DRAGON PHARMACEUTICAL INC
Form 10-Q
August 14, 2008

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 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 accelerate 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):

o Large accelerated filer o Accelerated filer ¨Non-accelerated filer ý 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)**

| **ASSETS** | 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 |
| | | | |
| **Liabilities and Stockholders□ Equity** | | | |
| **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** | | | |

| | | | |
|---|---|---|---|
| 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 | 3,833 |
| Accumulated other comprehensive income | | 7,958 | 4,796 |
| Due from stockholders | | - | (24) |
| Total Stockholders Equity | | 55,171 | 46,864 |
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | | 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 |

| | | | | |
|---|---|---|---|---|
| - 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 Paid-In | | | Accumulated other compre-hensive | Due from | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount ($'000) | Capital ($'000) | Deficit ($'000) | Reserves ($'000) | income ($'000) | Stockholders ($'000) | Total ($'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 LOWS**

**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: | | |

| | | |
|---|---|---|
| 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)

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**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 |

| | | | |
|---|---|---|---|
| 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:

| | 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 | | |

| | | |
|---|---|---|
| 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**

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**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**

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**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 | 29,796 | 109,741 |
| Cash and restricted cash | | | 4,736 |

| | |
|---|---|
| Consolidated total assets | 114,477 |

*The segment information for the three and six months ended June 30, 2007 and as of December 31, 2007 was restated to reflect the realignment of business segments.

**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**

Geographical segments information 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) |
|---|---|---|---|---|
| Sales | | | | |
| - China | 36,200 | 13,693 | 66,338 | 24,439 |
| - India | 6,312 | 5,556 | 10,919 | 10,682 |
| - Other | 1,635 | 728 | 2,758 | 1,759 |
| | 44,147 | 19,977 | 80,015 | 36,880 |

Total assets

| | June 30, 2008 ($'000) | December 31, 2007 ($'000) |
|---|---|---|
| -China | 139,936 | 114,307 |
| -Other | 227 | 170 |
| | 140,163 | 114,477 |

**NOTE 12**

**OTHER INCOME**

***(A) Government grants***

During the three and six months ended June 30, 2008 and 2007, Shanxi Weiqida, a wholly-owned subsidiary of the Company, applied for, and received non-refundable grants of $294,000 and $116,000, respectively, from the government of China for bringing in investment and new technology to Datong city, Shanxi, Province, China

***(B) Subsidies for employee benefit***

During the year ended December 31, 2007, Shanxi Weiqida received subsidies of $1,370,000 from the government of China for mandated employee benefit contributions for the period from July 2005 to June 2008. These subsidies were deposited directly into the employees social benefit and insurance accounts. During the year ended December 31, 2007, $950,000 was recognized as other income, and for the three and six months ended June 30, 2008, $179,000 and $420,000 was recognized as other income, respectively (for the three and six months ended June 30, 2007: nil).

**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 13**

**COMMITMENTS AND CONTINGENCIES**

***(A) Employee Benefits***

The full time employees of Shanxi Weiqida, a wholly-owned subsidiary in China, are entitled to employee benefits including medical care, worker compensation, unemployment insurance and pension benefits through a Chinese government mandated multi-employer defined contribution plan. The Company is required to accrue for those benefits based on certain percentages of the employees salaries. The total provision for such employee benefits was $226,000 and $118,000 for the three months ended June 30, 2008 and 2007, respectively, and $434,000 and $227,000 for the six months ended June 30, 2008 and 2007, respectively. The Company is required to make contributions to the plans out of the amounts accrued for medical and pension benefits. The Chinese government is responsible for the medical benefits and the pension liability to be paid to these employees.

***(B) Loan Guarantees***

The Company has guaranteed a bank loan to a supplier in the amount of $2,736,000 (RMB18.8 million), due on July 8, 2008. Interest on the loan is charged at 9.576% and the bank has the right to seek settlement from the Company for payment should the supplier fail to repay the loan. The loan was renewed with the principal amount of $2,590,000 (Rmb17.8 million), bearing interest at 10.458%. Such loan is due on July 7, 2009. There is no recourse or possible recovery for the Company should the supplier default on its bank loan. The maximum potential amount of future payments (undiscounted) that the Company could be required to make is $2,742,000 (RMB 18.83 million). The Company provided the guarantee to the supplier to maintain a good business relationship.

The Company has also issued a guarantee to a bank as collateral for loans to a third party vendor of $2,765,000 (RMB19 million) due on September 25, 2009 and $4,147,000 (RMB 28.5 million) due on October 26, 2009. Interest is charged at 8.715 %. The bank has the right to seek settlement from the Company for payment should the third party vendor fail to repay the loan. The maximum potential amount of future payments (undiscounted) that the Company

could be required to make is $7,689,000 (RMB 52.84 million). This vendor has pledged certain property and equipment to the Company as collateral for this guarantee.

