

**DRAGON INTERNATIONAL GROUP CORP.**

**(DRGG - OTC:BB)**

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Recent Price: **\$0.130**  
Target Price: **\$0.600**  
(12 month)

**SPECULATIVE STRONG BUY RATING**

**Main Headquarters**

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China

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**Dragon International Group Corp.**  
(all figures in Millions)

52 Week Hi/Lo Range	0.363/0.08
Fiscal Year End	30-Jun
Shares Outstanding (3/31/2006)	58.46
Float (approximately)	10.00
Share price (06/25/2006)	0.130
Market Capitalization	7.6
Average Volume (3 months)	0.15
Insider Ownership (3/22/2005)	29%
Institutional Ownership	NA
Enterprise Value	6.28
Total LT Debt	0.012
Total Cash (03/31/06)	1.333

6/2006 6/2007

FY2006 E	FY2007 E
-0.044	0.044

Earnings Per Share (EPS)	
Book Value (\$/share)	0.096

	FY2006 E	FY2007 E
Total Revenue	18.900	27.630
Cost of Sales	16.900	22.947
Gross Profit/Loss	2.000	4.683
Operating expenditures	1.063	1.275
Operating Loss /Profit	0.937	3.408
Other income	3.500	0.600
Income continuing operations	-2.563	2.808
Net Income	-2.563	2.808

NA = Not applicable/Not Available.  
A = Actual Reported figures E = Estimates

**Balance Sheet & Financial Statement Extracts (03/2006)**

Current Assets	9.987
Current Liabilities	8.479
Total Assets	14.094
Total Accumulated Deficit	0.538
Total Shareholder's Equity	5.602

Capital Structure (as at 03-31-06)	
Authorized Common Stock	200 000 000
Authorized Preferred Stock	25 000 000

**Crouching Fiber, Paper Dragon!**

**Company Overview**

Dragon International Group Corp (OTC:BB DRGG) is one of China's leading manufactures and distributors of a wide range of specialty paper products and packaging materials. The company operates in China under the name Ningbo Anxin International Trade Co. Ltd (Anxin). Anxin operates four subsidiaries that manufacture and distribute high-grade packaging products for the tobacco, alcohol, gift, tea, cosmetics and pharmaceuticals industries.

- Striving to create a dynamic integrated company, management seeks to position Dragon to **capitalize on the explosive growth in China's packaging industry**. The company is actively developing various strategies to become a dominant player in the sector through **consolidation by acquisitions and the expansion of its sales force**.
- Management has been **in place since 1997** demonstrating an ability to **create substantial growth in revenue as well as profits**.
- The company and its subsidiaries have cultivated strategic relationships with several of the world's largest paper and specialty packaging companies, including **International Paper Company (IP) and Asia Pulp and Paper Company (APP)**. The manufacturing facilities include state of the art equipment ensuring production of the highest quality products to their customers, at **competitive prices**.
- **China is the second largest paper and paperboard producing country** based on 2003 statistics. Despite ranking second in terms of production only to the US, the **per capita consumption in 2003 was only 36 kg well below developed countries and below the world average of 52 kg**. This clearly illustrates the extent of room for growth opportunities that exist in today's Chinese paper and packaging market.
- In 2006, **management plans to penetrate the pharmaceutical packaging industry** in China, as the demand for the high-grade pharmaceutical packing materials increases sharply, which provide a huge opportunity for DRGG to grow for years to come.
- Dragon is anticipating a substantial increase in revenues and net income in FY2007 and FY2008 compared to FY2005 and FY2006. **FY2007 Revenue and Earnings estimates** are projected to be between **\$27- 28 million** (increasing almost 50% from FY2006) and **\$2.8 million, or 4.4c EPS** (up +180% over FY2006 net income) respectively.
- The anticipated growth is expected to come both internally as well as externally. For **FY2008 early estimates** are set for **revenues** to be approximately **\$42 million** and **net income** near **\$4.5 million (6.6c FY 2008 EPS)**.
- **China not only represents the world's largest consumer market, it also has the potential of becoming the world's largest exporter of a wide range of products**. We believe that Dragon is **well positioned to capitalize on this growth through its participation in the paper and packaging industry, which should continue to experience firm demand supported by higher product export quantities**. We believe these conditions can allow DRGG to exhibit further **organic and acquisition-based growth that will add shareholder value**. When taken together with our outlook for **strong improvement in FY2007 and FY 2008 earnings** and the **robust underlying economic trends in China to persist**, we classify the shares in our **SPECULATIVE STRONG BUY** rating category. Our 12-month target price is pegged at 60c, which is a blend of (1) our **present value of earnings discount model** that incorporates our industry and peer group PE methodology and (2) a **peer price to revenue metric approach**. This target price of **\$0.60 implies a forward PE of 13.6x our FY 2007 EPS forecast of 4.4c**. See INVESTMENT THESIS & RECOMMENDATION for more in-depth discussion (Page 10-13)

