

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

DRAGON PHARMACEUTICALS INC

Form 10-Q

August 15, 2003

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, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-27937

DRAGON PHARMACEUTICAL INC.
(Exact name of small business issuer as specified in its charter)

Florida
(State or other jurisdiction of
incorporation or organization)

65-0142474
(IRS Employer Identification No.)

1055 West Hastings Street, Suite 1900
Vancouver, British Columbia
Canada V6E 2E9
(Address of principal executive offices)

(604) 669-8817 (Issuer's
telephone number)

(Former address if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Number of shares of common stock outstanding as of June 30, 2003: 20,334,000

Item 1. Financial Information

DRAGON PHARMACEUTICALS INC. & SUBSIDIARIES
Consolidated Balance Sheets

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

June 30, 2003 and December 31, 2002
 (Expressed in U.S. Dollars)
 (Unaudited - Prepared by Management)

-----		J

ASSETS		
Current		
Cash and short term securities	\$	3,
Accounts receivable		
Inventories		1,
Prepaid and deposits		

Total current assets		6,
Fixed assets		
Due from related party - Hepatitis B vaccine project		
Patent rights - related party		
Licence and permit		
-----		3,
Total assets	\$	12,
=====		
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Current		
Bank loans	\$	
Accounts payable and accrued liabilities		1,

Total current liabilities		1,

Commitments (Note 13)		
Stockholders' Equity		
Share capital		
Authorized: 50,000,000 common shares at		
par value of \$0.001 each		
Issued and outstanding: 20,334,000 common shares		
Additional paid in capital		
		26,
Accumulated other comprehensive (loss)		
		(
Accumulated deficit		
		(15,9

Total stockholders' equity		10,

Total liabilities and stockholders' equity	\$	12,
=====		

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

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

DRAGON PHARMACEUTICALS INC. & SUBSIDIARIES

Consolidated Statements of Stockholders' Equity
 (Expressed in U.S. Dollars)
 (Unaudited - Prepared by Management)

	Common stock		Additional paid-in capital	Compre- hensive income (loss)	Defi accumula
	Shares	Amount			
Balance, December 31, 2001	20,331,000	\$20,331	\$26,624,741	-	\$(9,743,
Exercise of stock options for cash	3,000	3	1,497	-	
Stock based compensation	-	-	18,760	-	
Components of comprehensive income (loss)					
- foreign currency translation	-	-	-	(10,003)	
- net (loss) for the year	-	-	-	(5,250,946)	(5,250,
Comprehensive (loss)				<u>\$ (5,260,949)</u>	
Balance, December 31, 2002	20,334,000	\$20,334	\$26,644,998		<u>\$(14,994,</u>

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

DRAGON PHARMACEUTICALS INC. & SUBSIDIARIES

Consolidated Statements of Stockholders' Equity
 (Expressed in U.S. Dollars)
 (Unaudited - Prepared by Management)

	Common stock	Additional paid-in	Compre- hensive income
	Shares	Amount	

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

	Shares	Amount	capital	(loss)	a
Balance, December 31, 2002	20,334,000	\$20,334	\$26,644,998	-	\$(
Components of comprehensive income (loss)					
- foreign currency translation	-	-	-	4,175	
- net (loss) for the year	-	-	-	(970,452)	
Comprehensive (loss)				\$(966,277)	=====
Balance, June 30, 2003	20,334,000	\$20,334	\$26,644,998		\$(
					=====

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

DRAGON PHARMACEUTICALS INC. & SUBSIDIARIES

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

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002
Sales	\$1,007,686	\$ 1,026,159
Cost of sales	326,988	174,465
Gross profit	680,698	851,694
Selling, general and administrative expenses	(723,743)	(1,316,578)
Depreciation of fixed assets and amortization of licence and permit and land-use right	(183,896)	(180,449)
Net write off of land-use right and fixed assets	-	-
Research expenses	-	(1,015,796)
New market development	(8,234)	(109,735)
Provision for doubtful debts	(10,701)	(54,693)