***(C) Capital Commitments***

According to the approval of the Business Bureau of Shanxi province, China on December 12, 2007, the total registered capital to Shanxi Weiqida increased from $24,175,000 (RMB200 million) to $51,519,000 (RMB400 million). The Company is required to contribute the additional registered capital of $27,344,000 (RMB 200 million) by paying cash of $14,536,000 (RMB106 million) and transferring $12,808,000 (RMB94 million) of retained earnings of Shanxi Weiqida within 3 years from November 20, 2007. For the six months ended June 30, 2008, the Company transferred $6,104,000 (RMB44 million) of retained earnings of Shanxi Weiqida to registered capital of Shanxi Weiqida. As at June 30, 2008, the Company has a capital commitment of $15,237,000 (RMB107 million) to Shanxi Weiqida.

According to the Articles of Association of Beijing Weixiang, the Company is required to contribute registered capital of $5,000,000 to Beijing Weixiang within five years from August 1, 2005. As of June 30, 2008, the Company has contributed $1,099,000 of the registered capital requirement and has registered capital commitments of $3,901,000.

**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**

***(D) Operating Leases***

The Company has commitments related to operating leases for property which require the following payments for each year ending December 31:

| | ($□000) |
|---|---|
| 2008 (for the remainder of the year) | 954 |
| 2009 | 161 |
| 2010 | 161 |
| 2011 | 103 |
| 2012 | 49 |
| | 1,428 |

The rent expense for the three months ended June 30, 2008 and 2007 was $486,000 and $17,000, respectively, and for the six months ended June 30, 2008 and 2007 was $954,000 and $43,000, respectively.

***(E) Other Commitments***

Capital expenditure contracted for but not yet incurred at June 30, 2008 and December 31, 2007 was $948,000 and nil, respectively.

**NOTE 14**

**STOCKHOLDERS EQUITY**

***(A) Reserves***

Pursuant to PRC regulations, Shanxi Weiqida is required to make appropriations to reserves funds, comprising the reserve fund, staff welfare fund and enterprise expansion fund, based on after-tax net income determined in accordance with generally accepted accounting principles of the People s Republic of China (the PRC GAAP ). Appropriations to the reserve fund should be at least 10% of the after-tax net income determined in accordance with the PRC GAAP until the reserve is equal to 50% of Shanxi Weiqida s registered capital. The reserve fund is established for covering potential losses. Appropriations to the staff welfare fund are at a percentage, as determined by the Board of Directors, of the after-tax net income determined in accordance with the PRC GAAP.

The staff welfare fund is established for the purpose of providing employee facilities and other collective benefits to the employees. Appropriations to the enterprise expansion fund are made at the discretion of the Board of Directors. The enterprise expansion fund is established for expanding business operation. The reserve fund and enterprise expansion fund are recorded as part of stockholders equity but are not available for distribution to stockholders other than in liquidation, while the staff welfare fund is recorded as a liability and is not for distribution to stockholders. The appropriations to reserves are made by the Board of Directors on an annual basis.

***(B) Stock Options***

The Company has adopted the 2005 Stock Option Plan, effective August 13, 2005, which allows for the granting of options to directors and employees for a period of up to ten years.

**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**

During the six months ended June 30, 2008, the Company granted options on February 17, 2008 to its directors and employees to purchase 170,000 shares at an exercise price of $0.75 (being the market price at the time) expiring on February 17, 2011. Of this grant, options to purchase 120,000 shares vested immediately with 25,000 options vesting on each of February 17, 2009, and 2010.

During the six months ended June 30, 2007, the Company granted options on May 17, 2007 to its directors and employees to purchase 4,760,000 shares at an exercise price of $0.51 (being the market price at the time) expiring on May 16, 2010. Of this grant, options to purchase 3,960,000 shares vested immediately with 400,000 options vesting on each of May 16, 2008, and May 16, 2009.

During the six months ended June 30, 2008, a director of the Company exercised 200,000 stock options. Pursuant to the share purchase agreement, dated June 11, 2004 and the escrow agreement, dated January 12, 2005 (the Agreements ), the Company released 431,912 shares from escrow to the former shareholders of Oriental Wave Holding Limited. The Agreements related to the acquisition of Oriental Wave Holding Limited and provided for the release of the escrowed shares if certain stock options outstanding at the date of acquisition were exercised prior to the expiry dates. As the release of the escrowed shares did not change the original purchase price, no value was ascribed to the common shares. As at June 30, 2008, no escrowed shares remain outstanding.

