DRAGON PHARMACEUTICAL INC
Form 10KSB
April 02, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-KSB

ANNUAL REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended December 31, 2006

Commission File Number 0-27937

DRAGON PHARMACEUTICAL INC.

(Exact name of small business issuer)

Florida	65-0142474
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

650 West Georgia Street, Suite 310

Vancouver, British Columbia V6B 4N9

(Address of Principal Executive Offices)

www.dragonpharma.com

(Registrant s Internet Address)

(604) 669-8817

(Registrant's telephone number including area code)

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: Common Stock, par value $0.001

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

Our revenues for the year ended December 31, 2006 were $54,865,805

State the aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the price at which the common equity was sold, or the average bid and asked priced of such common equity, as of March 15, 2007 was $21,378,521.

The number of shares outstanding of the issuer's common stock as of March 15, 2007, was 62,878,004.

Is the Company a shell Company Yes ___ No X

Documents incorporated by reference: None

Transitional Small Business Disclosure Format: Yes ____ No. X

1

TABLE OF CONTENTS

PART I

ITEM 1.

DESCRIPTION OF BUSINESS

With the exception of historical facts stated herein, the following discussion may contain forward-looking statements regarding events and financial trends that may affect Dragon Pharmaceutical Inc.'s future operating results and financial position. Such statements are subject to risks and uncertainties that could cause Dragon Pharmaceutical Inc.'s actual results and financial position to differ materially from those anticipated in such forward-looking statements. Factors that could cause actual results to differ materially include, in addition to other factors identified in this report, that Dragon Pharmaceutical has incurred losses since its inception, has a substantial amount of liabilities, all of which factors are set forth in more detail in the sections entitled "Item 1. Business Risks Associated With Dragon Pharmaceutical" and "Item 6. Management's Discussion and Analysis or Plan of Operation" herein. Readers of this annual report are cautioned not to put undue reliance on "forward looking" statements that are, by their nature, uncertain as reliable indicators of future performance. Dragon Pharmaceutical Inc.'s disclaims any intent or obligation to publicly update these "forward looking" statements, whether as a result of new information, future events, or otherwise except as required by law.

As used in this annual report, the terms "we", "us", "our", "the Company" and "Dragon" shall mean Dragon Pharmaceutical Inc. and its subsidiaries unless otherwise indicated. Further, unless otherwise indicated, reference to dollars shall mean United States dollars.

General

We are a diversified pharmaceutical company with three key business units consisting of a Chemical division for manufacturing bulk active pharmaceutical ingredient (API) and pharmaceutical intermediates, a Pharma division for manufacturing formulated generic drugs with a focus on Cephalosporin antibiotics and freeze-dry injectables, and a Biotech Division for manufacturing biologics, currently Erythropoietin or EPO.

Dragon currently has four production facilities in Datong, China, including three GMP production facilities certified by Chinese State Food and Drug Administration ("SFDA"): one pharmaceutical facility with a capacity of producing freeze-dry injectables, one biotech facility producing Erythropoietin injectables and one chemical facility producing

bulk Clavulanic Acid. The fourth facility produces bulk 7-ACA, an intermediate for Cephalosporin antibiotics by a fermentation process. 7-ACA is an intermediate and no GMP is required for the production facility. The Company now has 47 drugs approved by the Chinese SFDA of which the Pharma division products are sold only in the Chinese markets while products from the Chemical and Biotech divisions are sold in both Chinese and selected international markets.

As discussed below, the Company completed the acquisition of Oriental Wave Holding Ltd. ("Oriental Wave") on January 12, 2005 which transformed us from a single product company into a diversified pharmaceutical company with three key business units consisting of a Biotech Division for biotech products, a Chemical division for bulk pharmaceutical intermediate and API and a Pharma division for formulated generic drugs.

The Company s headquarters, located in Vancouver, accommodates corporate functions such as financial reporting, SEC compliance, corporate finance, investor relations, and regulatory affairs for international product approval. The Company also has a corporate office in Beijing, China to manage all the businesses in China including strategy formulation in the Chinese market, product development, production and sales and marketing management.

Corporate History

The Company was originally formed on August 22, 1989, as First Geneva Investments, Inc. First Geneva Investments was formed for the purpose of evaluating and acquiring businesses. On August 17, 1998, the Company acquired Allwin Newtech Ltd., a British Virgin Islands corporation. Allwin Newtech Ltd. was formed on February 10, 1998, for the purpose of developing pharmaceutical products in China. Allwin Newtech owned certain technology used to enhance the efficiency of producing EPO. On September 21, 1998, First Geneva Investments changed its name to Dragon Pharmaceutical Inc.

On January 12, 2005, we completed the acquisition of Oriental Wave. Oriental Wave was principally engaged in the production and sale of pharmaceutical products. In connection with the acquisition of Oriental Wave, the Company issued 44,502,004 shares of common stock to the three prior owners of Oriental Wave. As a result, these three prior owners of Oriental Wave collectively own 70.78% of our outstanding shares. The acquisition of Oriental Wave allowed us to expand our range of products, leverage both companies' marketing networks in China and in international markets, and improve our ability to execute our combined business strategy.

Oriental Wave, was the sole shareholder of Shanxi Weiqida Pharmaceutical Ltd. (Shanxi Weiqida), a China based pharmaceutical company engaged in the production, marketing and sale of pharmaceutical intermediates, active pharmaceutical ingredients and generic formulation drugs.

Shanxi Weiqida Pharmaceutical Ltd was primarily formed and organized through the acquisition of assets from three Chinese companies. Two of these acquisitions were completed out of bankruptcy procedures of state-owned pharmaceutical companies.

Shanxi Weiqida was formed in January 2002 as a Chinese domestic company. At the time it was established, Shanxi Weiqida acquired, for no cost, from Shanxi Tongling Pharmaceutical Co., Ltd., or Shanxi Tongling, all drug production permits, and product licenses of Datong No. 2 Pharmaceutical Factory, or Datong No. 2 Pharmaceutical. The assets of Datong No. 2 Pharmaceutical were acquired by Shanxi Tongling in June 2001 out of bankruptcy for RMB 42.3 million, or approximately $5.1 million. Shanxi Tongling was founded in 1994 by Mr. Han, our current Chief Executive Officer.

In April 2002 Shanxi Weiqida acquired from Shanxi Tongzhen Pharmaceutical Co. Ltd all of its product licenses and production permits in consideration for assuming approximately RMB 6.7 million, or approximately $0.8 million, of bank debt upon the liquidation of Shanxi Tongzhen.

In June 2002, Shanxi Weiqida purchased the assets relating to a capsules and injectables production line, including certain equipment, inventory, receivables and product licenses and related production permits, from Aurobindo Tongling (Datong) Pharmaceutical Co., Ltd., or Aurobindo Tongling (Datong), for consideration of approximately RMB 33.75 million, or approximately $4.1 million. At the time of the transaction, Mr. Han was also the Chairman of Aurobindo Tongling (Datong).