*See Appendix A-1 for Analyst Certification and Important Disclosures.*

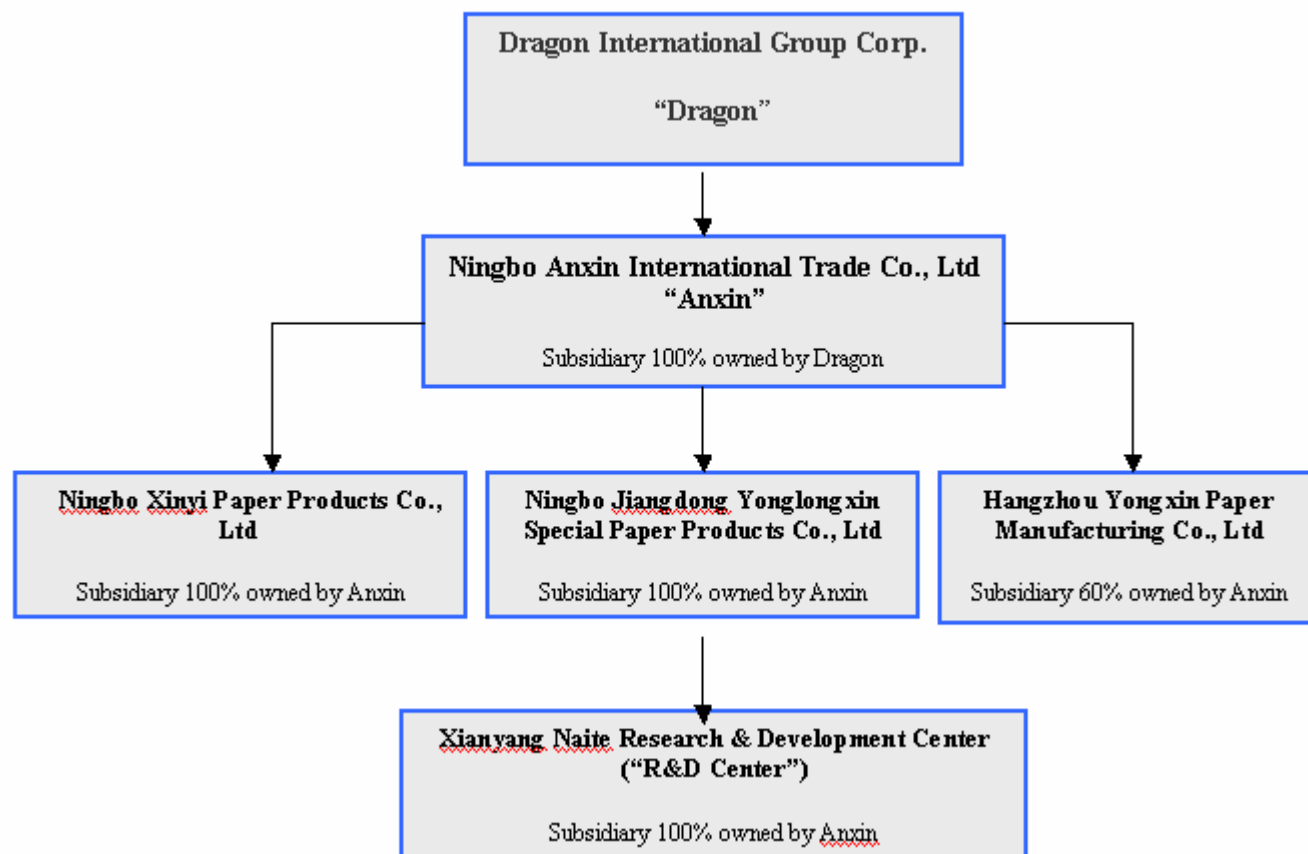
**THE COMPANY**

Dragon International Group Corp (OTC:BB – DRGG) was incorporated in the state of Nevada on February 17,1993, under the name LBF Corporation. On April 17, 1999 the company acquired certain assets to facilitate the company’s entry into electronic commerce and changed its name to Highway.com, Inc. Effective October 4, 2004 the company entered into an Agreement and Plan of Reorganization that involved issuing 24,625 million shares of stock in a merger transaction to acquire all of the outstanding capital of Dragon International Group Corp, a Florida Corporation. After amending its Articles of Incorporation the company subsequently changed its name to Dragon, International Group Corp. and management of the company changed and consisted by management of Dragon.

Dragon International Group Corp. owns 100% ownership interest of Ningbo Anxin International Trade Co. Ltd. (Anxin). DRGG first acquired 70% of Ningbo Anxin on October 4,2004. In December 2004, DRGG entered into a Stock Purchase Agreement with Ms. Shunli Shi, the holder of the balance of 30% interest in Ningbo Anxin International Company Limited that raised their stake to 100%.

Anxin is located in Ningbo, Zhejiang Province, China, 200 miles south of Shanghai, and was established in 1997. Anxin is one of China’s leading manufacturers and distributors of a wide variety of specialty paper products, and packaging materials. **Anxin operates four subsidiaries, (i) Jiagdong Yonglongxin Special Paper Company, Limited, (ii) Hanggzhou Yongxin Paper Products Company, Ltd., (iii) Ningbo Xinyi Paper Products Company, Ltd. and (iv) Xianyang Naite Research & Development Center.** The company holds an ISO9000 certificate and national license to import and export its product line globally. Anxin’s main products are "Federal" SBS, "Hang Kong" CCB, golden and silver paperboards, aluminum foil paperboards, pearl paperboards, laser paperboards and mirror-like paperboards. The company and its subsidiary have cultivated strategic relationships with several of the world’s largest manufacturers of paper and specialty packaging products. Anxin currently has a distribution network covering east and central China.

"Federal" SBS is manufactured by **International Paper Company (NYSE: IP), the No.1 paper manufacturing company in the world.** "Hang Kong" CCB is manufactured by **Asia Pulp & Paper Co. Ltd. (APP),** an Indonesian company that is one of the largest manufacturers in Asia. In our opinion these two companies provide products that represent the highest quality choices for China’s domestic high-level packaging materials industry. **Anxin is a primary distributor for IP and APP in China.** The products mainly aim at top-level packaging materials. They are utilized for the packaging of cigarettes, alcohol, gifts, cosmetics, pharmaceuticals and tea. The **company’s primary markets are printing and tobacco manufacturing industries.** Current clients of Anxin include **Dare Technology Co., Ltd.** (a Chinese Listed Company), **Shanghai Tobacco Industry Printing Factory and Xuzhou Tobacco Industry Company.**



In April 2005, DRGG signed a letter of intent to acquire **60% ownership interest of Hangzhou Yongxin Paper Company, Limited**. The acquisition has resulted in an increase in the production of packaging materials from approximately \$8 million in FY2005 to \$15 million in the current financial year that ends on June 30, 2006 (FY2006). Hangzhou Yongxin Paper Company Ltd. Established in 2003 is located in Hangzhou of Zhejiang Province, China. Dragon's strategy is to consolidate Yongxin's operations with its own subsidiary Ningbo. Following this consolidation, DRGG expects the transaction to contribute 7-8% in its overall net profit margin.

Striving to create a dynamic integrated company, management seeks to position Dragon to capitalize on the explosive growth in China's packaging industry. The company is actively developing various strategies to become a dominant player in the sector through consolidation by acquisitions and the expansion of its sales force. Dragon's growth is supported in its efforts by a management team that is dedicated to creating a corporate culture that rewards the success of the company's employees, producing the highest quality products, and enhancing shareholder values.

**INDUSTRY**

China is the **world's most populous country with 1.3 billion people** and in the midst of a **steady transition to a free market economy that is transforming global trade**. According to the Chinese Academy of Social Science the middle class is estimated between 120–150 million people or 40–50 million households, up five-fold from 8 million households in 1978. Household purchasing power is between \$9,000–12,000 and household wealth is approximately \$36,000. The combination of massive capital investment, low cost labor, re-admission to the WTO in 2001 and a blossoming domestic consumer economy presents a rare opportunity to invest in a nation becoming a major economic superpower, to surpass even the United States.

China's economy will expand faster this year than in 2005 as investment and exports continue to grow, the central bank's research bureau said. Chinese 2006 Gross domestic product will probably rise 10.3 percent in the first six months before slowing in the second half for full-year growth of 10 percent, the People's Bank of China said in a report, published June 25, 2006 in the state-owned China Securities Journal. **China's economy grew 9.9 percent in 2005, overtaking the U.K. as the world's fourth largest**. Given the country's size, demographics and rapidly expanding export market with international trading partners, **the paper and pulp currently plays a major role in the Chinese economy**. The paper industry is supporting our daily life as well as industrial activities by producing and supplying such paper and paperboard as are used for communication and packaging. China is the second largest paper and paperboard producing country based on 2003 statistics. Despite ranking second in terms of production only to the US, the **per capita consumption in 2003 was only 36 kg well below developed countries and below the world average of 52 kg**. This clearly illustrates the extent of room for growth possibilities that exist in the Chinese paper and packaging market.