The following table summarizes stock options information as at June 30, 2008:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Options outstanding at December 31, 2007 | 9,975,000 | $ 0.71 |
| Granted | 170,000 | $ 0.75 |
| Exercised | (200,000) | $ 0.68 |
| Expired and forfeited | (85,000) | $ 0.82 |
| Options outstanding at June 30, 2008 | 9,860,000 | $ 0.71 |

| Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|
| | Weighted Average | Weighted | Weighted Average | Weighted |

| Range of Exercise Prices | Number Outstanding | Remaining Contractual Life | Average Exercise Price | Number Exercisable | Remaining Contractual Life | Average Exercise Price |
|---|---|---|---|---|---|---|
| $0.51 - $0.75 | 8,040,000 | 2.04 | $ 0.60 | 7,595,000 | 2.04 | $ 0.61 |
| $1.18 | 1,820,000 | 1.54 | $ 1.18 | 1,820,000 | 1.54 | $ 1.18 |
| | 9,860,000 | 1.95 | $ 0.71 | 9,415,000 | 1.95 | $ 0.72 |

**DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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The Company recorded stock based compensation expense of $27,000 and $102,000 for the three and six months ended June 30, 2008, respectively ($998,000 and $1,020,000 for the three and six months ended June 30, 2007, respectively), related to stock options granted to directors and employees, the amounts of which are included in general and administrative expenses. The estimated fair value of stock options granted during the six months ended June 30, 2008 was determined using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility 81.51 % (2007: 67.23%); risk-free rate 4.4% (2007: 4.58%); expected average life of the options 3 years (2007: 3 year); dividend yield 0% (2007: 0%). The Company estimated a 0% forfeiture rate by considering the historical employee turnover rates and expectations about the future, and will subsequently adjust compensation cost for differences between expectations and actual experience. The estimated fair value of the options granted during the six months ended June 30, 2008 was $0.41 per share (2007: 0.25 per share). The fair value of the options is being expensed on a straight-line basis over the vesting period of the options.

Aggregate intrinsic value of the Company s stock options is calculated as the difference between the exercise price of the options and the quoted price of the common shares that were in-the-money. The aggregate intrinsic value of the Company's outstanding stock options as at June 30, 2008 was $3,950,000. For the three months ended June 30, 2008, stock options of 200,000 were exercised at a price of $0.68 (2007: nil). The estimated fair value of stock options vested was $0 and $943,000 during the three months ended June 30, 2008 and 2007, respectively, and $49,000 and 965,000 during the six months ended June 30, 2008 and 2007, respectively. There is approximately $75,000 of unrecognized compensation expense as of June 30, 2008 that is expected to be recognized over the next 24 months.

**NOTE 15**

**INCOME TAXES**

On March 16, 2007, The National People s Congress of China passed The Law of the People's Republic of China on Enterprise Income Tax (the Enterprise Income Tax Law ). The Enterprise Income Tax Law will become effective on January 1, 2008. This new law eliminated the existing preferential tax treatment that is available to the foreign invested enterprises ( FIE s). Under the new law, Shanxi Weiqida and Huaxin are subject to a unified income tax rate of 25% starting from 2008.

During the six months ended June 30, 2008, Shanxi Weiqida applied for and received an income tax credit for reinvestment of $450,000 ($nil for the six months ended June 30, 2007) from the government of China. This credit is related to reinvestment of retained earnings of 2006 of $6,704,000 (RMB 49 million) to paid-in capital of 2007. These

credits were recorded as a reduction of income taxes for the six months ended June 30, 2008 (for the six months ended June 30, 2007: nil). As a result, the effective income tax rate for Shanxi Weiqida for the six months ended June 30, 2008 is 18%.

**DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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The tax effect of temporary differences that give rise to significant components of the deferred tax assets are as follows:

| | June 30, 2008 ($,000) | December 31, 2007 ($,000) |
|---|---|---|
| Deferred tax assets | | |
| Inventory | $ 72 | $ 242 |
| Accounts receivable | 57 | - |
| Accrued expenses | 432 | 337 |
| Other assets, net | 582 | 547 |
| Property and equipment | 2,056 | 2,032 |
| Losses carried forward | 833 | 814 |
| Total deferred tax assets | 4,032 | 3,972 |
| Less: valuation allowance | (3,177) | (3,053) |
| Net deferred tax assets | 855 | 919 |
| Less: deferred tax- short term | 561 | 579 |
| Net deferred tax assets | $ 294 | $ 340 |

**NOTE 16**

**RELATED PARTY TRANSACTIONS**

During the three and six months ended June 30, 2008, the Company supplied certain raw materials to a related party, whose director is also a stockholder of the Company, for which the Company charged $385,000 and $719,000, respectively ($251,000 and $665,000 for the three and six months ended June 30, 2007, respectively). The Company also used this party as a contract manufacturer of certain Cephalosporin products for which the party charged $103,000 and $424,000 for the three and six months ended June 30, 2008, respectively ($33,000 and $222,000 for the three and six months ended June 30, 2007, respectively). The transactions were recorded at the exchange amount.

The balance arising from sales/purchase of goods and services are as follows:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|

| | ($'000) | ($'000) |
|---|---|---|
| a. Due from related parties | | |
| Due from a company whose director is also a stockholder and director of the Company | 883 | 940 |
| Less: current maturities | 883 | 940 |
| | - | - |
| b. Due to related parties | | |
| Due to a company whose director is also a stockholder and director of the Company | 308 | 106 |
| Less: current maturities | 308 | 106 |
| | - | - |

The balance due from/to related parties bear no interest and are under normal trade repayment terms.