In September 2002, Shanxi Weiqida acquired out of bankruptcy all assets of Datong Pharmaceutical Factory, or Datong Pharmaceutical, a state-owned enterprise, including the land use rights of Datong Pharmaceutical. Pursuant to the acquisition agreement entered into with the Datong Economic Committee of the Datong Municipal Government, Shanxi Weiqida acquired the assets in consideration for assuming all liabilities related to the employees of Datong Pharmaceutical. The agreement requires Shanxi Weiqida to pay the former employees of Datong Pharmaceutical certain minimum wages and health care costs until the date of their re-employment, retirement or death, whichever occurs first. Shanxi Weiqida has arranged for the re-employment or retirement of approximately 85% of the Datong Pharmaceutical employees.

In February 2003, Shanxi Weiqida commenced construction of a Clavulanic acid manufacturing facility, which was completed in August 2003. Pilot production began in August 2003 and full-scale production began in January 2004. Construction of Shanxi Weiqida's 7-ACA workshop was completed in December 2003 and pilot production of 7-ACA commenced on July 1, 2004. In July 2005, the Company started to ramp up the production.

In August, 2005, the Company closed its Biotech production facility in Nanjing, China and started the relocation of the Biotech production facility to a site next to the Chemical Division campus in Datong, China. The Company received the GMP certification for this new facility from the Chinese SFDA on December 29, 2005 and production at this facility started during the first quarter of 2006.

Shanxi Weiqida's head office is located in a special economic region in China. According to the tax laws for foreign enterprises, Shanxi Weiqida was granted a two-year national income tax exemption beginning in the first year after it became profitable and a 50% national income tax reduction for the following three years. Shanxi Weiqida became profitable in 2003. According to the current tax policy, the applicable tax rate for Shanxi Weiqida are 15% for 2006 and 2007. Pursuant to the Chinese Corporate Income Tax Law approved on March 16, 2007, the applicable income tax rate for Shanxi Weiqida starting 2008 is 25%. In addition, pursuant to a new regulation, No. 7 enacted during 2006 by the Shanxi Provincial Government , Shanxi Weiqida is exempted from the 3% Provincial income tax from 2006 to 2012.

On June 29, 2006, the Company signed an agreement with an arm-length third party to sell part of the Pharma division, including all the formulation production facilities located in the Economic Development Zone in Datong, China, 258 drug approvals from the Chinese SFDA, 900 employees and the whole direct sales team to hospitals for the formulation business and related inventories, account receivables and account payables. The total selling price for the assets was $13.32 million. The transaction was completed on July 1, 2006. In addition, the Company also signed a separate agreement, with an amendment on July 28, 2006, to deliver international registration documentation and services on a related product to this arm-length third party. This documentation and services agreement is valued at $1.5 million and was completed in September, 2006. The amended Agreement expanded the scope and coverage which will allow the Company to provide additional international registration documentation and assistance to complete the registration in other market areas. The fees related to the expanded scope will be negotiated and determined in the future.

Subsequent to the sales of part of the Pharma division, Oriental Wave transferred the ownership of Shanxi Weiqida to Allwin Biotrade Inc., another wholly owned subsidiary of the Company.

Business Segments

The Company operates three key business units consisting of a Chemical division for bulk pharmaceutical API and intermediate such as Clavulanic acid and 7-ACA, a Pharma division for formulated drugs with a focus of Cephalosporin antibiotics and freeze-dry injectables, and a Biotech division for biologics products, such as

Erythropoietin or EPO.

Chemical Division

The Chemical Division s facilities are located on Datong Gongnong Road, Datong City, Shanxi Province, China. The Chemical Division produces bulk pharmaceutical intermediates and API to sell to other pharmaceutical companies for further processing and formulation into finished products. The Chemical Division manages the production of Clavulanic acid and 7-ACA for both Chinese and international markets. The designed production capacity for Clavulanic acid and 7-ACA were 30 tons and 400 tons respectively. After the Company s investment in the process optimization and technology improvement, the current production capacity reaches 50 tons and 600 tons for Clavulanic Acid and 7-ACA respectively. The production for Clavulanic Acid was started in January 2004 and the production of 7-ACA was started in July 2004.

One of the key products in Chemical Division is Clavulanic acid, a drug that combines with antibiotics increase the effectiveness of the antibiotics. Another key product in the Chemical Division is 7-ACA, an intermediate for Cephalosporin antibiotics. The 600-ton production capacity of 7-ACA positions Dragon among the main producers in the world. The export of 7-ACA to India commenced in 2004 and the Company currently has a target to sell 50% of its 7-ACA production to the Indian market. The Chemical Division operates its business strategies to upgrade its technology in order to improve yields and lower production cost, to develop 7-ACA and Clavulanic acid downstream bulk products, and to apply for approvals in the United States and European Union to enter into European and North American markets.

Pharma Division

After taking into consideration the sale of part of the Pharma division on July 1, 2006, the Company owns 36 drug approvals from the SFDA for the Pharma division, mostly Cephalosporin powder for injection and API. With this more focused product combination, the Company is able to take advantage of being one of the significant producers of 7-ACA, an intermediate for Cephalosporin antibiotics. The Company uses qualified contract manufacturers to produce the Cephalosporin powder for injection and key sales agents and distributors to sell the formulation products in the Chinese market. The Company believes that it will be able to utilize excess production capacity of other formulation producers without having to commit huge capital expenditure in its own production facility.

In addition to the cephalosporin product lines, the Pharma division also offers freeze-dry injectable products. The Company has a freeze-dry injectable workshop, next to the EPO production facility, for the freeze-drying of temperature sensitive pharmaceutical products. Among these products is Levofloxacin, a product marketed by the Company whose production was outsourced to a third party contract manufacturer.

Biotech Division

The Biotech Division s facility was relocated to Datong, China from its original production site in Nanjing City, China at the end of December, 2005. The new EPO production site is adjacent to the campus of the Chemical division, which already includes the entire basic infrastructure such as power, steam, purified water supply and water treatment facilities. The relocation of the EPO production site to Datong will allow the Company to capitalize on the existing production infrastructure and the efficiency of unified operational management. In the new facility, the capacity for bulk EPO doubled to 120 grams and the capacity for sterile vialing tripled to 5 million vials. The sole product of the Biotech Division is Erythropoietin or EPO, an injectable that stimulates red blood cell development. Dragon s Biotech Division develops, manufactures and markets generic EPO in China and developing countries as the current core markets. Currently, Dragon s EPO is sold only in countries where there is no patent protection. In the past, Dragon was preparing to enter the European market with a new EPO product under development in Austria. However, in January 2006, the Company sold the development contract with the Austrian partner to a related party for $1 million cash and assumption of all commitments under the contract.

Products

The following table describes the top five products of the Company in terms of revenue contribution.