The **consumption of paper and paperboard products in 2001 reached 42.6 million metric tons**, increasing at an average annual rate of 10.38% over the last 2 decades. This pace of growth by comparison far outstrips that of the US where the growth rate over the same period averaged 1.85%. China's imports of paper and paperboard products grew at an average annual rate of 12.7% for the period 1979-2000, and the share of imports in the consumption increased from 9% to 17% for the same period. In 2001, China imported 5.57 million tons of paper and paperboard products; almost double the amount in 1995.

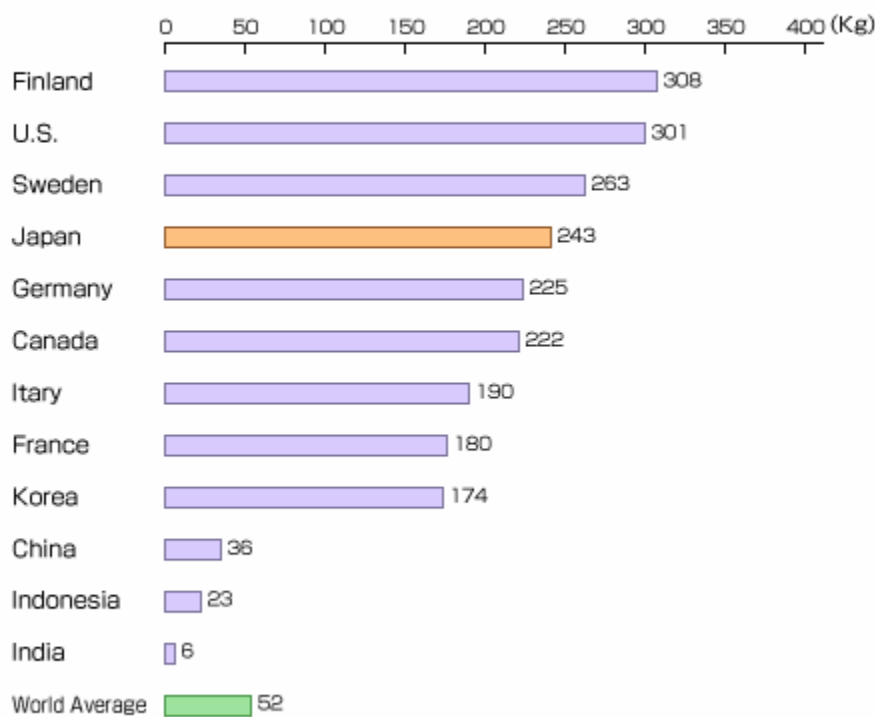


Currently China's small-scale mills and outdated technologies limit its ability to satisfy the growing demand. Its capacity and output are scattered among numerous small mills, which on average produce less than 6500 tons/year, while the world average is over 40,000 tons/year and the average in developed countries is well above 100,000 tons/year.

Given the highly capital-intensive nature of the paper and paperboard production, China needs a significant amount of investments to modernize its pulp and paper industry. **To address its growing need for fiber for paper and related products, China has developed a major forestry and pulp mill capacity enhancement plan. The plan is expected to cost approximately \$25 billion through 2010.** The objectives of this plan are to encourage the development of 12.5 million acres of plantations with fast-growing species in the southeast part of the country, and the siting of 42-large-scale pulp and paper mills comparable to the average mill capacity of industrialized countries, roughly 100,000 tons (American Forest and Paper Association,2004). China's natural forests are concentrated in the northeast and southwest so the plantations will likely not be displacing natural forests. China's current paper production capacity is 47.3 million tons, but under this new plan it is expected to grow by an additional 6 million tons by 2010.

This plan is evidence of China's clear intention to switch from a non-wood to a wood fiber base. The most likely reason is that there are insufficient agricultural residues and delivery infrastructure to supply the large-scale production facilities that are planned for China. While China expects to increase its domestic wood pulp capacity, it is clear the country's dependence on pulp products and recovered fiber will increase in the short term.

### ■ Per Capita Consumption (2003)



Source: Pulp & Paper International

### COMPANY MISSION

Under the leadership of David Wu, the company has experienced significant growth, and as well as the development and introduction of several new product lines. The company reported gross revenue of \$12 million for the year ending June 30, 2005, and is expected to report revenue of at least \$18 million for the year ending June 30<sup>th</sup>, 2006. DRGG believes it has developed plans to expand substantially both internally and externally and continue its track record and positive revenue and earnings momentum in FY2007/FY2008.

**The stated goal of DRGG is to become the dominant player in the manufacture and distribution of specialty packaging products in China.** A key component of their strategy has been accomplished by accessing the United States capital markets, when Dragon International Group Corp., acquired its initial 70% holding in Anxin. The company maintains close strategic relationships with their suppliers, in addition to the development of new and proprietary products that are being created by the staff of Anxin. The company anticipates a growth rate of 80% in annual revenues and 175% in earnings in FY2007 and FY2008 compared to FY2005 and FY2006.

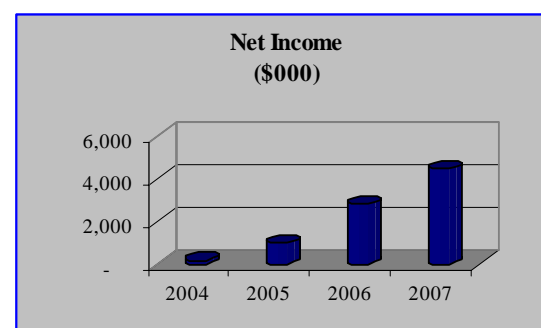
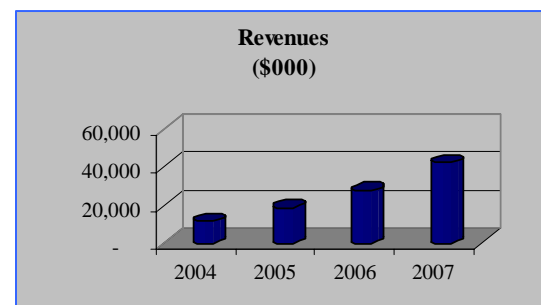
## OUTLOOK

Management of Dragon International Group Corp., plans to penetrate the pharmaceutical packaging industry in China in 2006. This strategy should prove effective as the demand for the high-grade pharmaceutical packing materials increases sharply, which positions DRGG to deliver and participate in growth for years to come.

In order to take advantage of this opportunity, management is **planning to make inroads into the Chinese pharmaceutical packing industry**. Management finds that the **pharmaceutical packing industry increases 25% annually**. Furthermore, the **cold forming aluminum foil pharmaceutical packing market increases 35-40% annually**.

In order to enter this industry quickly, the board of directors is considering acquiring a pharmaceutical packing company. The company expects to build up a new product line of 1,000 tons of "cold-forming aluminum foil" pharmaceutical packing material. This new product line should generate \$10 million in annual sales and \$2 million in net income in the next 12 to 24 months.