**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 17

## FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of the Company s cash, accounts receivable, investments, amounts due to and from related parties and short-term loans and other payables approximates their fair value. The fair value of long-term loans payable and long-term accounts payable are estimated using discounted cash flow analysis, based upon the Company s current borrowing rates, and approximate their carrying value.

## NOTE 18

## CONCENTRATIONS AND RISKS

82% and 83% of the Company s revenues for the three and six months ended June 30, 2008, respectively (68.5% and 66.3% for the three and six months ended June 30, 2007, respectively), were derived from customers located in China. During the three and six months ended June 30, 2008, the Company had sales of $6,312,000 and $10,919,000, respectively, to customers in India, representing 14.3% and 13.6%, respectively, of the Company s revenues for the three and six months ended June 30, 2008. During the three and six months ended June 30, 2007, the Company had sales of $5,556,000 and $10,682,000 respectively to customers in India, representing 27.8% and 29%, respectively, of the Company s revenues for the three and six months ended June 30, 2007.

Sales to the Company s largest customer, a Cephalosporin Division customer, accounted for approximately 7.1% and 6.67% of the Company s sales for the three months ended June 30, 2008 and 2007, respectively, and 8.38% and 20.4% for the six months ended June 30, 2008 and 2007, respectively. Amounts owing from one customer represented 21% of the Company s trade and other receivables at June 30, 2008.

The Company is exposed to the risk arising from changing interest rates. A detailed analysis of the Company s Loans Payable, together with their respective interest rates and maturity dates, is included in Note 9.

The majority of the Company s assets, liabilities, revenues and expenses are denominated in Renminbi, which was tied to the US Dollar and is now tied to a basket of currencies of China s largest trading partners, is not a freely convertible currency. The appreciation of the Renminbi against the US Dollar would result in an increase in the assets, liabilities, revenues and expenses of the Company and a foreign currency gain included in comprehensive income. Conversely, the devaluation of the Renminbi against the US Dollar would result in a decrease in the assets, liabilities, revenues and expenses of the Company and a foreign currency loss included in comprehensive income. As at June 30, 2008, approximately US$4,294,000 of cash and restricted cash (December 31, 2007: US$4,633,000) were held in Renminbi.

**ITEM 2.**

**MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Except for statements of historical facts, this section contains forward-looking statements involving risks and uncertainties. You can identify these statements by forward-looking words including "believes," "considers," "intends," "expects," "may," "will," "should," "forecast," or "anticipates," or the negative equivalents of those words or comparable terminology, and by discussions of strategies that involve risks and uncertainties. Forward-looking statements are not guarantees of the Company s future performance or results, and the Company s actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Risk Factors." This section should be read in conjunction with the Company s unaudited consolidated financial statements.*

The following discusses the Company s financial condition and results of operations for the three-month and six-month periods ended June 30, 2008 and 2007 based upon the Company s unaudited interim consolidated financial statements which have been prepared in accordance with the United States generally accepted accounting principles. It should be read in conjunction with the Company s audited consolidated 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, 2007.

Starting January 1, 2008, the Company has reclassified its business into two segments, Cephalosporin Division and Penicillin Division.

Cephalosporin Division operates the production and sales of 7-ACA, crude bulk drugs and formulation drugs. In addition to 7-ACA, an intermediate for cephalosporin antibiotics, the Company s current product offering in the Cephalosporin Division also has crude bulk drugs including ceftazidime crude powder, and formulation drugs including powder for injection for ceftriaxone, cefazolin, cefotaxime, cefoperazone, ceftazidime, cefuroxime, cefonicid and cefminox.

Penicillin Division currently operates the production and sales of Clavulanic Acid, cefalexin and cefadroxil. Cefalexin and cefadroxil were only launched and included in the Company s product portfolio during the first six months of 2008. Clavulanic Acid is a drug that combines with penicillin group antibiotics to increase the effectiveness against bacterial resistance. Cefalexin and cefadroxil are Penicillin G downstream products that are widely used to treat urinary tract infections, respiratory tract infections, skin and soft tissue infections.

**Results of Operations for the Three-month and Six-month Periods Ended June 30, 2008 and 2007**

***Revenues and Gross Margin Analysis***

For the quarter ended June 30, 2008

Sales for the quarter ended June 30, 2008 increased 121% to $44.15 million from $19.98 million for the same period in 2007. $36.20 million or approximately 82% of the sales for the quarter ended June 30, 2008 were generated from the sales of products in the Chinese market, and the remaining $7.95 million or approximately 18% were generated from the sales of products in the markets outside of China. By comparison, 69% of the sales for the quarter ended June 30, 2007 were generated from the sale of products in the Chinese market while the remaining 31% of the sales were generated in the international market outside of China.