Chemical Division

The Chemical Division currently produces Clavulanic acid and 7-ACA. Clavulanic acid is used together with antibiotics to make the antibiotics more effective and longer-lasting. 7-ACA is an intermediate which is converted into active pharmaceutical ingredients to produce Celphalosporin antibiotics.

Clavulanic acid. Beta-lactam antibiotics, such as the penicillins and cephalosporins, act by disrupting the development of bacterial cells walls thus causing the disintegration of the bacteria. However, some bacteria have acquired the genes to produce enzymes which inactivate this mode of action - so called beta-lactamases and thus drastically reducing the efficacy of this class of antibiotics. Clavulanic acid acts to inhibit the effectiveness of bacterial beta-lactamases since they are much more inclined to bond to Clavulanic acid than to beta-lactam antibiotics. In this way, bacterial beta-lactamases miss their target and the antibiotic has free access to the bacterial wall which it affects.

The Company s Clavulanic acid technology and production process was licensed and transferred from Alpha Process Trust Reg., or Alpha Trust. With the commencement of the production of Clavulanic acid in January 2004, the Company became the first commercial scale producer in China. By being the first producer in China, the Company believes it has a competitive advantage over other manufacturers to fulfill demands for Clavulanic acid domestically as well as internationally.

7-ACA.7 -ACA is made from Cephalosporin C and is a key intermediate for synthesizing cephalosporin antibiotics, the -lactam antibiotics family. Produced by the fermentation of a filamentous fungus (Cephalosporium acremonium now known as Acremonium chrysogenum), cephalosporin C in the fermentation broth is isolated from the biomass by filtration. The strongly hydrophilic Cephalosporin C is purified by laborious adsorption and ion exchange steps. Cephalosporin C can be a free acid or a salt (sodium, potassium or zinc). The conversion of Cephalosporin C to 7-ACA has two methods, chemical process, and enzymatic process. The Company adopts the chemical process in the conversion of Cephalosporin C.

Pharma Division

Subsequent to the sale of part of the Pharma division on July 1, 2006, the Company owns 36 drug approvals from the SFDA in three presentation formats: 16 types of powders for injection, 15 types of sterilized bulk drugs and five types of freeze-dry injectables. The Company focuses on generic drugs especially Cephalosporin antibiotics. With this more focused product combination, the Company is able to extend its cost competitive advantage as being one of the important producers of 7-ACA in China to downstream formulation products.

Biotech Division

The Company s primary product of the Biotech division is EPO, a glycoprotein that stimulates and regulates the rate of formation of red blood cells. In adult humans, EPO is produced by the kidneys and acts on precursor cells to stimulate cell proliferation and differentiation into mature red blood cells. Kidney disease and chemotherapy or radiation therapy for treating cancer may impair the body s ability to produce EPO and, in turn, reduce the level of red blood cells to less than one-half that of healthy humans. The shortage of red blood cells leads to insufficient delivery of oxygen throughout the body. The result is anemia, which symptoms include fatigue and weakness.

One of the treatments for anemia is to provide EPO protein. This treatment is administered through dialysis tubing or by injection approximately three times per week. EPO is most commonly administered to people with chronic renal failure, HIV patients being treated with anti-viral drugs, and cancer patients on chemo or radiation therapy. The treatment is less dangerous and generates fewer adverse side effects than alternative treatments that include blood transfusions and androgen therapy. However, side effects of EPO may include hypertension, headaches, shortness of breath, diarrhea, rapid heart rate and nausea.

While EPO has been tested to be effective in treating anemia, there are other drugs and treatments currently that exist or are in development that can treat anemia. These alternative drugs or treatments could be proven more effective, less expensive or preferable to customers than EPO. The inability of EPO to compare favorably to these alternative drugs could have an adverse affect on our business.

Sales and Marketing

Currently, the Company sells its products from the Chemical and Biotech divisions in both Chinese and international markets while only selling its Pharma division products in the China. The table below sets forth the Company s sales by product segments:

During 2006 and 2005, sales to the Company s five largest customers accounted for approximately 58.5% and 52.7% of the Company s sales, respectively; while sales to the Company s largest customer accounted for approximately 26.3% and 19.1% of the Company s sales, respectively. The Company has historically made its sales through purchase orders and not through long-term contracts.

Sales Models

The Company maintains different sales and distribution models for different products. For cephalosporin formulation drugs, the Company sells through its sales offices to regional wholesalers throughout China. For EPO, the Company sells through its representatives to hospitals. For API and pharmaceutical intermediates, the buyers are other pharmaceutical companies who use our products as raw material for further processing and formulation. The Company s sales department covers both Chinese and international markets.

Pricing Policy

All formulation drugs from the Pharma division and EPO from the Biotech division are subject to retail price control imposed by the government administration authorities. The main objective of price control policy is to set an upper limit to the retail prices of pharmaceutical products in order to prevent excessive increases in the prices of pharmaceutical products. The Company s products from Chemical Division are market-priced products and therefore not subject to retail price control.

9

Facilities

The Company has an office in Vancouver, Canada to provide certain corporate functions of the Company, such as Finance, Investor Relations and International Regulatory Affairs. The Company has two manufacturing facilities for the Chemical Division and one manufacturing facility for the Pharma Division (freeze-dry injectable) in Datong, China. The Company s biotech facility was originally located in Nanjing, China but was closed in August, 2005 and relocated to Datong, China.

The Company s Chemical, Biotech and Pharma Division facilities are all located in Datong City. This campus, with a total area of approximately 947,200 square feet, houses the Clavulanic acid production facility, power, boiler, steam and water facilities and 7-ACA production facility, EPO and freeze-dry production facility. The land use right for this facility expires in August 2053.

All manufacturing facilities of the Company that are required to be GMP certified, have been certified under current Chinese regulations. The Company s GMP certificate for the Clavulanic acid facility of the Chemical division will expire and is subject to recertification in January 2009. The Company was granted the GMP certificate for its biotech and freeze-dry injectable facilities on December 29, 2005. Such GMP certificate will expire and is subject to recertification in December 2010. The 7-ACA facility does not need to be GMP certified. All the facilities of the Company have been designed to meet potential production demands into the foreseeable future.

Competition

Chemical Division

Clavulanic acid. The world production of Clavulanic acid is dominated by manufacturers located in Europe. Among them, Lek Pharmaceutical and Chemical Company of Slovenia, SmithKline Beecham Pharmaceuticals of Britain, Deva Holding A.S. of Turkey, Amifarma S.L. of Spain and DSM of the Netherlands, are the leading manufacturers of Clavulanic acid.

In China, there are three other producers of bulk Clavulanic acid, namely, Zhangjiakou International Pharmaceutical, Shanghai Antibioticos and Zhuhai Lianbang Pharmaeutical. The Company is currently the market leader of such product in China.