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

Loan interest expense	(929)	(15,605)
Stock-based compensation	-	-

Operating loss	(246,805)	(1,841,162)
Interest income	10,381	16,295

Net (loss) for the period	\$ (236,424)	\$ (1,824,867)
=====		
(Loss) per share		
Basic and diluted	\$ (0.01)	\$ (0.09)
=====		
Weighted average number of common shares outstanding		
Basic and diluted	20,334,000	20,331,000
=====		

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

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

Cash flows from (used in) operating activities		
Net (loss) for the year		\$ (970,
Adjustments to reconcile net loss to net cash used in operating activities:		
- depreciation of fixed assets and amortization of licence and permit		477,
- net write off of land-use right and fixed assets		
- provision for doubtful debts		41,
Changes in non-cash working capital items:		
- accounts receivable		(29,
- inventories		21,
- prepaid expenses and deposits		(3,
- accounts payable and accrued liabilities		(84,
- management fees payable - related parties		

		(547,

Cash flows used in investing activities		
Purchase of fixed assets		(38,

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

(Increase) decrease in restricted funds	510,
Acquisition of Patent rights	
Acquisition of balance of Huaxin	
Refundable investment deposits	
Recovery from Hepatitis B Vaccine Project	

	471,

Cash flows from financing activities	
Loan proceeds	(483,

Foreign exchange (gain) loss on cash held in foreign currency	3,

Decrease in cash and cash equivalents	(555,
Cash and cash equivalents, beginning of period	4,425,

Cash and cash equivalents, end of period	\$ 3,870,
=====	

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

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

1. Basis of Presentation

The accompanying unaudited interim consolidated balance sheets, statements of operations and cash flows reflected all adjustments, consisting of normal recurring adjustments and other adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of the Company, at June 30, 2003, and the results of operations and cash flows for the interim periods ended June 30, 2003 and 2002.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instruction for Form 10-Q pursuant to the rules and regulations of Securities and Exchange Commission and, therefore, do not include all information and notes normally provided in audited financial statements and should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2002 included in the annual report previously filed on Form 10-K.

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

2. Restricted Funds

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

	June 30, 2003
Cash and cash equivalents	\$ 3,870,273
Term deposits held as collateral against bank loans	-
Cash and short term securities	\$ 3,870,273
<hr/>	
3. Accounts Receivable	
	June 30, 2003
Trade receivables	\$ 1,162,073
Allowance for doubtful accounts	(320,439)
	841,633
Other receivables	95,099
	\$936,732

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

	June 30, 2003
4. Inventories	
Raw materials	\$ 155,412
Finished goods	98,287
Work in progress	933,241
	\$1,186,940

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

5. Fixed Assets

	June 30, 2003	
	Cost	Accumulated depreciation
Motor vehicles	\$ 140,406	\$ 63,350
Office equipment and furniture	415,042	182,903
Leasehold improvements	1,067,093	396,129
Production and lab equipment	2,063,318	785,679
	\$ 3,685,859	\$ 1,428,061

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

For the six months ended June 30, 2003, depreciation expenses totalled \$201,374 (2002 - \$146,489). The majority of fixed assets are located in China.

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

6. Due from Related Party - Hepatitis B Vaccine Project

June 30,
2003

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

Hepatitis B Vaccine Project	\$4,000,000
Less : Repayment	(500,000)
Valuation allowance	(3,499,900)

	\$ 100
=====	

- (a) Pursuant to an agreement dated October 6, 2000, the Company paid \$4,000,000 for the acquisition of certain assets and technology relating to the production of Hepatitis B vaccine. The vendor of the transaction was a company named Alphatech Bioengineering Limited, incorporated in Hong Kong, with two shareholders who are both directors of the Company.
- (b) Pursuant to an amended agreement dated June 5, 2001, in the event that the Company failed to find a joint venture partner, establish a production facility for the vaccine project or sell the project to a third party within nine months from the date of this amended agreement, Dr. Longbin Liu, a director of the Company (and President and CEO of the Company at the time of the transaction) and one of the shareholders of Alphatech, demanded to repurchase the project from the Company. The repurchase price of \$4.0 million is payable as follows:
- (i) \$500,000 at the date of repurchase; and
 - (ii) the balance to be paid within eighteen (18) months of the date of repurchase with interest at 6% per annum. The interest will be accrued from six months after the date of repurchase.