(All figures in millions)	FY 2005 A	FY 2006 E	FY 2007 E	FY 2008 E
<b>Total Sales</b>	<b>11.282</b>	<b>18.7</b>	<b>27.6</b>	<b>42.0</b>
Net Income (Loss)	0.160	1.000	2.808	4.500
<b>EPS (in US\$)</b>		<b>0.017</b>	<b>0.044</b>	<b>0.066</b>
<b>Weighted average common shares outstanding</b>				
<b>Basic</b>		58.45	64.45	68.0



DRGG management guided that their organic growth should allow DRGG to achieve annual revenues of **\$25 to \$30 million and earnings of close to \$0.04 per share in FY2007**. Dragon International continues to achieve record growth in our core business segments, while improving our profitability and strengthening its balance sheet.

Management is very optimistic about its prospects, as demand continues to accelerate for its products. DRGG has the financial backing, research expertise, and proven management team needed to execute on its growth plan. Overall, DRGG anticipates continuing to build upon its successful track record and achieve record revenue and net profit growth for the full years of FY2007 and FY2008.

## PRODUCTS

All operations are conducted through Anxin. Anxin distributes an assortment of paper products and packaging materials. The main consumers of Anxin's products are packaging companies for the tobacco industry, cosmetics industry, and the wine and spirits industry. Anxin, through its wholly owned subsidiary, Jiangdong Yonglongxin Special Paper Co. Ltd. imports an assortment of paper and packaging products. The products imported by Anxin are used both as a finished product and as well as a raw material to manufacture a variety of paper products and packaging materials. Products manufactured by Anxin or one of its subsidiaries are then sold and distributed in China. The general process of a typical order are; (i) initial purchase order from customer, (ii) relay the purchase order to international supplier; (iii) receive letter of credit from bank; (iv) schedule transportation from supplier; (v) schedule transportation to customer; and (vi) receive payment from customer. This entire process can take anywhere from two to three months.

In addition to its own operations **Anxin operates 4 subsidiaries and has 5 series of products**, including golden and silver paperboards, aluminum foil paperboards, pearl paperboards, laser paperboards and mirror-like paperboards. The company's products are employed in high-end packaging for the tobacco, alcohol, gift, cosmetics, tea, and pharmaceutical industries. Dragon has established stable relationships with International Paper Company (IP) since 1994 and with Asia Pulp & Paper Company (APP) since 1999.

APP currently has multi-locational manufacturing facilities in Indonesia and markets its products in more than 65 countries on six continents. APP produces bleached hardwood pulp and a wide range of paper and packaging products. As such Dragon benefits from competitive agency pricing from both APP and IP. The company is a major distributor of "Federal SBS", manufactured by IP, and "Hangkong CCB", manufactured by APP, in China since 1999. Products provided by both IP and APP offer the highest quality choices in China's domestic packaging industry.

The company's main products are:

- Golden and silver paperboards
- Laser paperboards
- Mirror like paperboards
- Federal SBS (**Solid Bleached Sulfate PaperBoard**) – made by International Paper Company, the No.1 paper making company in Asia.
- Hang Kong CCB (**Cast Coated Board**) – manufactured by Asia Pulp & Paper Co. Ltd. (APP), a leading global paper manufacturer.

Among all the products manufactured and distributed by the company, we believe that **"Federal" SBS which represents approximately 15% of the total Chinese domestic market** and **"Hang Kong" CCB represents approximately 20% of the total domestic market in China** have the greatest upside potential.

Series	Kinds	Technology	Product Feature	Application
<b>PEARL</b>	<b>Paperboard</b>	Coating	The feeling of pearl and the changing colors make the paper attractive just like the elegant pearl light	packaging for boxes like gifts, cosmetics, Christmas card, tea, food, and so on.
<b>HOLOGRAPHIC</b>	<b>Paper</b>	Transfer	Reflected by light, the picture is clear, bright and colorful, it is a green packaging material with resolvable and recycle property	packaging for boxes like cigarettes, alcohol, gifts, cosmetics, pharmaceuticals, Christmas cards, tea, foods, handsets, and so on.
	<b>Paperboard</b>	Lamination	Reflected by light, the picture is clear, bright and colorful	packaging for boxes like cigarettes, alcohol, gifts, cosmetics, pharmaceuticals, Christmas cards, tea, foods, handsets, and so on.
	<b>Light-Pillar</b>	Lamination	Reflected by light, the picture is clear, bright and colorful, just like the light pillar	packaging for boxes like cigarettes, alcohol, gifts, cosmetics, pharmaceuticals, Christmas cards, tea, foods, handsets, and so on.
<b>GOLDEN AND SILVER</b>	<b>Paperboard</b>	Transfer	The paper is bright, colorful, and has a strong metallic sense, this elegant print is a green packaging material with resolvable and recycle property	packaging for boxes like cigarettes, alcohol, gifts, cosmetics, pharmaceuticals, Christmas cards, tea, foods, handsets, and so on.
		Lamination	The paper is bright, colorful, and has strong metallic sense, this print is bright and elegant	packaging for boxes like cigarettes, alcohol, gifts, cosmetics, pharmaceuticals, Christmas card, tea, foods, handsets, and so on
<b>MIRROR-LIKE GOLDEN AND SILVER</b>	<b>Paperboard</b>	Lamination	The surface of the product is very smooth and has a strong metallic sense, this print is bright and elegant	packaging for boxes like cigarettes, alcohol, gifts, cosmetics, pharmaceuticals, Christmas card, tea, food, handset, and so on.

The quality of SBS produced domestically has improved. In response, Anxin is exploring new forms of solid bleached sulfate paperboard produced domestically. Domestic manufacturers have had success with **new products such as Zhong Hua solid bleached sulfate paperboard and a form of water-proof art paper.**

Anxin is seeking ways to incorporate these new products into their product base. In the event Anxin is successful with this effort, it will attempt to sell and distribute the new products using the existing sales network. A main attraction to employ domestic products is the reduced cost as compared to foreign sources.

Anxin, through its subsidiaries, has gradually increased the sales of domestic products as it attempts to grab market share in this domestic market. Anxin expects to obtain a higher profit margin on sales of domestically manufactured SBS because of reduced raw material, transportation and export costs. Anxin has begun to establish a relationship with Ningbo Zhong' Hua Paper Company Limited ("Zhong Hua"), a manufacturer of SBS in China. Anxin believes that Zhong' Hua will be able to provide a stable supply of quality grades of SBS.

## ACQUISITIONS

On July 1, 2005, Dragon International acquired 60% interest in Hangzhou Yongxin Paper Company, Limited. Yongxin, established in 2003, is located in Hangzhou of Zhejiang Province, China, and manufactures and sells high-end cigarette packing material and was a direct competitor of the company. The company issued an aggregate of 1 million shares of its common stock in consideration for the net assets of Yongxin. The fair value of the common stock issued was based on the \$.34 quoted trading price of the common stock on the acquisition date and amounted to \$340,000. All operations are now located in the new manufacturing facilities in Ningbo. The company acquired Yongxin as part of its ongoing desire to consolidate interests in its industry.