7-ACA. Production of 7-ACA is concentrated among a few European and Chinese manufacturers. The Company will face significant competition from these companies. The Company s international competitors include Antibioticos, a subsidiary of the Fidia Group of Italy and Biochemie, a subsidiary of Novartis of Switzerland. In addition, there are four leading manufacturers in China: China Pharmaceutical, Shangdong Lukang Pharmaceutical, Fuzhou Pharmaceutical and Harbin Pharmaceutical. Among them, Fuzhou Pharmaceutical does not sell 7-ACA in the market as it further processes all the 7ACA it produced into downstream APIs. Harbin Pharmaceutical is a buyer of 7ACA in the market since its capacity cannot fulfill its own demand to make downstream formulation products. Therefore, we believe that there are only two other key manufacturers of 7-ACA in China directly competing with the Company.

Pharma Division

The world market for Cephalosporin antibiotics is highly competitive and producers in this market include some of the largest pharmaceutical companies, including Pfizer Inc., GlaxoSmithKline, Schering-Plough, Abbott Laboratories and Sandoz.

There are numerous pharmaceutical manufacturers of Cephalosporin antibiotics in China. The top four producers are Harbin Pharmaceutical Group Holding Co., Ltd., Shijiazhuang Pharmaceutical Group Co., Ltd., Shanghai Pharmaceutical Co., Ltd. and North China Pharmaceutical Co., Ltd. All these companies or their affiliates are publicly traded companies listed on the Shanghai Stock Exchange or Hong Kong stock exchange. All of these competitors are substantially larger than the Company and have a more diversified product portfolio. The current Chinese market size for cephalosporin injectables is estimated to be 4 billion units and is expected to increase 15% annually in the next 5 years. The Company s strategy is to take over market share of smaller regional players that can not compete effectively due to strengthened GMP and quality requirements.

Biotech Division

We have estimated that the world market for EPO to be approximately $13 billion in annual sales and believe the market is growing. The market is dominated by three firms: Amgen Inc. of Thousand Oaks, California; Ortho Pharmaceutical Corp., a subsidiary of Johnson & Johnson, Inc. of New Brunswick, New Jersey; and Kirin Brewery Company Limited of Japan. EPO is marketed by Amgen as "Epogen," by Johnson & Johnson as "Procrit/Eprex" and by Kirin as "Espo." A fourth participant in the international EPO market is Roche Holding AG of Switzerland, which markets an EPO drug with a different heritage.

In addition to these international drug companies, we are competing with existing and potential Chinese producers such as Sunshine SS Pharma and NCPC Genetech Biotechnology.

In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties that could increase their ability to reach customers in the Chinese market. Such existing and future competition could affect our ability to penetrate the Chinese market and generate sales. No assurances can be given that we will be able to compete successfully against current and future competitors, and any failure to do so would have a material adverse effect on our business.

Intellectual Property, Government Approvals and Regulations

Intellectual Property

The Company, through its subsidiary, Shanxi Weiqida, has 9 registered trademarks and has applied for registration of another 15 trademarks in China. Currently, the Company has submitted an application for a patent on a production technique.

Since all of the Company s products are generic drugs, they are not protected by any intellectual property rights except for their trade names.

Regulation of the Chinese Pharmaceutical Industry

The modernization of regulations for the pharmaceutical industry is relatively new in China and the manner and extent to which this industry is regulated will continue to evolve. As a pharmaceutical company, Shanxi Weiqida is subject to the Pharmaceutical Administrative Law, which governs the licensing, manufacturing, marketing and distribution of pharmaceutical products in China. Additionally, Shanxi Weiqida is subject to varying degrees of regulation by governmental agencies in China.

Principal supervisory authority in the industry. SFDA is the principal supervisory authority in the pharmaceutical industry in China. It was established in March 2003 on the basis of the former State Drug Administration of China, which was established in March 1998. The SFDA is responsible for the administrative and technological supervision of the research, production and trading of pharmaceutical products and the consolidated supervision of the safety management of food, health care and cosmetic products.

Certificates, permits and licenses for pharmaceutical manufacturing and trading enterprises. A pharmaceutical production enterprise or pharmaceutical trading enterprise must apply for the relevant permit from the relevant regulatory department in China. The Industry and Commerce Administration Department will issue a "business license" only after the pharmaceutical regulatory department has considered the application and approved the issue of a "pharmaceutical production permit" or "pharmaceutical trading permit". Such permits are valid for a period of five years and application for renewal must be made six months prior to its expiry date. A new permit will be issued after reassessment, examination and approval by the relevant pharmaceutical regulatory department.

Good Manufacturing Practices ("GMP"). GMP is a set of standards in respect of quality management of the manufacturing of pharmaceutical products which is promoted by the World Health Organization ("WHO"). These are applicable to the entire pharmaceutical production process and the key working procedures for the production of raw materials which affect the quality of finished medicine products. Many countries have formulated their own requirements for GMP based on the GMP promoted by WHO. The Administration Center of Pharmaceutical Certification of the SFDA is responsible for pharmaceutical GMP certification in China. A GMP certificate is valid for a term of five years and application for renewal has to be submitted three months prior to its expiration date.

Prescription medicines and over-the-counter medicines. Prescription medicines must be dispensed, purchased and taken with the prescription of practicing doctors or assistant doctors. Purchase of over-the-counter medicines do not require doctors prescriptions and can be dispensed, purchased and taken by users. The SFDA is responsible for the selection, approval, publication, and revision of the over-the-counter medicine catalogue.

Wholesalers of prescription and over-the-counter medicines and retailers of prescription and over-the-counter type A medicines must hold a "pharmaceutical trading enterprise permit". Commercial entities may engage in the retail of over-the-counter type B medicines subject to the approval of the provincial pharmaceutical regulatory authorities or their delegated bureaus. Prescription medicines may be advertised only in medical journals and over-the-counter medicines may be advertised in the mass media.

Import and export restriction. Imported pharmaceutical products are required to meet certain safety and quality standards set by the Chinese government. In addition, these products should have been approved for sale in the country or region where they are manufactured. If the products are not approved in the foreign countries, they can be imported only subject to the approval from the SFDA. The export of pharmaceutical products when there is shortage of supply in China may be restricted or prohibited.

Price control. In July 2000, in order to enhance market competition of the pharmaceutical industry and to reduce medical expenses, the former State Development and Planning Commission of the PRC promulgated a new policy in respect of reforming the price control of pharmaceutical products in China. According to the policy, the price of pharmaceutical products is subject to the control of the price supervising bureau at state and provincial levels. The bureau generally classifies pharmaceutical products into two groups: (1) government-pricing pharmaceutical products; and (2) market-pricing pharmaceutical products.

12

Pharmaceutical products where prices are determined by National Development and Reform Commission of the PRC are limited to Category A pharmaceutical products listed in Medicine Catalogue of National Basic Medical Insurance and pharmaceutical products with monopolistic attributes (including anaesthetic medicines, certain type of psychiatric medicines, vaccines and contraceptive drugs). The price of Category B pharmaceutical products listed in the Medicine Catalogue of National Basic Medical Insurance are determined by the price supervising bureau at the provincial level according to the price determination policies adopted by the Central Government.