The Company decided not to pursue the project and Dr. Liu has repurchased the project on the agreed terms.

The amount owing by Dr. Liu to the Company is unsecured. The Company has chosen, given the significant amount involved and the lack of security, to conservatively value the amount owing and has set up a provision for the full amount, less a nominal amount of \$100.

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

7. Patent Rights - Related Party

Pursuant to an agreement dated January 14, 2002, the Company entered into a Patent Development Agreement with the Dr. Longbin Liu, a director of the Company (and President and CEO of the Company at the time of the transaction) and a company controlled by the Dr. Liu entitling the Company to acquire one patent filed in the United States related to the discovery of a new gene or protein. Consideration for the right to acquire the patent was payment of US\$500,000 (paid) and the issuance of warrants to acquire 1,000,000 common shares of the Company at a price of \$2.50 per share for a period of five years. The patent may be acquired prior to January 14, 2005 at no additional cost other than the reasonable legal costs of obtaining the patent.

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

The issuance and exercise of the warrants to acquire 1,000,000 common stock of the Company is contingent upon the success of the patent applications. The US\$500,000 will be refunded to the Company if no patent applications have been filed by January 14, 2005.

8. Licence and permit

	June 30, 2003	December 31, 2002
Original cost	\$5,012,582	\$5,012,582
Accumulated amortization	1,812,588	1,536,842
	\$ 3,199,994	\$ 3,475,740

Amortization expenses for the licence and permit for the six months ended June 30, 2003 was \$276,041 (2002 - \$275,956)

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

2003 (balance of the year)	\$276,000
2004	\$552,000
2005	\$552,000
2006	\$552,000
2007	\$552,000

The above amortization expense forecast is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, changes in foreign currency exchange rates, impairment of intangible assets, accelerated amortization of licence and permit, and other events.

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

9. Bank Loans

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

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

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

10. Income Taxes

- (a) Kailong and Huaxin are subject to income taxes in China on its taxable income as reported in its statutory accounts at a tax rate in accordance with the relevant income tax laws.

Allwin and Biotrade are not subject to income taxes. As at June 30, 2003, \$3.7 million of unremitted earnings attributable to international companies were considered to be indefinitely invested. No provision has been made for taxes that might be payable if these earnings were remitted to the United States. The company's intention is to reinvest these earnings permanently or to repatriate the earnings when it is tax effective to do so. It is not practicable to determine the amount of incremental taxes that might arise were these earnings to be remitted.

As at June 30, 2003, the company has estimated losses, for tax purposes, totalling approximately \$8,200,000, which may be applied against future taxable income. The potential tax benefits arising from these losses have not been recorded in the financial statements. The Company evaluates its valuation allowance requirements on an annual basis based on projected future operations. When circumstances change and this causes a change in management's judgement about the realizability of deferred tax assets, the impact of the change on the valuation allowance is generally reflected in current income.

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

	June 30, 2003	Decem 2002
	\$ 2,790,000	\$ 2,790,000
Tax losses carried forward		
Stock-based compensation	6,400	
Provision for amount owing from Hepatitis B Vaccine Project	1,118,000	1,118,000
Less: valuation allowance	(3,914,400)	(3,914,400)
	\$ -	\$ -

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

10. Income Taxes (continued)

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

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

	2003	2002
Federal statutory income tax rate	34%	34%
Benefit of loss carry forward	(34%)	(34%)
Effective income tax rate	-	-

11. Stock Options and Warrants

(a) Stock Options Plans

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

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

	Shares	Weight Exerc
Options outstanding at December 31, 2001	2,969,500	\$
Granted	920,000	\$
Forfeited	(598,500)	\$
Exercised	(3,000)	\$
Options outstanding at December 31, 2002	3,288,000	\$
Granted	500,000	\$
Forfeited	(296,000)	\$
Options outstanding at June 30, 2003	3,492,000	

