MANAGEMENT DISCUSSION AND ANALYSIS

During the period under review, Hung Hing was able to take advantage of an overall improvement in the market environment and an increase in demand for quality paper products to achieve an overall increase of 43 per cent in turnover to HK$1,732 million. Long-term strategies such as expansion to new geographic markets and an increase in new products, as well as increased orders from existing customers, also contributed to the increase in business.

Hung Hing continued to benefit from the ongoing trend of outsourcing production to China-based manufacturers in markets like the US and Europe. The paper and carton box printing and manufacturing division and paper trading division performed particularly strongly in this regard, recording 16 per cent and 50 per cent growth respectively in external sales. The two paper manufacturing companies in Zhongshan contributed significantly to the Group's turnover in China following the Group's increase in stake in them from 35 per cent to 59 per cent, while the Wuxi plant achieved steady growth in business volume, moving a step closer to its target of breaking even.

With the consolidation of the results of the two Zhongshan paper manufacturing companies, the Group incurred a correspondingly increased share of their cost of sales, and administrative and selling expenses. As a result, the Group's overall cost of sales increased by 49 per cent during the period under review. Overall administrative and selling expenses also increased by 22 per cent respectively for the same reason.

The period under review saw continued adjustments in oil prices, which impacted the Group's material and transportation costs. There was an improvement in the power supply situation in China, although the situation was not completely rectified. These factors, as well as keen competition from mainland China manufacturers, and ongoing increases in labour costs continued to have an impact on margins.

Despite these challenges, the Group leveraged its vertically integrated operations, economies of scale and quick response to market needs to achieve a 21 percent increase in profit from operating activities. Net profit attributable to equity holders of the parent increased 10 per cent to HK$172 million. Earnings per share increased 8 per cent to HK29.7 cents.

The Board of Directors has declared an interim dividend of HK9.5 cents per share in cash with a scrip option for the current financial period.

Growth in domestic and export markets

The Group's growth in turnover came from an improvement in performance across domestic as well as export markets.

Hong Kong: The Group achieved an increase in turnover of 42 per cent for the Hong Kong market, primarily resulting from increased orders from mainland China exporters owned by Hong Kong-based companies.

Mainland China: The robust mainland economy, as well as the inclusion of the turnover achieved by the two paper manufacturing companies, resulted in a growth of 78 per cent in the mainland China market.

Growth in domestic and export markets *(continued)*

Europe: The Group recorded strong business growth in Europe, particularly in Germany and the UK. The growth was partly driven by the increase in demand for conventional books, greeting cards and packaging, and partly by the expansion of the customer base.

US: The Group achieved a stable performance, with turnover remaining steady at HK$172 million during the period under review. Orders from new as well as existing customers remained steady, and the overall economy remained strong, contributing to the improved business.

Paper and Carton Box Printing and Manufacturing

The Group's largest business division contributed 54 per cent and 75 per cent of the Group's turnover and profit from operating activities respectively for the period under review.

The growth was primarily due to an increase in direct exports and the success of marketing efforts in key geographic markets in Europe such as the UK and Germany, and new markets such as South America. The Group's strategy of diversification of product portfolio as well as a broadening of its customer base also helped improve the division's turnover.

Due to the Group's vertically integrated operations and cost controls, this division continued to benefit from the trend for outsourcing. The Group's investment strategy in its Wuxi plant has been successful with the plant entering its third year of operations. The plant increased its turnover in paper and carton box printing by 57 per cent following improved demand from mainland China.

Paper Trading

The Group's paper trading division improved its external sales performance by 50 per cent. The division benefited from the six-month operations of the Shenzhen logistic warehouse, as well as improved demand for a variety of paper types.

Despite the strong growth in external sales, the increase in the division's contribution to the Group's profit from operating activities was 17 per cent. This was mainly due to pricing pressure as a result of competition, as well as a drop in inter-segment sales.

The Group remains committed to the overall success of this division, which is a core part of its vertically integrated approach. The division will focus on expanding the range of papers it sells and introduce new types of paper to the market.