On November 21, 2000, the former State Development and Planning Commission of the PRC promulgated Notice Regarding Rules on Application for Approval for the Prices of Pharmaceutical Products set by the PRC Government, stating that:

(i)

for all pharmaceutical products first launched in China as listed in the price index of the State Development and Planning Commission of China, drug manufacturing enterprises are required to submit their price-setting applications to the price supervising bureau at the provincial level. The provincial price supervising bureau would then transfer such applications to the former State Development and Planning Commission of the PRC after review for further approval;

(ii)

for all new pharmaceutical products first launched in China as listed in the price index of the provincial government, drug manufacturing enterprises are required to submit their price-setting applications to price supervising bureau at the provincial level;

(iii)

for the patented pharmaceutical products, Categories 1 and 2 new pharmaceutical

products not listed in Medicine Catalogue of National Basic Medical Insurance, after trial production in China, drug manufacturing enterprises are required to submit their price-setting applications to the price supervising bureau at the provincial level for preliminary approval when they make applications for formal production. Then the provincial price supervising bureau would then transfer such applications to the former State Development and Planning Commission of the PRC to determine the price;

(iv)

for the patented pharmaceutical products, Categories 1 and 2 pharmaceutical products not listed in Medicine Catalogue of National Basic Medical Insurance, which are not required to be carried out trial production in China,

drug manufacturing enterprises are required to submit their price-setting applications to the price supervising bureau at the provincial level for approval after one year from obtaining of the production approval or the first import permit. Then the provincial price supervising bureau would then transfer such applications to the Economic Planning Commission of China for further approval; and

(v)

for all pharmaceutical products currently sold in the China market as listed in The Price Index of the Provincial and the State Development and Planning Commission of China, before new prices are set by the relevant price supervising authorities according to the market survey information, drug manufacturing enterprises can sell their products at the then prevailing price.

All the formulation drugs from the Pharma division and EPO from the Biotech division are subject to retail price control imposed by the government administration authorities. The main objective of price control policy is to set an upper limit to the retail prices of pharmaceutical products in order to prevent excessive increases in the prices of pharmaceutical products. The Company s products from the Chemical Division are subject to market price fluctuation and are not subject to retail price control. If manufacturing costs increase for products of the Company that are subject to price ceilings, and the retail price for those products is not adjusted upwards, the Company's profitability may be adversely affected.

Reimbursement. Only those drugs that appear on the provincial and municipal reimbursement lists are covered by the national medical insurance system, which may favor locally-manufactured products as they may be lower cost alternatives. The State Development Planning Commission of China has announced its intention to re-examine the pricing of drugs in China.

Product liability. Product liability claims may arise if harmful products are sold to members of the public or if there are any alleged harmful effects from the consumption of the products. Under current Chinese laws, manufacturers and vendors of defective products in China may incur civil and criminal liability for loss and injury caused by such products.

Research and Development

Dragon s research and development activities mainly focus on the improvement of product quality and production technology. In order to fulfil those objectives, the research and development department utilizes both internal and external resources, such as cooperation with universities and other research laboratories. From time to time the Company, through its subsidiary, has established on-going collaborations on production techniques development with external research institutes such as universities and other research laboratories.

Total expenditures on research and development for the years ended December 31, 2006 and 2005 were $85,562 and $96,347, respectively.

Geographical Breakdown

64% and 70% of the Company s revenues for the years ended December 31, 2006 and 2005, respectively, were derived from customers located in China. The Company had sales of $14,451,791 in the Chemical Divisions to customers in India, representing 27.6% of the Company s revenues for the year ended December 31, 2006; while the Company had sales of $6,593,391 and $644,100 in the Chemical and Biotech divisions to customers in India, representing 13% of the Company s revenues for the year ended December 31, 2005. Substantially all of the Company s assets at December 31, 2006 and 2005 were located in China.

Suppliers

The Company uses many different raw materials in the manufacturing process of its pharmaceutical products. The Company mainly sources its raw materials in China, but also purchases raw materials from some overseas markets. The Company has not entered into any supply contracts with any of its suppliers which exceed twelve months. During 2006, the Company did not experience any significant difficulties in sourcing raw materials and the management of the Company does not anticipate that, if required, it will face any material difficulties in sourcing its

raw materials from alternative suppliers.

Customers

For the Chemical division, our customers are pharmaceutical companies that purchase our API and pharmaceutical intermediate for further processing and formulation.

For the antibiotic formulation products, our customers are regional wholesalers at the provincial, municipal or county level. They will then sell the drugs to hospitals and clinics within their territories.

For EPO, our customers in China are hospitals with dialysis clinic. For the international markets, our customers are our licensees which purchase the products from us and then resell it to hospitals.

Employees

As of December 31, 2006, the Company has 11 employees in North America and approximately 1,000 employees in China. Employees in China are union members under the Chinese law and there has been no labor disputes.

Business Risks Associated with Dragon Pharmaceutical

An investment in our common stock involves a high degree of risks. Before you invest, you should carefully consider the risks described below. If any of the following risks occur, our financial condition or results of operations could be materially affected.

Certain Officers and Directors have significant control.

Messrs. Han and Weng and Ms. Liu, who are officers and/or Directors of our Company own, in the aggregate, 70.78% of our issued and outstanding shares of common stock. As a result, these shareholders will be able to control certain corporate governance matters requiring shareholders' approval. Such matters may include the approval of significant corporate transactions requiring a majority vote without seeking other shareholders' approval. They will also have the ability to control other matters requiring shareholder approval including our election of directors that could result in the entrenchment of management.

Dragon has a negative working capital and we must restructure the short-term loans.

As of December 31, 2006, the Company had current liabilities of $33.95 million and current assets of $17.73 million, including cash and cash equivalents of $1.08 million and accounts receivables of $4.25 million. The excess of current liabilities over current assets is mainly due to the fact that the Company finances its operations, development of its new EPO and freeze-dry injectable facilities, and increased production level at its Chemical Division through operating revenues, accounts payables and short-term loans. As a result, Dragon must, during the upcoming twelve months, negotiate with its banks to restructure or renew its notes. Assuming that Dragon is successful in renegotiating its notes and that vendors continue to work with Dragon as to their accounts payables, Dragon believes that it will be able to fund its operations from product sales for the near future. However, there is no assurance that the Company will be able to renegotiate and extend its loans. If our banks do not extend our loan or they are extended on unfavourable terms, the Company may be adversely affected.

Dragon relies heavily on main clients.

