Management Discussion and Analysis

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Managing Director

Our emphasis on cost control, economies of scale and ongoing marketing enabled us to achieve an increase of 10% in operating profit. Our investments made in the past have helped us achieve satisfactory growth, particularly in an improved economy.

Global economic conditions saw a gradual improvement through the second half of the year, enabling the Group to achieve growth of 12% in revenue. Another positive factor was the growing trend among multinational customers to outsource their orders to single, vertically integrated suppliers who could offer a range of services.

Paper price adjustments and price-based competition in the market resulted in pressure on margins.

The Group achieved an increase of 44% in the other revenues and gains due to increased sales of scrap materials from production, a write back of diminution in listed investments, and exchange gains from foreign currency deposits. The revenue growth achieved by the Group came with an associated increase of 20% in distribution costs – including both freight costs from exports and transportation costs within China.

However, the Group's emphasis on cost control, economies of scale and ongoing marketing enabled it to achieve an increase of 10% in operating profit.

An analysis by business division is as follows:

	Turnover			Contribution to operating profit		
	2004		% change	2004		% change
	HK$'000	%	from 2003	HK$'000	%	from 2003
Paper and carton box printing and manufacturing	1,304,781	64	+17	273,610	81	+14
Paper trading	251,929	13	-6	44,937	13	+29
Corrugated carton manufacturing	472,210	23	+8	27,370	8	-33
Eliminations	–	–	–	(1,366)	–	N/A
	2,028,920	100	+12	344,551	102	+9
Interest, dividend income and other gains				11,341	4	+17
Corporate and unallocated expenses				(19,275)	–6	–2
				336,617	100	+10

PAPER AND CARTON BOX PRINTING AND MANUFACTURING

Our largest division achieved satisfactory growth levels with an 17% increase in turnover over the previous year. This growth was driven by continued growth in demand for innovative children's books and paper products, particularly from the export markets of US and Europe during the second half of the year. A second driver was increased demand for packaging, particularly for indirect exports from mainland China.

Paper price adjustments over the second half of the year and ongoing pricing pressure affected margins. However, through prudent operating policies and economies of scale this division recorded an increase of 14% in profit from operating activities.

This division diversified its customer base especially in terms of industry sector. A key trend that emerged relative to this division was the consolidation of suppliers by major customers and publishers from export markets. This division was able to take advantage of the vertically integrated operations of the Group to broaden and deepen existing customer relationships.

Paper consumption for this division grew by 13%, reflecting strong end-user demand. Demand from the US and Europe was strong, resulting in an increase of 20% in export sales.

This division took full advantage of the recovery in consumer confidence through aggressively acquiring new customers, and added a further thrust to its marketing efforts by recruiting additional members to its local sales teams.

PAPER TRADING

The paper trading division faced stiff competition from paper merchants and manufacturers in mainland China, resulting in a decline of turnover of 6%. However, the division capitalized on strong internal demand from the Group's other manufacturing divisions to achieve an increase of 29% in profit from operating activities. The division's prudent inventory policies meant it could benefit from the paper price adjustments prevalent during the second half of the year. More strategically, the division's ready supply of paper to the Group's other manufacturing divisions contributed significantly to the sound growth levels achieved by the other divisions of the Group.

The division's focus on offering a wide range of paper, sourced both from China and from locations such as Brazil and Scandinavia, also elevate it to a different niche in the market.

Construction at our Shenzhen distribution and warehouse facility was completed and it became operational during the beginning of the current financial year. We are confident that the facility will enhance the division's service capabilities, enabling it to stock a wider range of local and imported novelty paper, increasing its competitiveness, yield enhanced economies to the other manufacturing divisions of the Group and also appeal to printers in China's domestic market.

Management Discussion and Analysis

1, 2 & 3: Exterior and inside operation of the Shenzhen distribution and warehouse facility
4, 5 & 6: The showroom and operation of our plant in Fuyong, Shenzhen

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CORRUGATED CARTON MANUFACTURING

This division was positively impacted by overall economic recovery and increased its turnover levels by 8%. However, paper price adjustments and aggressive pricing strategies followed by local competitors continued to exert pressure on margins, leading to a decline of 33% in profit from operating activities.

The division focused on increasing its turnover and the breadth of customers to counter the competition. With increased emphasis on value-added service and end-to-end solutions, this division allowed the Group to further deepen its relationships with key customers of other divisions. The growth in sales volume also allowed the division to achieve greater efficiencies and economies of scale.