For the quarter ended June 30, 2008, $31.11 million or approximately 70% of the sales were from the Cephalosporin Division and $13.04 million or 30% of sales were from the Penicillin Division. For the same period in 2007, 79% of sales were from the Cephalosporin Division and 21% of sales were from the Penicillin Division. The increase in sales for the three-month period ended June 30, 2008 as compared to the prior year was primarily due to an increase in sales quantities for all products, especially, crude bulk drugs and formulation drugs of the Cephalosporin Division and cefalexin and cefadroxil of the Penicillin Division. Crude bulk drugs of the Cephalosporin Division and cefalexin and cefadroxil of the Penicillin Division were new products the Company introduced during the six-month period of 2008.

Cost of sales for the quarter ended June 30, 2008 was $36.42 million compared to $16.43 million for the same period in 2007. The increase in the cost of sales was mainly due to the increase in production and sales of products from both Cephalosporin and Penicillin Divisions as mentioned above. Overall gross profit for the quarter ended June 30, 2008 increased 118% to $7.73 million from $3.54 million for the same period in 2007. While every product in both divisions experienced an increase in gross margin during the second quarter of 2008, different product mix led to the same overall gross margin of 18% for the second quarter for both 2008 and 2007.

For the six-month period ended June 30, 2008

Sales for the six-month period ended June 30, 2008 increased 117% to $80.02 million from $36.88 million for the same period in 2007. $66.34 million or approximately 83% of the sales for the six-month period ended June 30, 2008 were generated from the sales of products in the Chinese market, and the remaining $13.68 million or approximately 17% were generated from the sales of products in the markets outside of China. By comparison, 66% of the sales for the six-month period ended June 30, 2007 were generated from the sale of products in the Chinese market while the remaining 34% of the sales were generated in the international market outside of China.

For the six-month period ended June 30, 2008, $54.84 million or approximately 69% of the sales were from the Cephalosporin Division and $25.18 million or 31% of sales were from the Penicillin Division. For the same period in 2007, 77% of sales were from the Cephalosporin Division and 23% of sales were from the Penicillin Division. The increase in sales for the six months of 2008 as compared to the same period of the prior year was primarily due to an increase in sales quantities for all products, especially, crude bulk drugs and formulation drugs of the Cephalosporin Division and cefalexin and cefadroxil of the Penicillin Division. Crude bulk drugs of the Cephalosporin Division and cefalexin and cefadroxil of the Penicillin Division were new products the Company introduced during the six-month period of 2008.

Cost of sales for the six-month period ended June 30, 2008 was $66.12 million compared to $29.59 million for the same period in 2007. The increase in the cost of sales was mainly due to the increase in production and sales of products from both Cephalosporin and Penicillin Divisions as mentioned above. Overall gross profit for the six-month period ended June 30, 2008 increased 91% to $13.89 million from $7.29 million for the same period in 2007. While every product in both divisions experienced an increase in gross margin for the first six months of 2008 as compared to the same period in 2007, overall gross margin for the six-month period of 2008 was 17%, lower than

the overall gross margin of 20% for the same period in 2007. The decrease of the overall gross margin was due to the change in product mix with an increase in sales of Cephalosporin formulation drugs, which had a lower margin than other products, and the introduction of crude bulk drug of the Cephalosporin Division and cefalexin and cefadroxil of the Penicillin Division, which carried slightly lower margins initially.

***Divisional Revenues and Gross Margin Analysis***

The Company s businesses are currently organized under two business Divisions: the Cephalosporin and the Penicillin Division.

***Cephalosporin Division***

For the quarter ended June 30, 2008

Sales for the Cephalosporin Division for the quarter ended June 30, 2008 were $ 31.11 million, representing a 98% increase from the sales of $15.70 million during the same period in 2007. The increase in sales is mainly due to an increase in the selling price and volume for 7-ACA and Cephalosporin formulation drugs as well as the introduction of crude bulk drug in the market. Sales of 7-ACA and Cephalosporin formulation products for the quarter ended June 30, 2008 increased 26% and 199% respectively year-over-year.

The Cephalosporin Division s gross margin for the quarter ended June 30, 2008 was 17%, the same as that for the quarter ended June 30, 2007 even though every product of the division experienced an increase in gross margin year-over-year. Gross margin for 7-ACA, crude bulk drugs and Cephalosporin formulation drugs was 30%, 8% and 3% respectively for the second quarter of 2008, an improvement from the gross margin of 24%, nil and -9% respectively for the same period in 2007. The increase in gross profit margin of these products reflected an increase in the selling price of 7-ACA as well as the cost improvement of the Cephalosporin formulation drugs. During the quarter ended June 30, 2008, the contribution of the sales from Cephalosporin formulation drugs to the total sales of the Cephalosporin division was over 35% as compared to 23% for the same period in 2007.

For the six-month period ended June 30, 2008

Sales for the Cephalosporin Division for the six-month period ended June 30, 2008 were $54.84 million, representing a 93% increase from the sales of $28.36 million during the same period in 2007. The increase in sales is mainly due to the growth of the Cephalosporin formulation business which increased 274% year-over-year from $5.54 million for the first six-month in 2007 to $20.74 million for the same period in 2008 as well as the introduction of the crude bulk drugs to the market which had sales of $5.36 million for the six-month period of 2008.