On August 1, 2005, DRGG acquired the Xianyang Naite Research & Development Center located in Ningbo, China, which was created to **improve production efficiencies in the specialty packaging industry.** DRGG paid \$25,000 in cash and issued 500,000 shares of its common stock in consideration for this acquisition. The fair value of the common stock issued was based on \$.28 per share, quoted trading price of the common stock on the acquisition date, for a fair value of \$140,000. The Research & Development Center is **expected to reduce time to commercialization for new products substantially and allow the Company to leverage innovative paper transferring techniques developed at the Center.**

Anxin has consolidated the operations of two divisions in an effort to reduce fixed operational expenses. Anxin operates the underlying business of each entity from the headquarters located in Ningbo. The two consolidated divisions are Shanghai An'Hong Paper Company Limited, ("An'Hong") and Ningbo Long'An Industry and Trade Company Limited (Long'An).

## FINANCIAL STATEMENTS

The company filed Form 10-QSB with the Securities and Exchange Commission (SEC) with audited financial results for the quarter ended 31 March 2006. The reporting currency is the U.S. dollar. The functional currency of the Company's Chinese subsidiary, Anxin, is the local currency. The financial statements of the subsidiaries are translated into United States dollars using year-end rates of exchange for assets and liabilities, and average rates of exchange for the period for revenues, costs, and expenses. Net gains and losses resulting from foreign exchange transactions are included in the consolidated statements of operations. The cumulative translation adjustment and effect of exchange rate changes on cash at March 31, 2006 was \$30,826.

During the nine months ended March 31, 2006, DRGG generated revenues of \$14.19 million as compared to revenues of \$8.789 million for the nine months ended March 31, 2005, an increase of \$5.4 million, or 61.5%. This increase was mainly attributable to Yongxin subsidiary that was acquired effective July 1, 2005 that contributed approximately \$1,955 million. The remaining increase was attributable to sales to new customers during the nine months of March 31, 2006. The cost of sales was \$12.95 million for the 9 month period compared to \$7.87 million during the comparable 2005 period, an increase of \$5.087 million, or 64.6%. Anxin was exposed to higher raw material costs, including raw pulp and pulp related products, over the past 12 months, as well as increased import/transportation costs as a result of the worldwide increase in the price of oil. For the nine months ended March 31, 2006, gross profit was \$1.239 million, as compared to gross profit of \$0.917 million for the same nine months of FY2005, an increase of \$321,469. For the nine months ended March 31, 2006, gross profit on a percentage basis decreased to 8.7% from 10.4% for the nine months ended March 31, 2005.

Operating expenses amounted to \$797,282 in the first 3 quarters of FY2006, or 5.6% of net revenues as compared to \$725,929, or 8.3% of revenues for the first 3 quarters of FY2005, a decrease of \$71,353, or 9.8%. Management has made efforts to reduce fixed administrative costs to alleviate the burden of an increase cost of sales during FY2006. For the nine months ended March 31, 2006, SG&A expenses were \$516,087 as compared to \$387,334 for the nine months ended March 31, 2005, an increase of \$128,753 or approximately 33%. **The closures and consolidations planned by management will allow Anxin to decrease fixed administrative costs. Furthermore efforts will be made to maintain lower actual shipping costs by generating sales in closer proximity.**

*See Appendix A-I for Analyst Certification and Important Disclosures.*

DRGG recorded debt settlement expense of \$914,689 related to the additional shares issued upon conversion and \$423,112 of debt settlement expense related to the granting warrants to purchase 5,642,300 shares of common stock at \$0.15 per share for an aggregate debt settlement expense of \$1.337 million.

Interest expense was \$1,790,114 during FY 2006 Q1 through Q3 as compared to \$105,787 for same periods in FY 2005, an increase of \$1.684 million and was related to increased borrowings; and the recording of \$1.58 million in amortization of discount on debentures payable that was included in interest expense. In February 2006, upon conversion of these debentures to common stock, the company expensed all un-amortized discount related to the debentures. As a result of all of these factors, the company reported a net loss of \$2.732 million or a net loss of 6c EPS for the nine months ended March 31, 2006 as compared to net income of \$94,847 (less than 1c EPS) for the nine months ended March 31, 2005.

The Stock Purchase Agreement between Dragon and Anxin has been accounted for as a reverse acquisition under the purchase method for business combinations. Accordingly, the combination of the two companies is recorded as a re-capitalization of Dragon, pursuant to which Anxin is treated as the continuing entity. At March 31, 2006, the allowance for doubtful accounts was \$203,131. At March 31, 2006, convertible notes payable outstanding amounted to \$6,438, which is convertible into 858,400 shares of common stock. In connection with the conversion of debentures payable, the company issued 18,478,568 shares in FY2006 of common stock upon conversion of outstanding debenture balances and accrued interest of \$1,663,086 (see below).

### Liquidity, Share Capital and Capital Resources

At March 31, 2006, DRGG had \$1,066,411 in cash of which 1,065,902 was held in China and the balance on deposit in the United States. In March 2005, the company received net proceeds \$321,750 from 7 accredited investors under a private offering of Units. The minimum subscription was for \$50,000 or one Unit and fractional units were allowed. The Debentures were to mature 6 months following the closing of the offering. Interest only was payable monthly. However, the investors in this offering converted to the second offering.

During the period from May 2005 to July 2005, DRGG successfully closed a second private offering of Units. DRGG sold an aggregate of **\$1,927,400 (\$1,569,900 in new subscriptions and \$357,500 from the March 2005 offer)** from the sale of the Units (\$1,413,910 net) to a total of 36 accredited investors, including the 7 investors who purchased Units in the first offering. Each Unit consisted of a \$100,000 8% Secured Convertible Debenture and Class A Common Stock Purchase Warrants to purchase 200,000 of common stock at \$0.30 per share for a period of 5 years expiring July 1, 2010. The debentures were convertible into shares of DRGG common stock and would have matured two years after issuance. DRGG had the option to satisfy principal and interest payments in cash or common stock. The principal and interest was convertible into shares of "registered" common stock. Principal payments began on the first day of the fourth month following the final closing date of the offering. During the nine months ended March 31, 2006, the company repaid principal amounts amounting to \$183,592.

In January 2006, the company made an offer to all of the holders of outstanding Units wherein it offered the holders of the Units an opportunity to convert the outstanding principal and interest owed pursuant to the debentures into shares of common stock at a conversion price of \$0.09 per share. This offer also **provided for the reduction of the exercise price on the warrants included in the Units issued in the July Offering from \$0.30 to \$0.15 per warrant.** As further inducement, if the holder agreed to convert, DRGG agreed to issue additional common stock purchase warrants equal to the number of warrants held by each Unit holder that are also exercisable at \$0.15 per warrant for a period of 3 years. All of the Unit holders accepted this offer, except for two holders who assigned their debentures to third parties who subsequently converted. Accordingly, the company converted principal balances and accrued interest payable of \$1,663,086. These holders kept the warrants issued as part of their original Units. As a result, an aggregate of **18,478,568 shares of common stock were issued and 5,642,300 common stock purchase warrants**, pro rata to the number of Units held by each holder that elected to convert. The exercise price on the 3,704,800 warrants held by the converting holders was reduced to \$0.15 per share, while maintaining the exercise price on 150,000 warrants for those holders who elected not to convert at \$0.30 per share. The exercise price on the 1,787,500 warrants received as consideration for the March offering was reduced from \$0.40 to \$0.15 per share.