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

11. Stock Options and Warrants (continued)

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.01 - \$1.00	1,716,500	1.94	\$ 0.55	1,591,500	\$ 0.54
\$1.01 - \$2.00	440,500	3.82	\$ 1.70	440,500	\$ 1.70
\$2.01 - \$3.00	60,000	1.36	\$ 2.50	60,000	\$ 2.50
\$3.01 - \$4.00	1,275,000	2.38	\$ 3.13	1,275,000	\$ 3.13
	-----	-----	-----	-----	-----
	3,492,000	2.32	\$ 1.67	3,367,000	\$ 1.71
	=====	=====	=====	=====	=====

The Company accounts for its stock-based compensation plan in accordance with APB Opinion No. 25, under which no compensation is recognized in connection with options granted to employees except if options are granted with a strike price below fair value of the underlying stock. The Company adopted the disclosure requirements SFAS No. 123, Accounting for Stock-Based Compensation. Accordingly, the Company is required to calculate and present the pro forma effect of all awards granted. For disclosure purposes, the fair value of each option granted to an employee has been estimated as of the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 5.5%, dividend yield 0%, volatility of 90%, and expected lives of approximately 0 to 5 years. Based on the computed option values and the number of the options issued, had the Company recognized compensation expense, the following would have been its effect on the Company's net loss:

	June 30, 2003	June 30, 2002
Net (loss) for the period:		
- as reported	\$ (970,452)	\$ (2,762,745)
- pro-forma	\$ (970,452)	(2,762,745)
Basic and diluted (loss) per share:		
- as reported	\$ (0.05)	\$ (0.14)
- pro-forma	\$ (0.05)	\$ (0.14)

(b) Warrants

Share purchase warrants outstanding as at June 30, 2003:

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

Number Underlying Exercise Price

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

of Warrants	Shares	Per Share	Expiry Date
3,500,000	1,750,000	\$2.00	September 13, 2003
50,000	50,000	\$1.70	November 15, 2004
1,000,000*	1,000,000	\$2.50	January 14, 2007

* See Note 7

12. Related Party Transactions

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

	June 30, 2003	June 30, 2002
Management fees	\$ 40,000	\$115,000

- (b) Pursuant to an agreement dated January 14, 2002, the Company entered into a Project Development Agreement with Dr. Longbin Liu ("Dr. Liu"), a director of the Company (and President and CEO of the Company at the time of the transaction) to continue the research and development of G-CSF and Insulin for the Company. The Company will make payment for the development of G-CSF as follows:

- (i) US\$500,000 to be provided at the commencement of the research in the G-CSF Project (paid);
- (ii) US\$500,000 to be provided when cell-line and related technology is established and animal experimentation commences in the G-CSF Project; and
- (iii) US\$300,000 to be provided when a permit for clinical trials for G-CSF has been issued by the State Drug Administration of China ("SDA"); and
- (iv) US\$200,000 to be provided when a new drug license for G-CSF is issued to Dragon by the SDA.
- (v) US\$500,000 to be paid as a bonus if the SDA issues the new drug license for G-CSF to Dragon before January 14, 2005.

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

- (i) US\$750,000 to be provided by at the commencement of the research in the Insulin Project (paid);
- (ii) US\$750,000 to be provided when cell-line and related technology is established and animal experimentation commences in the Insulin Project (paid);
- (iii) US\$300,000 to be provided when a permit for clinical trials for Insulin has been issued by the SDA;

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

Notes to Consolidated Financial Statements
June 30, 2003
(Expressed in U.S. Dollars)
(Unaudited - Prepared by Management)

12. Related Party Transactions (continued)

- (iv) US\$200,000 to be provided when a new drug license for Insulin is issued to Dragon by the SDA; and
- (v) US\$500,000 to be paid as a bonus if the SDA issues the new drug license for Insulin to Dragon before January 14, 2005.