Overall gross margin for the Cephalosporin Division for the six-month period ended June 30, 2008 was 16%, decreased from the 19% for the same period in 2007, even though every product experienced an increase in gross margin year-over-year. The decrease of the overall gross margin for the division was due to the change in product mix with an increase in sales contribution of the Cephalosporin formulation drug business from 20% of the divisional sales for the six-month period in 2007 to 38% for the same period in 2008 and the new introduction of the crude bulk drugs. During the six-month period in 2008, gross margins for 7-ACA, crude bulk drugs and formulation drugs increased to 29%, 8% and 1% respectively from 25%, nil and -6% respectively for the same period in 2007.

***Penicillin Division***

For the quarter ended June 30, 2008

The Penicillin Division s sales for the quarter ended June 30, 2008 were $13.04 million, accounting for 30% of the total sales of the Company. By comparison, Penicillin Division s sales were $4.28 million for the same period in 2007, contributing 21% of the total sales of the Company.

The 204% increase in sales of the Penicillin Division during the quarter ended June 30, 2008 as compared to the same period in 2007 was mainly due to the increase in both sales volume and selling prices of Clavulanic Acid as well as the introduction of cefalexin and cefadroxil in the market since the beginning of 2008. Sales of Clavulanic Acid for the second quarter of 2008 increased 51% year-over-year from $4.27 million to $6.45 million while the sales of cefalexin and cefadroxil already reached $6.59 million for the second quarter of 2008.

The overall gross margin for the Penicillin Division for the quarter ended June 30, 2008 was 19% as compared to 22% for the same period of 2007. Clavulanic Acid had a gross margin of 31% for the second quarter of 2008 as compared to 20% for the same period in 2007. This reflected the increase in sales contribution of sterilized Clavulanic Acid powder which normally had a higher margin than other Clavulanic Acid products. The slight decrease of the overall gross margin of the Division was due to a change in product mix with the introduction of cefalexin and cefadroxil, two new products launched in the market only since January, 2008, which had an average of 8% gross margin initially during the second quarter of 2008.

For the six-month period ended June 30, 2008

The Penicillin Division s sales for the first six-month of 2008 were $25.18 million, accounting for 31% of the total sales of the Company. By comparison, Penicillin Division s sales were $8.52 million for the same period in 2007, contributing 23% of the total sales of the Company. The 195% increase in sales of the Penicillin Division during 2008 as compared to 2007 was mainly due to the increase in both sales volume and selling prices of Clavulanic Acid as well as the introduction of cefalexin and cefadroxil in the market since the beginning of 2008. Sales of Clavulanic Acid for the six months period ended June 30, 2008 increased 50% from $8.48 million for the same period in 2007 to $12.70 million while the sales of cefalexin and cefadroxil already reached $12.47 million for the six-month period of 2008.

The overall gross margin for the Penicillin Division for the first six months of 2008 was 20% as compared to 24% for the same period of 2007. While Clavulanic Acid products had an increase in gross margin from 24% for the first six month of 2007 to 32% for the same period of 2008, the decrease of the overall gross margin of the Division was due to a change in product mix with the introduction of cefalexin and cefadroxil, two new products launched in the market only since January, 2008, which had an average of 7% gross margin initially during the six-month period of 2008.

***Expenses***

For the quarter ended June 30, 2008

Total operating expenses were $3.56 million for the quarter ended June 30, 2008. The major category of operating expenses was general and administration expenses of $1.75 million, and research and development expenses of $0.55 million, selling expense of $1.00 million, and depreciation and amortization expenses of $0.26 million. Total

operating expenses were $2.70 million for the quarter ended June 30, 2007 with the major expenses being general and administration expenses of $1.96 million, selling expense of $0.54 million, and depreciation and amortization expenses of $0.19 million.

The increase in operating expenses of $0.86 million for the quarter ended June 30, 2008 as compared to the same period for the prior year reflects the increase of $0.46 million in the selling expense due to an increase in sales commission related to the increase in revenues for both the Cephalosporin and Penicillin Divisions and an increase of $0.53 million in the research & development expenses offset by a decrease of $0.21 million in the general and administration expenses.

Included in the general and administration expense for the quarter ended June 30, 2008 was $0.03 million non-cash stock based compensation. Comparatively, the non-cash stock based compensation for the prior year was $1.00 million. Excluding the decrease of the non-cash stock based compensation of $0.97 million year-over-year, the general and administration expense for the second quarter of 2008 was increased by $0.76 million as compared to the same period of 2007. Such an increase was mainly due to an increase in headcounts and hence, the salaries and benefits expenses by $0.15 million, related to the formulation facilities in China and an increase in property tax expenses by $0.36 million due to the receipt of exemption for prior years property tax expenses during the second quarter of 2007.