**Net cash used in operating activities** during the nine months ended March 31, 2006 were **\$603,962** as compared to net cash used in operating activities of \$217,451 during the nine months ended March 31, 2005. Net cash provided by investing activities during the nine months ended March 31, 2006 was \$34,966 as compared to net cash used in investing activities of \$280,017 for the nine months ended March 31, 2005. During the nine months ended March 31, 2006, DRGG used cash for capital expenditures of \$389,594. Net cash provided by financing activities during the nine months ended March 31, 2006 was \$702,022 as compared to net cash provided by financing activities during the nine months ended March 31, 2005 of \$438,200.

During the nine months ended March 31, 2006, DRGG received gross proceeds of \$503,500 from debentures payable and \$716,030 from borrowings offset by the repayment of loans payable of \$193,830, the payment of placement fees of \$48,350, and the repayment of debentures payable of \$275,328. For the nine months ended March 31, 2005, the company received proceeds of \$101,450 from loans payable, received net proceeds of \$321,750 from debentures payable, and received contributions of \$15,000.

In 2005, Yonglongxin, a subsidiary of Anxin, borrowed money pursuant to several lines of credit that DRGG established with three banks. At March 31, 2006, the company owed \$2,885,683 to these lenders with six to 12 months term from through September 2006, with an annual interest rate ranging from approximately 5 to 7%. All loans are renewable when they mature.

The company generates sufficient cash flow from financing and operations to pay for its debt services and does not anticipate these loans will have material impact on its liquidity. These loans are secured by inventory, equipment and assets owned by the third parties. DRGG remains current on all payments relating to these loans and expect to renew the loans at terms and at interest rates comparable to the current loans. Also DRGG currently has no material commitments for capital expenditures.

DRGG has sufficient funds to conduct its business and operations as they are currently undertaken, but has stated they intend to build an additional manufacturing line in order to expand its paper product production. A portion of the proceeds derived from the private offering(s) will be used to update the manufacturing facilities.

Effective January 10, 2006, DRGG entered into a new three-year consulting agreement with China Direct an agreed to issue 6,000,000 of the Company's common stock to China Direct. As of March 31, 2006, **the 6 million shares had not been issued** and are reflected in common stock issuable on the accompanying balance sheet.

**Other noteworthy financial and per share statistics are listed in the table found on page 1 of this report.**

### RISK FACTORS /CONCERNS

The various operating units have inherent risk. The company's future is largely dependent upon revenues derived from the sale of paper products in the PRC. A downturn or stagnation of the economic environment in China could have a material adverse effect on DRGG. DRGG's business development is substantially dependent on the expertise of its management team and directors, the loss of which could materially adversely affect future anticipated results. The company is still considered to be early in its life cycle and has modest reported revenues and short financial history. The company may not be able to generate or obtain sufficient funds to operate its business which, could harm results and force the company to curtail or cease plans for expanding operations. There can be **no assurance the company will be successful in its effort to secure additional financing** to support operations that will necessitate achievement of near and medium term goals.

There are several risks associated with doing business in China. Changes in the political leadership of the PRC may have a significant effect on laws and policies related to the current economic reforms program, other policies affecting business and the general political, economic and social environment in the PRC, including the introduction of measures to control inflation, changes in the rate or method of taxation, the imposition of additional restrictions on currency conversion and remittances abroad, and foreign investment. These effects could substantially impair DRGG business, profits or prospects in China. There is exchange rate risk inherent in investing in DRGG, since future **fluctuation in the value of the Renminbi (Yuan) may negatively affect the company's ability to convert its return on operations to U.S. dollars in a profitable manner and its sales globally.** Currently, PRC is in a period of growth and is openly promoting business development in order to bring more business into PRC. Additionally PRC allows a Chinese corporation to be owned by a United States corporation. If laws or regulations are changed by the PRC government, Dragon International's ability to operate the PRC subsidiaries could be affected. **Regulatory risk** of doing business in China remains high and should be considered by investors. The company may from time to time be parties to various legal **actions, litigation or legal claims.**

In addition to competing with other companies, Dragon International could have to compete with larger US companies who have greater funds available for expansion, marketing, research and development and the ability to attract more qualified personnel if access is allowed into the PRC market. If U.S. companies do gain access to the PRC markets, they may be able to offer products at a lower price. There can be no assurance that the company will remain competitive should this occur.

The company may not be able to generate or obtain sufficient funds to operate its business. There can be no assurance the company will be successful in its effort to secure additional financing for acquisition based expansion that lie ahead. Trading in the shares will continue to be subject to major fluctuations for the foreseeable future. The stock is thinly traded at prices below \$0.20 and selling of small positions could have a negative impact on the share price in absence of sufficient liquidity. The reverse is true if one or more large investors decide to acquire a block of DRGG shares that would result in demand outstripping supply and result in an upward squeeze in the price given the scant liquidity and daily trading volume. **We caution that historical volume activity on DRGG has been noticeably light, and we are unable to forecast the direction of trading volumes in the coming months.** Major dilution of common stock can occur if company issues large blocks of common stock or convertible debt are converted/warrants exercised into common stock, that can negatively impact on the value of the shares either theoretically or if sold in the open market. NASD and SEC Regulations covering rules on Penny Stocks apply for DRGG. All of the company's operations, revenues and assets are generated in and located in China. **Revaluation of the Chinese Renminbi** by authorities to allow the currency to strengthen can occur in 2006 that may provide a boost to financial numbers since the reporting currency is in US dollars. Likewise a risk exists that more flexibility introduced and more steps are announced to liberalize Chinese Yuan market could have an adverse affect if capital is re-allocated on predominantly redeployed in the US.

For further elaboration we advise readers to refer to the discussion on risk factors included in past filings with the SEC.

*See Appendix A-I for Analyst Certification and Important Disclosures.*

## MANAGEMENT

### David Wu – President, CEO & Chairman

David Wu received B.S. from Zhejiang University in 1992. In 1994, he became the first distributor of "Federal" SBS in Chinese market and initiated the promotion of the products in China. He established Ningbo Daxie Development Zone Chengxin Trade Corporation in 1995, which focuses on the packing materials industry (the main product is SBS). In 1997, he founded Ningbo Anxin International Trade Co., Ltd. Then in 1999, Mr. Wu founded Ningbo City Jiangdong Yonglongxin Special Paper Co., Ltd. ("Yonglongxin")

### Xuejun Chen – Director & Vice President

In December 1995, Xuejun Chen joined in Ningbo Daxie Development Zone Chengxin Trade Corporation as a salesman. In June 1999, he joined in Anxin as a salesman, responsible for the sales of "Hang Kong" CCB. He is a veteran in the marketing & sales. He has been in the field for 15 years and focused on the sales of packaging materials for more than 10 years.