For both the G-CSF and Insulin Projects:

- (i) If the Company elects to cease development of the project it will forfeit any payments made and lose ownership of the Project, but it will not be obligated to make any further payments toward the Project;
- (ii) if an application for permit for clinical trials is not submitted within three years with respect to the G-CSF Project or four years with respect to the Insulin Project or if the SDA rejects the Projects for technical or scientific reasons or If development of the Project is terminated by Dr. Liu, then Dr. Liu will refund to the Company all amounts paid, without interest or deduction, with respect to the Project within six months.

As at June 30, 2003, the Company has paid a total of \$1,500,000 and \$500,000 towards the Insulin and G-CSF Projects, respectively. The Company has paid an additional \$100,000 to a company controlled by Dr. Liu to produce Insulin samples for drug registration purposes.

- (c) see Notes 6 and 7 also.

13. Commitments

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

2003	\$ 274,240
2004	491,659
2005	492,928
2006	496,736
2007	369,134
2008 - 2009	470,841

Total	\$ 2,595,938
=====	

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

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

14. Segmented Information

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

	June 30, 2003

ASSETS	
North America	\$ 3,425,332
China	7,812,546
Others	871,915

Total	\$ 12,109,793
=====	

	Six months ended June 30, 2003

REVENUE	
North America	\$ -
China	1,031,242
Others	640,767

Total	\$ 1,672,009
=====	

15. Comparative Figures

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discusses the Company's financial condition and results of operations based upon the Company's consolidated financial statements which have been prepared in accordance with generally accepted accounting principles. It should be read in conjunction with the Company's financial statements and the notes thereto and other financial information included in the Company's Form 10-K for the fiscal year ended December 31, 2002.

Overview

The Company (or "Dragon") was formed on August 22, 1989, under the name First Geneva Investment Inc. First Geneva Investment's business was to evaluate businesses for possible acquisition. On July 28, 1998, First Geneva Investment entered into a share exchange agreement with Allwin Newtech. Allwin Newtech was formed in 1998 for the purpose of developing and marketing pharmaceutical drugs for sale in China. Prior to the acquisition of Allwin Newtech, First Geneva Investment had no operations. On September 21, 1998, First Geneva Investment changed its name to Dragon Pharmaceutical Inc.

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

On July 27, 1999, Dragon acquired a 75% interest in Nanjing Huaxin Bio-pharmaceutical Co. Ltd. ("Huaxin"), which manufactures EPO in China. The Company increased the efficiencies in the production of EPO by improving a proprietary high-yield mammalian cell line and "vectoring process" which has been developed by Dragon. The Company successfully achieved commercial production during the last quarter of calendar 1999. In January 2002 the Company purchased the balance of Huaxin for \$1,400,000.

On September 6, 2000, Dragon incorporated Allwin Biotrade Inc. ("Biotrade"). Biotrade was incorporated for the purpose of marketing and distributing biopharmaceutical products outside China. On September 15, 2000, Dragon incorporated Dragon Pharmaceutical (Canada) Inc. ("Dragon Canada"). Dragon Canada was incorporated for the purpose of researching and developing new biopharmaceutical products.

Results of Operations

Revenues. Revenue is generated from the sale of EPO in China by Huaxin and throughout the developing world by Biotrade. Revenue for the three-month period ending June 30, 2003 was \$1,007,686 compared to \$1,026,159 for the three-month period ending June 30, 2002. Sales in and outside of China were \$576,894 and \$430,792, respectively during the three-month period ending June 30, 2003. Sales during the three-month period ending June 30, 2002 were \$826,659 in China and \$199,500 outside of China. Cost of sales for the three-months ended June 30, 2003 of \$326,988 is attributed to the production costs of the pharmaceutical products. The cost of sales for the three-months ended June 30, 2002 was \$174,465. The gross profit margin was 68% for the three-month period ending June 30, 2003 and 83% for the three-month period ended June 30, 2002. The profit margin decreased during the three months ended June 30, 2003 because the Company decided to sell and sold some product with short-term expiry dates at a reduced price.