Sales to the Company s five largest customers accounted for approximately 58.54% and 52.74% of the Company s sales for the year ended December 31, 2006 and 2005, respectively; while sales to the Company s largest customer accounted for approximately 26.3% and 19.1%, respectively. Although we do not anticipate that there will be a material change in these customer relationships, a change in demand for these products due to world competition, market forces or other factors outside of the control of clients, could adversely affect our sales and net income.

Dragon relies heavily on the sale of a few products.

Dragon's top five products for 2006 were 7-ACA, Avecil and Clavulanate Potassium, Amoxicillin Clavulanate Potassium (5:1), Ceflriaxone for Injection, Amoxicillin Clavulanate Potassium (2:1), while the top five products for 2005 were 7-ACA, EPO, clavulanic acid, Mezlocillin, and Amoxicillin Sulbactam. The top five products sold by Dragon amounted to approximately $45.45 million and $27.37 million of its sales during 2006 and 2005, respectively, representing approximately 82.83% and 78.07% of Dragon's total sales for those periods. Although we do not anticipate that there will be a material change in demand for these products, a change in demand for these products due to world competition, market forces or other factors outside of its control, could adversely affect our sales and net income.

Shanxi Weiqida is required to contribute a portion of its net income to Reserve Funds which may not be distributed.

By law, Shanxi Weiqida is required to contribute at least 10% of its after tax net income (as determined in accordance with Chinese GAAP) into a reserve fund until the reserve is equal to 50% of Shanxi Weiqida's registered capital, a further percentage of its after tax net income, as determined by Shanxi Weiqida's Board of Directors, into a staff welfare fund, and into an enterprise expansion fund if determined by 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 shareholders other than in the case of liquidation, while the staff welfare fund is recorded as a liability, and is not available for distribution to shareholders. As a result of this requirement, the amount of net income available for distribution to shareholders will be limited.

We intend to raise additional capital through the issuance of equity securities that will dilute the ownership of other shareholders.

We intend to raise additional capital through the issuance of our equity securities to finance our growth and reduce short-term debt and other liabilities. No assurance can be given that we will be successful in our efforts. Further the

issuance of equity securities will reduce other shareholders' ownership in us.

We may be subject to product liability claims in the future that could harm our business and reputation.

Product liability claims may arise if harmful products are sold to members of the public or if there are any alleged harmful effects from the consumption of our products. Under current Chinese laws, manufacturers and vendors of defective products in China may incur liability for loss and injury caused by such products, including having their business licenses revoked and facing criminal liability. Consistent with industry practice in China, Shanxi Weiqida does not carry liability insurance coverage. Should any product liability claim be brought against us, there is no assurance that it would not have an adverse impact on our business, profitability or business reputation.

We will be dependent upon the services of Mr. Han.

Mr. Yanlin Han is our largest shareholder and serves as our CEO and Chairman of the Board. As a result, our operations will be dependent on Mr. Han who has been the driving force behind the Company. If something happens to Mr. Han, this could divert management's time and attention and adversely affect our ability to conduct the combined business effectively.

Dragon relies heavily on the China market and changes in the market could harm our business.

During 2006 and 2005, 64% and 70% of Dragon's sales, respectively, were derived from China. It is anticipated that Dragon s products in China will continue to represent a significant portion of sales in the near future. As a result of its reliance on the China market, the operating results and financial performance of Dragon could be affected by any adverse changes in economic, political and social conditions in China. For example, if legislative proposals for pharmaceutical product pricing, reimbursement levels, approval criteria or manufacturing requirements should be proposed and adopted, such new legislation or regulatory requirements may have a material adverse effect on our financial condition, results of operations or cash flows. In addition, we will be subject to varying degrees of regulation and licensing by governmental agencies in China. At this time, we are unaware of any China legislative proposals that could adversely affect our business. There can be no assurance that future regulatory, judicial and legislative changes will not have a material adverse effect on Dragon, that regulators or third parties will not raise material issues with regard to compliance or non-compliance with applicable laws or regulations or that any changes in applicable laws or regulations will not have a material adverse effect on Shanxi Weiqida or our operations.

Certain products are subject to price controls and if the related manufacturing costs increase, our potential profits may be harmed.

In July 2000, in an effort to enhance market competition in the pharmaceutical industry and to reduce medical expenses, the former State Development and Planning Commission of the People's Republic of China promulgated a new policy to reform the price control of pharmaceutical products in China. According to the policy, the price of pharmaceutical products and biotech products is subject to the control by government bureaus at state and provincial levels. In the event that the sale prices of our products are limited by government bureaus at the state and provincial levels, this may have an adverse effect on our net income, especially if our costs associated with those products increase. All formulation drugs from our Pharma division and EPO from our Biotech division are subject to retail price control imposed by the government administration authorities, which accounted for approximately 17% of 2006 sales and 22% of 2005 sales. If manufacturing costs increase for these products that are subject to price ceilings, and the retail price for those products is not adjusted upwards, our profitability will be adversely affected.

Dragon is required to maintain compliance with GMP standards.

All pharmaceutical manufacturers in China, including Shanxi Weiqida, a subsidiary of Dragon, are required to comply with certain Good Manufacturing Practice, or GMP, standards by certain time limits and, if not met, their pharmaceutical manufacturing enterprise permits will be revoked or they will not be renewed and accordingly production will have to be terminated. A GMP certificate is valid for five years from the issuance date of such certificate.

Shanxi Weiqida has been accredited with all GMP certificates it requires for its production facilities. Shanxi Weiqida's GMP certificate for the Clavulanic acid facility of the Chemical division will expire and is subject to recertification in January 2009, and the GMP certificate for the EPO and freeze-dry facility of the Biotech division will expire and is subject to recertification in December 2010. The standard of compliance required in connection with GMP certificates may change from time to time, which may give rise to substantial compliance burdens and increase Shanxi Weiqida's costs in the future. If the recertification of any required GMP-related status is not granted, the relevant operations of Shanxi Weiqida may have to be terminated which in turn would have an adverse impact on our profitability.

Currency conversion and exchange control could adversely affect our operations and profitability.

The sales and expenses of Shanxi Weiqida are substantially settled in Renminbi, or RMB, however, our financial statements are reported in U.S. dollars. Accordingly, our net income, the value of our assets and our ability to pay dividends, if any, in U.S. dollars may be adversely affected by negative changes in the exchange rate of RMB against the U.S. dollar or other currencies.

Major reforms have been introduced to the foreign exchange control system of China. In 1994, the previous dual exchange rate system for RMB was abolished and a unified floating exchange rate system, based largely on supply and demand, was introduced. Since December 1996, under the rules of International Monetary Fund, or IMF, China has provided a free exchange of current accounts, while capital accounts have been subject to foreign exchange control. Foreign exchange transactions under a capital account, including foreign currency-denominated borrowings from foreign banks and principal payments in respect of foreign currency-denominated obligations, continue to be subject to significant foreign exchange controls and require the approval of the State Administration of Foreign Exchange. However, the payment in and transfer of foreign exchange for current international transactions, such as the payment of dividends or other distributions to shareholders, is deemed a current account and therefore is not subject to Chinese government controls or restrictions. Although China's commitment to IMF is unlikely to change, limitations on foreign exchange could affect our ability to obtain foreign exchange for capital expenditures and we continue to be exposed to negative changes in exchange rates.