### Xiali Gan – CFO and Director

Ms. Gan graduated from Ningbo Senior College with a degree of accounting in 1986. From September 1986 through June 1993, she was CFO of Ningbo Development Zone Import and Export Corporation. From June 1993 through October 1997, she was the vice manager of Ningbo Bonded Area International Trade Corporation. She has been the CFO of Anxin since 1997.

### Orson Zhang – Vice President and Secretary

Orson Zhang graduated from Northwestern Light Industrial College in 1988, majored in Autocontrol Technology. He was the vice director of Huaiyin Light Industrial Machinery Factory. In 1997, he became the Chairman of the Board and General Manager of Jiangsu Xinshen Food Co., Ltd. In 1999, he became the standing vice General Manager of Jiangsu DARE Xinlian Foil Goods Co., Ltd. In 2001, he was the QA/QC Manager of SH International Paper Pacific Millennium Cup Co., Ltd. Since 2003, he has been the vice General Manager of SH DIJI Investment Management Co., Ltd.

## INVESTMENT THESIS AND RECOMMENDATION

Our analysis suggests **Dragon International Group Corp.** is an interesting speculative play among micro-cap companies **offering exposure to the investor on the economic boom and the rapidly growing paper and packaging markets in the People's Republic of China.** For stone-cold and patient investors, the obvious play here is to tag along by taking early **strategic positions** in foreign and domestic companies supplying to or **benefiting from the Chinese juggernaut.** **Every product imported from China needs to be packaged. DRGG went public to capitalize on this unprecedented phenomenon,** according to DRGG President & CEO, David Wu.

China is the latest and greatest investment frontier for growth-oriented investors. The combination of China's massive size and rapid modernization is **creating one of the greatest investment opportunities of the 21st Century.** The Chinese government is increasingly encouraging entrepreneurship in the nation of 1.3 billion people, with promising initial results. Numerous startups and high growth companies have hit the ground running, contributing and as a direct result of China's rapid GDP growth. **It's clear that China is the place to consider investing in, both now and in the years ahead. The profits will be stunning and stock performance of Chinese related growth companies could very well mirror that of the US technology industry during the late 1990's.**

**Dragon International Group Corp is a 100% pure play opportunity with regards to Chinese paper industry demand and export-trade advancement since all of its subsidiaries conduct business in China** As China emerges as a growing force on the global stage, **DRGG's professionals will provide invaluable services for Western investors seeking to reap rewards indirectly from the strong export-led growth in China and rising consumption levels of paperboard and pulp products.**

**Both operating and financial risk involved** in investing in a young paper and packaging company are **typically high and should be considered by investors.** In this case the risks are tied to the uncertainties **surrounding competition and cost side effects such as high transportation and other unforeseen sharp rises in raw material costs and many other factors that can counteract positive demand or growing revenues and orders.** Due to the business model that also provides for new proprietary paper products that will be produced for customers, there is a risk to overcome the prevailing consumer adoption of new products, which if not achieved will raise marketing costs and to concentrate selling efforts.

*See Appendix A-I for Analyst Certification and Important Disclosures.*

SG&A costs and capital expenditures need to be **managed well** and the **interest expense be lowered in order to achieve consistent profitability**. Readers should understand that there can be **no assurance that the company will be able to fast-track its** intended path towards **growing its paper and packaging portfolio of products and companies and the underlying client base, that will flow through directly to the top and or bottom line** to build a consistent longer term profitable track record to enrich shareholder value.

We therefore **only recommend investors that have a high tolerance for risk that are able and willing to forfeit either most or all of their capital in search for extraordinary returns**, to consider investing in the shares. Also, in our view investors willing to commit capital to DRGG should do so with **absolute minimum 2 year investment horizon, but preferably longer, to allow ample opportunity for growth to emerge until broader price discovery can materialize within the investment community that will allow the value behind the current acquisitions to be unlocked as consolidation and synergies are explored throughout Anxin and for its plans to enter the pharmaceutical packaging market(s)**. Short term we expect an upward price bias in DRGG stock.

We believe that the company will be able to **continue to build a consistent track record upon its solid early foundations that will ultimately lead to a re-rating of the stock which will better reflect what we believe is a more realistic reflection of the true worth of the company vis-à-vis listed competitors**. Dragon already ranks in the **top 4% in revenues of all companies listed on the OTCBB and secondly, Dragon is one of a select group of companies (only 2%)** out of the entire OTCBB universe of companies that has a **history of earnings**. In our opinion these facts are not adequately reflected in the current rating of the stock. Based on recent outlook provided by management for FY 2007 and beyond for the consolidated group as a whole, we expect financial performance to continue to show an improvement. **Under the assumption that any further capital raising activity is well-managed to contain any further major I/O increases and positive cash flow from operations to be generated in FY 2007 as more progress is made to consolidate and synergize recent acquisitions, while pursuing its pharmaceutical packaging strategy, we are of the opinion that DRGG stock has compelling upside potential**.

**Given managements and our own independent forecasts**, we are of the opinion that **revenue potential of \$27.6 million is achievable for FY 2007**. Using our gross margin and operating cost and other assumptions we **estimate net income of \$2.8 million for FY 2007**, and forecast **FY 2007 EPS of 4.4c** (assuming 64.5 million weighted number of shares outstanding). We have not made any allowance for tax expense.

**Our view is that DRGG shares are not yet reflecting the expected positive financial improvements we expect in FY 2007 and which can accelerate into FY2008**, but given the current low forward PE and Price to book multiples, we argue that the market is **still assigning a low probability to the fact that high growth rates can be achieved off a larger revenue base**. Despite the 6 million shares that has not been issued that will enlarge the shares outstanding we do not see this as a major negative as it will **likely only dilute the current shareholder interest by approximately 9%**.

**We believe that a general lack of knowledge and exposure of the company in the investor community and/or other concerns that may be present on the marketplace are exaggerated and that this negative dampening effect on the low rating of the shares will be reversed once the company extends its track record and can garner more institutional interest, conduct an investor relations campaign and position taking occurs in DRGG**. Using our FY FY2007 and FY 2008 EPS forecasts and applying a forward 12 and 24 month PE multiples of 21x (close to industry PE used as point estimate) and in either case, we arrive at forward share values of 81c and 111c going out 12 and 24 months. We have applied a discount rate (k) of 13.2%, which is a function of the **stocks beta measure, expected return for the market (S&P 500 benchmark used as proxy) and interest rates**.

We compute a **present value of these two future values and also including today's share price by discounting and determining the average between these three values** (SEE TABLE ON NEXT PAGE). This process yields a result of **67c**, which is our **mathematical estimate of the value of DRGG** under these assumptions of **earning generation power**. We have decided also to use the price-to sales metric using our FY 2008 revenue forecast of \$42 million. The premise of this argument is that **we have observed that the price to sales multiple for the peer group appears have tended to stay in well confined in a range converging to values between 0.6 to 0.7 times**. Using a forward price to sales multiple on FY 2008 revenue forecast we arrive at a share price goal of 47c on 0.65x P/S. Making use of a blended approach of Price-to-Sales and our earnings power model we obtain an average between these two approaches of 57c.