Revenue for the six-month period ending June 30, 2003 was \$1,672,009 compared to \$2,398,966 for the six-month period ending June 30, 2002. Sales in and outside of China were \$1,031,242 and \$640,767, respectively during the six-month period ending June 30, 2003. Sales during the six-month period ending June 30, 2002 were \$1,351,966 in China and \$1,047,000 outside of China. The overseas sales during the six-month period ending June 30, 2002 included delivery of a \$700,000 bulk order to be used by the purchaser for new drug research and development.

Interest income is related primarily to interest earned on cash received from the private placement of common stock received during the third quarter of 2001. Interest income for the three-months period ended June 30, 2003 was \$10,381 compared to \$16,295 for the three-month period ended June 30, 2002. Interest income for the six-months period ended June 30, 2003 was \$16,819 compared to \$49,902 for the six-month period ended June 30, 2002.

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

Expenses. Total operating expenses for the three-months ended June 30, 2003 were \$927,504. The major expenses incurred in the second quarter of 2003 was selling expenses of \$287,667 representing 31% of total expenses. The remaining major expense items are represented by administrative expenses.

Significant operating expenses for the three-months ended June 30, 2003 included rent of \$123,912, salaries and benefits of \$198,586, \$34,055 in travel costs and a bad debts provision of \$10,701. Management fees of \$20,000 were paid to a director for services during the second quarter of 2003.

Other significant expenses for the second quarter include the depreciation of

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

fixed assets and amortization of license and permit of \$183,896.

Comparatively, total operating expenses for the three-months ended June 30, 2002 were \$2,692,855. The major expenses incurred in the second quarter of 2002 were research and development expenses of \$1,015,796 and the selling expenses of \$473,911 representing 38% and 18% of total expenses, respectively. Administrative expenses represent the remaining major expense items.

Significant operating expenses for the three-months ended June 30, 2002 included consulting fees of \$162,543, loan interest of \$15,605, rent of \$109,906, salaries and benefits of \$124,270, \$184,100 in travel costs and management fees of \$58,443. Management fees include \$57,500 incurred to two directors for services during the second quarter of 2002.

Other significant expenses for the second quarter of 2002 include the depreciation of fixed assets and amortization of license and permit and land-use rights of \$180,449.

Total operating expenses for the six-months ended June 30, 2003 were \$2,131,011. The major expense incurred in the first half of 2003 was selling expense of \$793,339 representing 37% of total expenses. The remaining expense items are primarily administrative expenses.

Significant operating expenses for the six-months ended June 30, 2003 included rent of \$212,111, salaries and benefits of \$389,978, \$100,393 in travel costs and a bad debts provision of \$41,412. Management fees of \$40,000 were paid to a director for services during the first half of 2003.

Other significant expenses for the first half of the year include the depreciation of fixed assets and amortization of license and permit of \$369,195.

Comparatively, total operating expenses for the six-months ended June 30, 2002, were \$4,846,624. The major expenses incurred in the first half of 2002 were research and development expenses of \$1,771,368 and the selling expenses of \$951,107 representing 37% and 20% of total expenses, respectively. Administrative expenses represent the remaining expense items.

Significant operating expenses for the six-months ended June 30, 2002 included bad debt write offs of \$80,549, consulting fees of \$311,280, loan interest of \$56,015, rent of \$171,452, salaries and benefits of \$265,956, \$262,490 in travel costs and management fees of \$132,636. Management fees include \$115,000 paid to two directors for services during the six-months ended June 30, 2002.

Other significant expenses for the second half of 2002 include the depreciation of fixed assets of and amortization of license and permit and land-use rights of \$362,107 and new market development of \$162,323.

Overall, expenditures have decreased in 2003 from 2002 levels as the Company has streamlined operations, closed its Beijing and Hong Kong representative offices and diligently pursued cutting costs in all areas, where practical.

Net and Comprehensive Loss. Dragon had a net loss and a comprehensive loss of \$236,424 for the three-month period ending June 30, 2003 compared to \$1,824,867 for the same period last year.