To increase further synergy with other divisions, the Group is investing in new converting, die-cutting and folding machines, and building a new facility in Zhongshan. The new facility will be ready towards the end of this year and is expected to enhance the competitiveness and efficiency of the corrugated carton division.

ASSOCIATES

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

The Group's associates in Zhongshan, southern China, continued to benefit from paper price adjustments to achieve a growth of 20% in volume contributing to the Group's profits by HK$9.1 million. Upgrades in existing machinery at the Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited and the commencement of full operations of the fourth paper-making production line at the Zhongshan Ren Hing Paper Manufacturing Company Limited, have helped increase our competitiveness and capitalize on growth in demand.

The year under review was the Zhongshan Ren Hing Paper Manufacturing Company Limited's first year of profitable operations. The associate accordingly started to enjoy preferential tax rates, together with a tax rebate for technological facilities from Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited, helped reduce overall tax expenditure by 57%.

NEW PRINTING AND CORRUGATING FACILITY IN WUXI

Our new printing and corrugating facility in Wuxi, a city near Shanghai, is now operational and has enhanced our capacity. The facility has been completed in a timely fashion as the market trends upwards, and we believe that it will enhance our efforts to increase market share in both domestic China and export markets.

The Wuxi plant has made a normal start-up and initial operational loss of HK$14 million since it became operational in October 2003. The summer peak season and the overall upturn in demand, however, will increase the plant's throughput further and we are confident the facility's performance will improve steadily.

Management Discussion and Analysis

7, 8, 9, 10 & 11 : Exterior and inside operation of our new plant in Wuxi

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FINANCIAL AND CAPITAL RESOURCES

The Group's capital expenditure during the year amounted to HK$193 million, of which HK$58 million was spent on land and plant construction and HK$135 million was spent on machinery and equipment.

In terms of location, the Group invested HK$115 million and HK$23 million on the Wuxi plant and the Shenzhen distribution and warehouse facility respectively. Other investments included HK$39 million and HK$16 million on enhancements to the Group's existing Shenzhen and Zhongshan facilities.

Construction of a new printing and corrugating facility at our Zhongshan plant has started and together with capacity expansion in our Shenzhen plant, we expect that our total capital expenditure for the next fiscal year will be approximately HK$200 million.

With acceleration of capacity expansion in our China plants, we have arranged more term loans to support the investment needs of our growth strategy. Of our total bank borrowings of HK$341 million at 31 March 2004, HK$111 million was in short term borrowings repayable within 1 year and HK$230 million was in long term borrowings repayable within two to five years.

During the year under review, surplus cash when placed in short-term RMB deposits, earned us a higher interest than Hong Kong dollar and U.S. dollar deposits. Operating expenses of our subsidiaries in mainland China also needed to be paid in RMB. As a result we kept more cash in RMB than any other currency during the year under review. As at 31 March 2004 we had total cash on hand of HK$437 million, of which 56% was in RMB, 19% in Hong Kong dollars, 14% in U.S. dollars and 11% in Euros and Pounds Sterling.

On the other hand because of the low interest rate in Hong Kong, our bank borrowings were primarily in Hong Kong dollars. Of our total bank borrowings of HK$341 million, 89% was in Hong Kong dollars and 11% was in U.S. dollars.

Though we had a higher level of bank borrowings, our interest expenses declined by 9% to HK$5.6 million as a result of declines in interest rates in Hong Kong. Our total bank borrowings as a ratio to shareholder equity was 20% representing a gearing ratio which was within a comfortable level.

As at 31 March 2004, we held cash net of debt of HK$96 million. Because of our strong financial position and improvement in profit for the year the Board has recommended an increase in final dividend to shareholders from HK19 cents per share last year, to HK20 cents per share this year.

EMPLOYEES

As at 31 March 2004, the Group (excluding its associates) employed a total of 10,166 staff in Hong Kong and China. Of the total, 280 were employed in Hong Kong and 9,886 in China.

The Group continues to provide technical, management and safety training to employees at all levels to increase their professional knowledge and contribute to their career development.

The management gratefully acknowledges the dedication of Hung Hing's staff, without which it would not be possible to grow or perform in this competitive marketplace. We look forward to continuing to work with them in the coming years.

Matthew C.M. Yum
Managing Director

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