**Given these calculations and our bottom up analysis; which is more qualitative in nature, we set a 12-month target price for the security of \$0.60**. All factors considered, we anticipate a stake in DRGG still has compelling upside potential in the coming 12 months.

**Our 12 month price target also implies a forward PE ratio (FY2007 EPS) of 13.6x**, which is not demanding when compared to fellow sector or related industry names, such as International Paper (IP), Chesapeake Corp (CSK), Packaging Corporation of America (PKG), Packaging Dynamics Corporation (PKDY) etc.

{k=Risk-free rate + (Market risk premium) \* Beta}

		Forward PE multiple	EPS Growth	PEG Multiple	Forward Price	Discount Rate (k)	Present Value
FY 2006 EPS					0.00	13.2%	0.13
FY 2007 EPS	0.043	21.0		0.14	0.91	13.2%	0.81
FY 2008 EPS	0.066	21.0	52%	0.38	1.39	13.2%	1.09
Average							0.67
<b>Assumptions</b>							
Price to Book	1.36			Beta		1.70	
Price to Sales	0.40			R <sub>f</sub>		5.5%	
Current PE	NA			R <sub>m</sub>		10.0%	
Forward PE	3.0			k		13.2%	
(FY 2006 EPS)							
EV	6.28			$k=R_f+(R_m-R_f)*Beta$			
EBITDA*	0.73						(in \$ millions)
EV/EBITDA	8.7			FY2007 Revenue Estimate			27.5
<i>*estimate for FY2006</i>				FY2008 Revenue Estimate			42.0
Debt/Equity	0.002			FY2007 Net Income Forecast			2.80
Current Ratio	1.178			FY2008 Net Income Forecast			4.50

We HIGHLIGHT to the reader that this forecast (12 month target price of 60c) is made under the assumption that the company can attain our FY2007 revenue expectation of at least \$27.6 million and FY2008 revenue expectation of at least \$42 million and a minimum of 4.4c positive EPS in FY2007 and 6.6c in FY2008 respectively. Moreover, we believe that the present market for DRGG shares is far from efficient, does not fully reflect the leverage possible from the future acquisitions and consolidation related benefits and synergies that will bolster revenue, encouraging cost savings and cultivate earnings growth. To summarize, we view that the share price and corresponding market capitalization does not adequately reflect the company's progress or potential. The dynamics of the OTC BB is unlikely to consistently support true valuations based on financial performance or future potential. Recent empirical evidence suggests that micocap stocks tend to react after (e.g. lagging rather than leading) the company has produced the goods rather than ahead of what may be regarded as an upswing in reported numbers.

Finally, in addition to expected +45% organic sales growth in the coming year, DRGG is actively pursuing its aggressive acquisition strategy to add new revenue streams and land additional major orders. In January 2006, its subsidiary, Hangzhou Yongxin Packing Materials Company, Limited received two purchase orders from Hangzhou Jianan Printing Company, Limited. Yongxin will supply 150 tons of glassy paperboard and 0.51 ton holographic paperboard per month. The initial orders are valued at \$3.3 million per year. These recent orders demonstrate the benefits of consolidation strategy of the specialty package in China. We expect DRGG have a solid year in 2006 and major growth in 2007 and do not rule out additional orders of this magnitude be closed in the coming months.

While appearing to offer considerable potential for substantial capital gains, this is a highly speculative security, which should only be considered by investors with very high risk-tolerances. General business risks include competitive nature of the high-tech business, uncertainties related to the foreign domicile, limited capital resources at this early stage and potential for significant dilution. Other evident risk factors involving compliance issues and the nature of the penny stock regulatory environment include limited financial information due to lack of SEC reporting, low liquidity, high price volatility and other risks associated with the general lack of broker interest in pink sheet listings. However, notwithstanding the above risks, DRGG appears to offer very attractive opportunities to speculators willing to assume the high risks. The strong background of the management team and the very early major accomplishments against the backdrop of solid industry and domestic Chinese economic growth, augur well for the company's long term success.

DRGG's is a young dynamic innovator in the Specialty Paper and Packaging Industry with major opportunity for growth. Under our stated assumptions we initiate coverage on DRGG with a SPECULATIVE STRONG BUY rating, which is our highest category rating.

*See Appendix A-I for Analyst Certification and Important Disclosures.*



*Risk to our recommendation include amongst other: failure of new marketing campaign(s) to its Chinese retail and corporate customer base and landing of additional contracts, a slowdown in growth of current contract and product revenue streams that will lead to a contraction in revenue, earnings and forward PE multiple assumptions. New competition in regional markets, any stringent or bold regulatory changes impacting adversely on the Chinese domestic paper, specialty paper and pulp and packaging markets, any inability to obtain necessary financing from capital markets when needed, to continue its business projects and/or major share dilution that can occur, if large quantities of shares are issued to extinguish debt or paid for services, are some additional factors that will counteract price appreciation potential or cause shares to decline in value.*

*Continuing sharp rises in transportation costs or escalation in raw material prices used to manufacture products, or of terms with suppliers are renegotiated at terms less favorable to current terms, may materially adversely affect the business, margins, financial condition and results of operations and additional risk factors that could adversely affect the attainment of our share price target include: market acceptance of new or existing products of DRGG; consumer demand for products that are produced and packaged; the company's ability to create customer-centric products at competitive prices to rivals and its unproven and evolving business model. Reduced capital spending budgets by DRGG customers caused by the ongoing industry downturn can lead to continued soft demand for products and packaging materials, which can result in decreased revenues, earnings levels or growth rates.*

*We would caution that given the size of the company (microcap) and risks involved, overall we advise private client positions be limited below 5% of the client's total portfolio size.*



## ANALYST CERTIFICATIONS

## APPENDIX-A1

The research analyst, who upon request wrote this report, certifies that the views expressed in this research report, accurately reflects his personal view about the subject company. The analyst also certifies that he does not own or have any beneficial interest in shares of the covered company, also that no part of his compensation was, is or will be directly or indirectly related to the specific recommendation or view expressed in this report. Based on the facts that were provided, the industry trends present and sources of information used to produce this report, it is my best opinion and reflection of what the company's rating and share appreciation potential could be once research coverage is widely adopted. Investors are urged to consider this report as only a single factor in making their investment decision. Information, opinions or recommendations contained in this report or research note are submitted solely for advisory and information purposes and we also do not accept any obligation to provide updates to this report in future.

Clients of the analyst firm collectively own less than 1% of total shares outstanding of the issuer. For securities recommended in this report the firm is not a market maker, but may from time to time provide bids and offers and may act as principal in connection with such transactions to facilitate trading liquidity or execution. Bridge IR Group Inc. has been compensated sixteen thousand dollars and one hundred thousand restricted shares of DRGG by a third party. The firm of the analyst does not actively seek to do investment banking business with the company covered in this research report. This independent analysis and judgment relies on material supplied by the subject company and other sources, such as SEC filings believed to be reliable. The analyst that prepared this report cannot guarantee the information contained herein for accuracy or completeness.

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