibiotics, the Company's current product offering in the Cephalosporin Division also includes ceftazidime crude powder (downstream API) and formulation products such as powder for

injection for ceftriaxone, cefazolin, cefotaxime, cefoperazone, ceftazidime and cefuroxime. Penicillin Division currently operates the production and sales of Clavulanic Acid, Cefalexin and Cefadroxil. Cefalexin and Cefadroxil were launched and included in the Company's product portfolio in January 2008. Clavulanic Acid is a drug that combines with penicillin group antibiotics to increase the effectiveness against bacteria resistance. Cefalexin is a Penicillin G downstream product that is widely used to treat urinary tract infections, respiratory tract infections, skin and soft tissue infections.

This realignment better reflects the Company's business strategy to become a leading vertically integrated manufacturer and distributor of a broad line of high-quality antibiotic products.

The Company evaluates segment performance based on gross profit. All sales by division were to external customers (see Note 18 also). Sales relating to the Cephalosporin Division's 7-ACA product represented approximately 34.39% and 35.92% of the total sales for the three and six months ended June 30, 2008 respectively (60.22% and 61.88% for the three and six months ended June 30, 2007). Substantially all of the Company's assets are located in China. The following is a summary of the Company's segment information for the three and six months ended June 30, 2008 and 2007 and as of June 30, 2008 and December 31, 2007.

DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)

Expressed in US Dollars

	Cephalosporin Division (\$'000)	Penicillin Division (\$'000)	Total (\$'000)
Three months ended June 30, 2008			
Sales	31,111	13,036	44,147
Gross profit	5,199	2,528	7,727
Depreciation and amortization	1,441	459	1,900
Additions to long-lived assets	14,255	316	14,571
Six months ended June 30, 2008			
Sales	54,838	25,177	80,015
Gross profit	8,880	5,014	13,894
Depreciation and amortization	2,804	847	3,651
Additions to long-lived assets	16,940	1,766	18,706
As at June 30, 2008			
Intangible assets	1,430	-	1,430
Total assets for reportable segments	98,356	37,355	135,711
Cash and restricted cash			4,452
Consolidated total assets			140,163
Three months ended June 30, 2007			
Sales	15,696	4,281	19,977
Gross profit	2,607	937	3,544
Depreciation and amortization	1,012	279	1,291
Additions to long-lived assets	1,817	180	1,997
Six months ended June 30, 2007			
Sales	28,359	8,521	36,880
Gross profit	5,269	2,025	7,294
Depreciation and amortization	1,995	582	2,577
Additions to long-lived assets	3,460	342	3,802
As at December 31, 2007			
Intangible assets	1,417	-	1,417
Total assets for reportable segments	79,945		