On July 22, 2005, the Chinese government decided to no longer peg the value of the Renminbi to the US dollar but rather to a basket of currencies of its largest trading partners. The result was an appreciation of the Renminbi of approximately 2% against the value of the US dollar (and a further 3.6% increase by the end of 2006). The effect of the revaluation was an increase in the assets, liabilities, revenues and expenses of the Company and a foreign currency gain included in comprehensive income.

The majority of the company s assets, liabilities, revenues and expenses are denominated in Renminbi, which was tied to the US Dollar until July 22, 2005 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.

Dragon does not have patent protection and is subject to substantial competition.

Dragon competes in the generic drug segment of the pharmaceutical industry and has no patent protection for any of its products. Many pharmaceutical companies compete in the same market segment with similar products or products having comparable medicinal applications or therapeutic effects which may be used as direct substitutes for Dragon's products. Further, many of these competitors are larger and have greater resources and market presence than Dragon. Larger competitors may, as a result of economies of scale, be able to afford to sell competing products at lower prices than Dragon. This will have an adverse effect on Dragon's profitability. These competitors include Harbin Pharmaceutical Group Holding Co. Ltd, Shijiazhuang Pharmaceutical Group Co., Shanghai Pharmaceutical Co., Ltd. and North China Pharmaceutical Co., Ltd.. As a result of the lack of patent protection, competitors with potential substitutes could launch similar products in the market with their prices analogous with or lower than those manufactured and sold by Dragon. Further, the lack of patent protection could also attract an even greater number of competitors who believe they can develop products that are substantially similar to those of Dragon at a lower cost.

Chinese economic planning could negatively impact the pharmaceutical market in which our products are sold.

China has a long history of a planned economy and is still subject to plans formulated by the Central Chinese government. In recent years, the Chinese government has introduced economic reforms aimed at transforming the Chinese economy from a planned economy into a market economy with socialist characteristics. These economic reforms allow greater utilization of market forces in the allocation of resources and greater autonomy for enterprises in their operations. However, many rules and regulations implemented by the Chinese government are still at an early stage of development and further refinements and amendments are necessary to enable the economic system to develop into a more market oriented form. No assurance can be given that any change in economic conditions as a result of the economic reform and macroeconomic measures adopted by the Chinese government will have a positive impact on the Chinese economic development or its pharmaceutical sector, which is the market where our products are sold. At the same time, there can be no assurance that such measures will be consistent and effective or that we will benefit from or will be able to capitalize on all such reforms.

19

ITEM 2.

DESCRIPTION OF PROPERTY

Our corporate administrative office is located at Suite 310, 650 West Georgia Street, Vancouver, British Columbia, Canada covering 2,222 square feet for approximately CDN$73,000 ($60,000) per annum until March 31, 2011. From March 2006 to March 2007, the Company subleased its original corporate administrative office space at 1055 West Hastings, Suite 1900, Vancouver, British Columbia, Canada V6E 2E9. The Company anticipates recovering $124,000 and $41,000 during fiscal 2006 and 2007, respectively, under its sublease agreement.

Company s production facilities for all three divisions are all located in Datong city, China. This production campus, with a total area of approximately 947,200 square feet, houses the Clavulanic acid, 7-ACA, EPO and freeze-dry injectable production facilities with its own boiler, power, steam and water facilities. The land use right for this campus expires in August 2053.

ITEM 3.

LEGAL PROCEEDINGS

We are not currently involved in any litigation.

ITEM 4.

SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted for shareholders vote during the fourth quarter.

PART II

ITEM 5.

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock began quotation on the OTC Bulletin Board on October 9, 1998 under the symbol "DRUG". In addition, our shares of common stock are listed on the Toronto Stock Exchange under the symbol "DDD" and are quoted on the Berlin-Bremen Exchange, the Frankfurt Exchange and the XETRA Exchange under the symbol "DRP". The OTC Bulletin Board represents our primary market. Our common stock being quoted and traded on the Berlin-Bremen Exchange, Frankfurt Exchange and XETRA Exchange are without the Company's prior knowledge. The following quotations reflect the high and low bids for our common stock on a quarterly basis for the past two fiscal years as quoted on the OTC Bulletin Board. These quotations are based on inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

	Common Stock	
Quarter Ended	**High**	**Low**
December 31, 2006	$0.54	$0.30
September 30, 2006	$0.58	$0.41
June 30, 2006	$0.94	$0.45
March 31, 2006	$0.78	$0.57
December 31, 2005	$0.85	$0.51
September 30, 2005	$1.00	$0.69
June 30, 2005	$1.03	$0.75
March 31, 2005	$1.26	$0.80

Holders

As of March 15, 2007, there were 59 registered holders of our common stock**.** Many of the shares of common stock are held in street name, there may be additional beneficial holders of our common stock.

Dividend Policy

We have paid no dividends on our common stock since our inception and may not do so in the future. For the foreseeable future, we expect earnings, if any, will be retained to finance the growth of the Company.

ITEM 6.

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

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 our future performance or results, and our 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 our consolidated financial statements.

The following discusses the Company s financial condition and results of operations for the years ended December 31, 2006 and 2005 based upon the Company s consolidated financial statements which have been prepared in accordance with the United States generally accepted accounting principles. Due to the fact that Dragon s acquisition of Oriental Wave Holding Limited (Oriental Wave) on January 12, 2005 is deemed to be a reverse-take-over transaction, the following discussion reflects the Company s results of operations for the year ended December 31, 2005, including the results of Oriental Wave for the full year and the results of Dragon s biotech business for the period of January 12, 2005 to December 31, 2005. In addition, since the Company sold part of the Pharma division business on July 1, 2006, that part of the Pharma division business sold was reclassified as discontinued operations in the Company s results of operations for the years ended December 31, 2006 and 2005.

Results of Operations for the Fiscal Years Ended December 31, 2006 and 2005

Sales for the year ended December 31, 2006 increased 57% to $54.87 million from $35.06 million for the same period in 2005. $35.26 million or approximately 64% of the sales for the year ended December 31, 2006 were generated from the sales of products in the Chinese market, and the remaining $19.61 million or approximately 36% were generated from the sales of products in the international markets (outside of China). 70% of the sales for the year ended December 31, 2005 were generated from the sale of products in the Chinese market while the remaining 30% of the sales were generated in the international market outside of China. In the year ended December 31, 2006, $6.61 million or approximately 12% of the sales were from the Pharma Division, $45.80 million or 83% of sales were from the Chemical Division, and $2.46 million or 5% of sales were from the Biotech Division. For the same period in 2005, 11% of sales were from the Pharma Division, 78% of sales were from the Chemical Division, and 11% of sales were from the Biotech Division. The increase in sales for the year ended December 31, 2006 as compared to the prior year was primarily due to increase in sales from the Chemical and Pharma Division.

