MANAGEMENT DISCUSSION AND ANALYSIS

The Group achieved steady growth across all divisions during the period under review.

For the six months ended 30 September 2002, total turnover grew by 6 per cent to HK$1,024 million. Profit attributable to shareholders was HK$167 million, representing a growth of 7 per cent compared to 2001. However, profit from operating activities was HK$194 million, a 2 per cent decrease from last year, mainly as a result of increased cost of materials, freight costs and overheads.

The Board of Directors has declared an interim dividend of HK9.5 cents per share.

During the six months under review, the business was impacted by the continuing global economic slowdown. This resulted in tighter order implementation schedules, as well as pressure on margins. Paper price adjustments caused by supply issues were also a factor throughout the period under review, and affected the Group's cost of sales.

In the face of this challenging environment, the Group strengthened its marketing efforts to secure new business in China and in overseas markets, while focusing on lowering costs and tightening credit controls. As a result, all divisions of the business achieved steady volume growth. The marketing efforts of the Group in mainland China and overseas markets in the US and Europe have been successful, with 26 and 24 per cent growth in turnover in mainland China and overseas markets respectively.

Preparations for future growth

Even though the economic scenario is challenging, the Group continues to invest strategically in research, new technologies and facilities to take better advantage of present conditions, and to be ready for the future. As part of a long-term outlook and policy of reinvesting profits back into the business, the Group has continued to invest in high-quality equipment and staff training so as to win both new contracts and repeat orders from satisfied customers.

During the period under review, a total of HK$76 million was spent in capital expenditures, mainly payment of land and building costs at our Shenzhen, Wuxi and Zhongshan facilities. The Group has also signed up new machinery for the Wuxi facility worth HK$50 million, and expects to spend a total of about HK$180 million in capital expenditure this year.

The relocation of all production facilities to China has resulted in improved operating efficiencies. In response to keen competition and more stringent customer requirements, the Group has continued to invest in value-added services, new production techniques and enhanced customer service.

Construction of the new Shenzhen paper distribution and logistics warehouse has begun, with plans adjusted to provide for increased final capacity. Completion of the construction has been re-scheduled to the first quarter of 2003 and the warehouse is expected to be ready for operation during the second quarter. The new corrugator installed in the Shenzhen facility is operational and has increased capacity significantly.

Preparations for future growth *(continued)*

The Group has also ordered a ten-colour printing machine for the Shenzhen printing facility as well as a new press for the Zhongshan printing facility. Testing of the fourth paper making production line at the Group's paper mill in Zhongshan is continuing and full operation is expected to begin in early 2003.

Construction of the planned printing and corrugating facility in Wuxi is on track, and is expected to be operational in the second quarter of 2003.

Paper and Carton Box Printing and Manufacturing

This division achieved economies of scale through higher volumes during the period under review. Higher material costs and competition affected the performance of the division, and the Group responded to the challenge with a combination of competitive pricing strategy and enhanced customer service.

The division recorded an increase in volume of 10 per cent over the same period last year and accounted for 61 per cent of the Group's turnover for the period. Demand for children's books and innovative stationery products remained strong, particularly from export markets such as the US and other global markets, and was a key driver for this division. The division's contribution to the Group's profit from operating activities was 76 per cent, an increase of 1 per cent from the same period last year.

Paper Trading

The paper trading division benefited from the upward adjustment of paper prices and increased demand, both from other divisions within the Group and from external customers. As a result, it recorded the highest increase in revenues for the Group, with a turnover of HK$164 million, 13 per cent higher than in the same period last year. The volume of sales to external customers recorded a 7 per cent growth.

Paper price adjustments during the period have adversely affected most of the printing industry, but the Group implemented a prudent inventory management strategy that enabled it to achieve growth even in this adverse environment.

Corrugated Carton Manufacturing

This division faced intense competition and increased material costs, and as a result saw a decrease in margins and profit from operating activities. This was partly offset by enhanced customer demand, particularly from the consumer goods sector of the domestic market in China. With a 18 per cent increase in volume, the division recorded a 13 per cent increase in turnover.

The new corrugator installed at the Shenzhen facility has proved useful in tackling low-cost competition. This new corrugator, together with increased sales efforts in the China domestic market, are expected to enable us to further improve the performance of this division.

Associates

Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited
Zhongshan Ren Hing Paper Manufacturing Company Limited

The Group's 35 per cent-owned joint venture, Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited, was able to take advantage of the adjustments in paper price to record modest growth. The Group's share of profits from this joint venture increased by 159 per cent during the period under review.

The fourth paper making production line, once it becomes fully operational, will further enhance the paper mill's ability to service the growing demand in mainland China, as well as demand in overseas markets.

Liquidity and Capital Resources

During the period under review, the Group took advantage of the prevailing low interest rates in Hong Kong to increase its usage of Hong Kong dollar loan facilities. Of the Group's total bank borrowings of HK$186 million as at 30 September 2002, HK$110 million were in Hong Kong dollars, HK$57 million in US dollars and HK$19 million in Renminbi. The lower interest rates enabled interest expenses to be reduced by 33 per cent to HK$2.93 million, but also impacted interest income from surplus cash placed in time deposits, which decreased by 31 per cent to HK$5.07 million.

As at 30 September 2002, the Group had cash on hand of HK$285 million and bank borrowings of HK$186 million. Cash net of debt stood at HK$99 million, which, together with established banking facilities, was adequate to finance the Group's investment plans in Wuxi and Shenzhen.

Prospects

Through prudent management and sound inventory strategies, the Group has achieved steady growth in the period under review despite challenging business conditions, and remains cautiously optimistic about the outlook for the rest of the year, as well as in the long term.

In the near term, the Group will work together with its major clients, especially on their packaging programs, to develop customized solutions. Prudent fiscal management has paid off for the Group and these policies will continue. The Group has taken and will continue to take advantage of the prevailing low interest rates to invest in appropriate foundations for the future, and will also continue to diversify its existing customer base to create growth and expansion.

Prospects *(continued)*

The Group foresees consolidation of contracts with key suppliers to enable both supplier and client to achieve savings through economies of scale. The trend of outsourcing into China is expected to continue, favouring businesses with a focus on top-level quality and excellence in customer service. To be prepared for this opportunity, the Group continues to expand and enhance its facilities in China.

Overall, the Group expects to see a gradual recovery in export markets and a continuance in the upswing in demand for high-quality and reliable partners, and is confident that its focus on excellent customer service, product quality and efficiency, along with a policy of partnering with clients to meet their specific needs at reasonable costs will enable it to benefit from these opportunities.