For the six-month period ended June 30, 2008

For the six-month period of 2008, total operating expenses were $7.16 million. The major category of operating expenses was general and administration expenses of $3.62 million, and research and development expenses of $0.98 million, selling expense of $2.12 million, and depreciation and amortization expenses of $0.44 million. Total operating expenses were $4.71 million for the six-month period ended June 30, 2007 with the major expenses being general and administration expenses of $3.39 million, selling expense of $0.94 million, and depreciation and amortization expenses of $0.32 million.

The increase in operating expenses of $2.45 million for the six-month period ended June 30, 2008 as compared to the same period for the prior year reflects the increase of $1.18 million in selling expenses due to an increase in sales commission related to the increase in revenues from both the Cephalosporin and Penicillin Divisions, an increase of $0.91 million in research and development expense as well as an increase of $0.24 million in the general and administration expense. The increase in the general and administration expense for the second quarter of 2008 was due to a number of reasons, including an increase in headcounts, and hence, salary and benefits expenses and office expenses by $0.64 million, mainly related to the formulation facilities, an increase in travel expenses by $0.18 million , an increase in foreign exchange loss by $0.19 million and an increase in property tax expenses by $0.41 million due to the receipt of exemption for prior years property tax expenses during the six-month period ended June 30, 2007. However, these increases in expenses were partially offset by a decrease in accounting & auditing and consulting expenses by $0.26 million and $0.14 million respectively, as well as a decrease of the non-cash stock based compensation expenses by $0.92 million.

Included in the general and administration expenses for the six-month period ended June 30, 2008 was $0.10 million non-cash stock based compensation. Comparatively, the non-cash stock based compensation for the same period in the prior year was $1.02 million.

***Other Expense***

For the quarter ended June 30, 2008

During the quarter ended June 30, 2008, the Company recognized a net other expense of $0.42 million. This amount primarily consisted of $0.81 million of interest expense (including $0.79 million cash interest expense and $0.02 million non-cash accreted interest expense on the long term payable) which was partly offset by a $0.18 million government subsidies for mandated employee benefit contributions. Other expenses for the quarter ended June 30, 2007 were $0.45 million.

For the six-month period ended June 30, 2008

For the six-month period ended June 30, 2008, the Company had a net other expense of $0.99 million as compared to $1.18 million for the same period in 2007. The decrease of the net other expense reflected an offset by a higher other income from government subsidies for mandated employee benefits and government grants for investment in new technology.

***Net Income***

For the quarter ended June 30, 2008

For the quarter ended June 30, 2008, the Company had a net income of $2.92 million representing an increase of 544% from $0.45 million for the same period in 2007. The increase in net income was attributed to an increase in sales and profitability of all product lines in both Cephalosporin and Penicillin Divisions.

For the six-month period ended June 30, 2008

For the six-month period ended June 30, 2008, the Company had a net income of $4.88 million representing an increase of 274% from $1.30 million for the same period in 2007. The increase in net income was attributed to an increase in sales and profitability of all product lines in both Cephalosporin and Penicillin Divisions.

***Comprehensive Income***

For the quarter ended June 30, 2008

As a result of a gain on foreign currency translation of $1.22 million, the Company had a comprehensive income of $4.14 million for the second quarter of 2008, compared to a comprehensive income of $1.04 million for the same period of 2007, which included a gain on foreign currency translation of $ 0.59 million. The gain on foreign currency translation results from translation of the financial statements expressed in Chinese Renminbi (RMB) to United States Dollar. The increase reflects the appreciation of the RMB relative to the United States dollar.

For the six-month period ended June 30, 2008

For the six-month period ended June 30, 2008, the Company had a comprehensive income of $8.05 million representing an increase of 256% from $2.26 million for the same period in 2007 due to the increase in foreign currency translation arising from the appreciation of RMB relative to the United States dollar. The gain on foreign currency translation results from translation of the financial statements expressed in Chinese Renminbi (RMB) to United States Dollar. The increase reflects the appreciation of the RMB relative to the United States dollar.

***Net Income per Share - Basic***

For the quarter ended June 30, 2008

Company s net income per share has been computed by dividing the net income for the period by the weighted average number of shares outstanding during the same period. The weighted average number of shares outstanding was 66,992,531 and 62,878,004 for the second quarter of 2008 and 2007 respectively. Net Income per share was $0.04 for the second quarter of 2008 as compared to $0.01 per share for the same period of 2007.

For the six-month period ended June 30, 2008

The weighted average number of shares was 66,683,519 and 62,878,004 for the six-month period of 2008 and 2007 respectively. Net Income per share was $0.07 for the six-month period of 2008 as compared to $0.02 per share for the same period of 2007.

***Net Income per Share Diluted***

For the quarter ended June 30, 2008

During the second quarter of 2008, some of the stock options outstanding had a dilutive impact of the Company s net income. The weighted average number of shares on a diluted basis was 68,891,910 and 62,878,004 for the second quarter of 2008 and 2007 respectively. Net Income per share on a diluted basis was $0.04 for the second quarter of 2008 as compared to $0.01 per share for the same period of 2007.