Corrugated Carton Manufacturing

This key division recorded a slight drop in turnover of 4 per cent, largely due to keen competition and price pressure, which affected margins. Business volume dropped slightly by 2 per cent. Despite these factors, the division benefited from increased business and improved operational efficiency at the Wuxi plant to record a modest increase in profit from operating activities of 3 per cent.

Corrugated Carton Manufacturing *(continued)*

The new corrugator in Zhongshan is now operational. It has enhanced the competitiveness of this division which is an important component of the Group's long-term vertically integrated strategy.

Paper Manufacturing

Following the Group's increase in stake from 35 per cent to 59 per cent, the two paper manufacturing companies in Zhongshan improved their management and operational efficiency. Their faster response to changing market conditions, and an improvement in product quality led to an increase in business. This division contributed 20 per cent and 10 per cent to the Group's turnover and profit from operating activities respectively.

Progress in development of new Heshan facility

Construction work on the Group's new printing facility at Heshan has been proceeding as planned. Phase One will become operational towards the beginning of the second quarter of 2006. The new facility will allow the Group to increase its capacity while diversifying its production base and leveraging the lower costs prevailing in Heshan.

Liquidity and Capital Resources

Capital expenditure during the period amounted to HK$70 million, of which HK$30 million was spent on land and buildings and HK$40 million on machinery and equipment.

As at 30 September 2005, total bank borrowings stood at HK$732 million, of which HK$447 million was short term borrowings repayable within one year and HK$285 million, long-term borrowings repayable within two to five years. Of the Group's total bank borrowings, 78 per cent was in Hong Kong dollars, 21 per cent in Renminbi and 1 per cent in U.S. dollars.

With a higher level of borrowings and the inclusion of loan interest of HK$5.9 million following the consolidation of the two Zhongshan paper manufacturing companies, the Group's interest expenses increased by 336 per cent to HK$15.2 million.

As at 30 September 2005, the Group had cash on hand of HK$394 million, an increase of 18 per cent compared to 31 March 2005. Bank borrowings net of cash stood at HK$338 million. Net debt to equity ratio (bank borrowings net of cash over shareholders' equity) was 17 per cent, similar to 31 March 2005.

The Group has sufficient cash and available banking facilities to meet its working capital requirements and to support its capital investment plan.

Employees

As at 30 September 2005, the Group employed a total of 18,018 people in Hong Kong and China. Of the total, 309 were employed in Hong Kong and 17,709 in China. There is an increase over the previous year — particularly in China, where our operations have grown by approximately 971 employees.

Employees *(continued)*

The Group continues to provide its employees with competitive salaries. We also offer bonuses based on the working performance of the employee and business performance of the companies within the Group. The Group values its employees and is committed to the provision of regular training to enhance their operational efficiency and facilitate further career development.

Ongoing Enhancements in Operational Procedures and Labour Relations

Over the years, Hung Hing has remained committed to the highest standards of ethical business dealings and good labour practices. The Group values its workers as its most important assets and Hung Hing's goal as a leader in the field is to become a model for best practice in labour practices in the print and packaging industry.

The Group conducted an overall review of its operations during the period under review. This included upgrading various aspects of our operations including the working environment, health and safety measures, and training for staff on workplace safety and health. Communication channels with workers were also improved with the strengthening of the existing workers representative committee, the establishment of workers helplines and other measures. These measures have already resulted in a better and safer workplace, and improvements in worker relations.

Prospects

The Group is cautiously confident of continued steady growth with the expectation of a stable macro-economic environment in the coming months. Indications are that the trend for outsourcing will continue across the globe. We will continue to aim for steady performance by leveraging economies of scale to offset pressure on margins.

We believe that the Group's vertically integrated, synergistic operations, as well as its commitment to quality and high business standards have earned it a long-term and stable customer base. This strong reputation will serve to help the Group attract and retain quality customers in the months ahead.