Cost of sales for the year ended December 31, 2006 was $44.85 million compared to $30.57 million for the same period of 2005. The cost of sales is attributed to the production costs of products. The increase in the cost of sales was mainly due to the increase in production and sales of products from the Chemical and Pharma Divisions. Gross profit and gross margin for the year ended December 31, 2006 were $10.02 million and 18.25% compared to $4.49 million and 12.80% for the same period of 2005. The increase in gross margin was mainly due to an improved margin of the Chemical Division as a result of an increase in production level and hence, better utilization of the production facilities.

Divisional Revenues and Gross Margin Analysis

The Company s businesses are organized under three business divisions: the Chemical Division, the Pharma Division and the Biotech Division.

Chemical Division

The Chemical Division s revenues for the year ended December 31, 2006 were $45.80 million, representing a 68% increase from the revenues of $27.33 million during the same period in 2005. The increase is due to the increase of sales from both the China market and international market.

The Chemical Division s gross margin for the year ended December 31, 2006 was 19.85% compared to 3.97% for the year ended December 31, 2005. The increase in gross margin reflected the lowering of per unit production cost as the production level continued to increase.

Pharma Division

The Pharma Division s revenues for the year ended December 31, 2006 were $6.61 million, accounting for 12% of the total revenues of the Company. Comparatively, Pharma Division s revenues were $3.90 million for the same period in 2005, contributing 11% of the total revenues of the Company. The 70% increase in revenues of the Pharma division during 2006 as compared to 2005 was mainly due to the increase in sales quantity as the Company has a more focused product and sales strategies.

The overall gross margin for the division for the year ended December 31, 2006 was -12.76% as compared to 15.90% for the same period of 2005. The decrease in the gross margins was due to a lowering of selling prices of the products.

Biotech Division

The Biotech Division s revenues for the year ended December 31, 2006 were $2.46 million representing 5% of the Company s revenues for the year. Comparatively, Biotech Division s revenues were $3.83 million for the same period in 2005, contributing 11% of the total revenues of the Company. The decrease was due to the Company having less international sales as the Company relocated its biotech production facility to the city of Datong during 2006. Such a new production facility may be required to be approved by regulatory bodies of certain international countries in which the Company intends to sell its products. Gross margin for the year ended December 31, 2006 was at 71.88% as compared to 72.57% for the same period of 2005. The gross margin was slightly lower because of the lowering percentage of contribution from international sales during 2006 which typically carries a higher margin than sales in the Chinese market and a slightly lower price in the Chinese market in 2006 than in 2005.

Expenses. Total operating expenses were $9.06 million for the year ended December 31, 2006. The major category of operating expenses was general and administration expenses of $5.75 million, selling expense of $2.31 million, and depreciation and amortization expenses of $1.00 million. Total operating expenses were $8.12 million for the year ended December 31, 2005 with the major expenses being general and administration expenses of $5.22 million, selling expense of $2.00 million, and depreciation and amortization expenses of $0.90 million. During the year ended December 31, 2006, the general and administration expenses included $1.60 million for salaries, compensation and benefits, $0.68 million for accounting and auditing, $0.49 million for travel expenses, $0.39 million for non-cash stock-based compensation, $0.34 for consulting fees, and $0.29 million for office and miscellaneous compared to $1.79 million for salaries, compensation and benefits, $0.34 million for accounting and auditing, and $0.49 million for travel expenses, $0.28 million for consulting fees, and $0.41 million for office and miscellaneous for the same period in 2005.

The increase in operating expenses of $0.94 million for the year ended December 31, 2006 as compared to the same period for the prior year reflects the increased overhead related to an increase in non-cash stock-based compensation expense, audit fees and consulting fees related to the compliance of Sarbanes-Oxley Act as well as selling expenses due to an increased in revenues especially for the Chemical Division.

Other Income / Expense During the year ended December 31, 2006, the Company recognized a net other expense of $1.74 million. This amount primarily consisted of $3.24 million of interest expense (including $ 1.67 million cash interest expense and $1.57 million non-cash accreted interest expense on the long term payable), which was offset partly by a $1 million gain on the sale of the European EPO cell line development and $0.57 million government grant from the Chinese government. The other expense for the year ended December 31, 2005 was 0.66 million.

Income from Discontinued Operations. During the third quarter of 2006, the Company completed the sales of part of the Formulation business and the Registration Documentation Services to an unaffiliated party. As a result of the transactions, the Company recognized an after-tax gain of $4.22 million from the disposal of assets and an after-tax income of $0.92 million from the discontinued operations for the year ended December 31, 2006. Comparatively, the Company recognized an after-tax income of $4.50 million from the discontinued operations for the year ended December 31, 2005.

Net Income. Dragon had a net income of $4.62 million for the year ended December 31, 2006 compared to a net income of $0.18 million for the same period in 2005,

Comprehensive Income. Dragon had foreign currency translation income of $1.18 and $0.75 million as other comprehensive income for the years ended December 31, 2006 and 2005, respectively. The foreign currency translation income results from translation of the financial statements expressed in RMB to United States Dollar.

On July 22, 2005, the Chinese government decided to no longer peg the value of the Renminbi to the US dollar but rather to a basket of currencies of its largest trading partners. The result was an appreciation of the Renminbi of approximately 2% against the value of the US dollar (and a further 3.6% increase by the end of 2006). The effect of the revaluation was an increase in the assets, liabilities, revenues and expenses of the Company and a foreign currency gain included in comprehensive income.

Basic Net Income Per Share. Dragon 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. Net income per share for the year ended December 31, 2006 was $0.07 per share and $0.00 for the year ended December 31, 2005. The weighted average number of shares outstanding during year ended December 31, 2006 was 62,878,004 and was 62,273,862 shares during year ended December 31, 2005. The outstanding common stock options have no significant dilutive effect on the weighted average number of shares outstanding.

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 shareholders other than in liquidation; while the staff welfare fund is recorded as a liability and is not for distribution to shareholders. As at December 31, 2006, the Company s reserve fund is $2.69 million, 11.14% of the Company s registered capital.

Liquidity and Capital Resources

As of December 31, 2006, Dragon had current liabilities of $33.95 million and current assets of $17.73 million, including cash and cash equivalents of $1.08 million and accounts receivables of $4.25 million. The working capital deficiency is mainly due to the fact that some long-term account payables and bank loans will become due within a year and therefore transferred from long-term liabilities to short-term liabilities.

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 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. The Company s financial statements do not include any adjustments that might result from this uncertainty.

As of December 31, 2006, Dragon had current liabilities of $33,953,660 as follows:

Accounts Payable	$5,709,796
Other Payables and Accrued Expenses	