For the six-month period ended June 30, 2008

The weighted average number of shares on a diluted basis was 68,531,398 and 62,878,004 for the six-month period of 2008 and 2007 respectively. Net Income per share on a diluted basis was $0.07 for the six-month period of 2008 as compared to $0.02 per share for the same period of 2007.

Dividends of the PRC subsidiary may only be distributed after allowance has been made for i) recovery of losses, if any; ii) appropriations to the reserve fund; iii) appropriations to the staff welfare fund; and iv) appropriations to an enterprise expansion fund if determined by the Board of Directors. Under current regulation, appropriations to the reserve fund should be at least 10% of the after tax net income determined in accordance with the PRC GAAP until the reserve is equal to 50% of PRC subsidiary s registered capital; appropriations to the staff welfare fund are at a percentage, as determined by the Board of Directors, of the after tax net income determined in accordance with the PRC GAAP; appropriations to the enterprise expansion fund are made at the discretion of the Board of Directors. The reserve fund and enterprise expansion fund are recorded as part of stockholders equity but are not available for distribution to stockholders other than in liquidation; while the staff welfare fund is recorded as a liability and is not for distribution to stockholders. As at June 30, 2008, Shanxi Weiqida s reserve fund was $ 3.83 million, 7% of its registered capital.

***Liquidity and Capital Resources***

As of June 30, 2008, Dragon had current liabilities of $71.75 million and current assets of $45.09 million, including cash of $1.54 million, restricted cash of $2.91 million and accounts receivables of $8.34 million. The deficiency in working capital was mainly due to the use of short-term loans to finance the increase in working capital requirements as the business grows.

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. To meet these objectives, the Company plans to seek additional equity through the exchange 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. 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. The Company s financial statements do not include any adjustments that might result from this uncertainty.

As of June 30, 2008, the Company had current liabilities of $71.75 million as follows:

| | |
|---|---|
| Accounts Payable | $14.21 million |
| Other Payables and Accrued Expenses | $28.67 million |
| Loans Payable - Short Term | $22.74 million |
| Note Payable | $5.82 million |
| Due to related companies | $0.31 million |
| Total Current Liabilities | $71.75 million |

As of June 30, 2008, the Company had outstanding short-term loans (less than one year term) totaling $22.74 million. The Company believes that it will be successful in the renegotiating loans based on the assumption that the Company has enhanced its ability to generate additional cash flow from its operation since the loans were originally entered into, even though there is no assurance of renewing the loans.

Long-term Liabilities:

At June 30, 2008, the Company had long-term loan payable of $13.24 million. During the quarter ended June 30, 2008, the Company financed its operations and increased production level at its Cephalosporin and Penicillin Divisions through operating revenues, accounts payables and short-term loans. The Company intends to seek additional funding through equity financing to improve its financial position, which may include conversion of certain receivables by certain vendors of Shanxi Weiqida into the Company s common stock.

**Item 3.**

**Quantitative and Qualitative Disclosure about Market Risk**

Not applicable since the Company is a smaller reporting issuer.

**Item 4.**

**Controls and Procedures**

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief 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 the period covered by this report pursuant to Exchange Act Rule 13a-15(b)), and concluded that the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed in the Company s reports filed with the Securities and Exchange Commission pursuant to the Exchange Act is accumulated and communicated to management, including the Company s Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, as of the end of the period covered by this report, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective in recording, processing, summarizing and reporting information required to be disclosed by the Company 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 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 1.A.**

**Risk Factors**

No updates

**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**

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.

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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)

Date: August 14, 2008

/s/ Yanlin Han
Yanlin Han
Chief Executive Officer

Date: August 14, 2008

/s/ Garry Wong
Garry Wong
Chief Financial Officer

**EXHIBIT 31.1**

Section 302 Certification of Principal Executive Officer

I, Yanlin Han, certify that:

1.

I have reviewed this quarterly report on Form 10-Q 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.

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

c.

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

5.

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

a.

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

b.

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

Date: August 14, 2008

/s/ Yanlin Han
Yanlin Han
Chief Executive Officer

**EXHIBIT 31.2**

Section 302 Certification of Principal Financial Officer

I, Garry Wong, certify that:

1.

I have reviewed this quarterly report on Form 10-Q 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.

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

c.

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

5.

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

a.

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

b.

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

Date: August 14, 2008

/s/ Garry Wong
Garry Wong
Chief 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-Q for the quarter ended June 30, 2008 as filed with the Securities and Exchange Commission (the "Form 10-Q") that, to the best of their knowledge:

(1) the Form 10-Q 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-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: : August 14, 2008

/s/ Yanlin Han
Yanlin Han

Chief Executive Officer

Dated: : August 14, 2008

/s/ Garry Wong

Garry Wong
Chief Financial Officer