The Company's net and comprehensive loss of \$970,452 for the six-month period ending June 30, 2003 compared to \$2,762,745 for the same period last year.

Basic and Diluted Net Loss Per Share

The Company's net loss per share has been computed by dividing the net loss for

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

the period by the weighted average number of shares outstanding during three-month and six-month periods ended June 30, 2003. The loss per share for the three-month period ended June 30, 2003 was \$0.01 and the loss per share for the six-month period ended June 30, 2003 was \$0.05. Common stock issuable upon the exercise of common stock options and common stock warrants have been excluded from the net loss per share calculations as their inclusion would be anti-dilutive.

Liquidity and Capital Resources

Dragon is a development stage pharmaceutical and biotechnological company that has commenced the manufacture and marketing of pharmaceutical products in China

through its 100% equity interest in Nanjing Huaxin Bio-pharmaceuticals Ltd. Previously, the Company has raised funds through equity financings to fund its operations and to provide working capital. The Company may finance future operations through additional equity financings.

As of June 30, 2003, the Company had \$3,870,237 in cash available. This cash, the \$936,732 in accounts receivable and anticipated sales will be used to fund the ongoing operations and research and development. Working capital was \$4,711,357 at June 30, 2003.

During the six months ended June 30, 2003, the Company incurred losses of \$970,452 and the Company will continue to incur losses until sales for its products increase. The Company will continue to fund its operations through working capital.

Item 3. Quantitative and Qualitative Disclosures About Market Risks

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

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

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

By Currency

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

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

	June 30, 2002	June 30, 2003
U.S. Dollar	26%	15%
Canadian Dollar	48%	66%
Renminbi Yuan	26%	19%
Total	100%	100%

Such administrative expense by currency may change from time to time. Further, the Company incurred expenses in China of \$1,334,159 and \$965,968 for the six-months ended June 30, 2003 and 2002, respectively, all of which were paid in RMB.

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

Item 4. Controls and Procedures

Within the 90 days prior to the date of this Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, of the design and operation of the Company's disclosure and internal controls and procedures pursuant to Exchange Act Rule 13a-14. The review identified a number of areas where there could be improvements to increase the effectiveness of controls and the Company is currently in the process of improving the controls and procedures in these areas. Notwithstanding the above, the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer have concluded that the Company's disclosure controls and procedures are sufficient enough to ensure adequate and appropriate disclosure of material information relating to the Company (including its consolidated subsidiaries) required to be included in this Form 10-Q.

There have been no significant changes in the Company's internal controls or in other factors, which could significantly affect internal controls subsequent to the date the Company carried out its evaluation, other than those being undertaken to increase the effectiveness of controls as discussed above.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds.

None

Item 3. Defaults Upon Senior Securities.

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

None

Item 4. Submission of Matters to a Vote of Security Holders.

On June 26 2003, the shareholders elected the following five persons to serve as directors until the next annual meeting:

	In Favour -----	Against -----	Withheld -----
Dr. Alexander Wick	9,249,115	0	49,694
Dr. Longbin Liu	8,578,115	0	720,694
Dr. Ken Z. Cai	9,249,615	0	49,194
Dr. Y.K. Sun	9,249,815	0	48,994
Mr. Philip Yuen	9,249,615	0	49,194

In addition, the shareholders ratified the reappointment of Moore Stephens Ellis Foster Ltd. as the Company's independent accountants as follows:

In Favour -----	Against -----	Withheld -----
9,257,076	22,400	0

Item 5. Other Information.

None

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

Exhibit No.

31.1 Certification by the Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act

31.2 Certification by the Principal Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act

32 Certification by the Principal Executive and Financial Officers Pursuant to Section 906 of the Sarbanes-Oxley Act

(b) Reports on Form 8K.

On May 29, 2003, the Company filed a Current Report on Form 8-K, regarding first quarter results for 2003.

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.

/s/ Matthew Kavanagh

Dated: August 14, 2003

Edgar Filing: DRAGON PHARMACEUTICALS INC - Form 10-Q

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