# Management Discussion And Analysis

**"The Group expanded capacity by adding new machinery in the Tai Po, Shenzhen and Heshan plants. The new Heshan plant commenced operations in March 2007 and has shown satisfactory progress, now employing 1,000 staff."**

**Yum Chak Ming, Matthew,**
**Managing Director**

During the period under review, the global economy continued to improve, helping the Group achieve turnover growth of 6%. The Group capitalized on the exchange rate environment as well as a continued trend among overseas customers to consolidate their orders with a smaller number of reliable, value added suppliers. As a result, the Group achieved steady growth in Europe and Australia.

Several factors continued to affect the Group and the entire industry throughout the year, including power shortages across southern China. Oil price adjustments remained a factor globally, impacting the Group's transportation and paper costs and ultimately increasing the Group's cost of sales by 8%. Due to intense competition in mainland China, these cost increases could not be fully passed on to customers, which exerted pressure on margins.

The appreciation of the Renminbi has had an impact on our operating costs. However, conversion of our Renminbi monetary assets into Hong Kong dollars resulted in exchange gains. Together with interest income earned on surplus cash placed on deposits with bank, other income and gains were up 92% to HK$70 million.

Operating efficiencies and cost controls also helped increase operating profit by 3%.

## ANALYSIS BY BUSINESS DIVISION

An analysis by business division is as follows:

| | Turnover | | | Contribution to operating profit | | |
|---|---|---|---|---|---|---|
| | 2007<br>HK$'000 | % | % change<br>from 2006 | 2007<br>HK$'000 | % | % change<br>from 2006 |
| Paper & carton box printing & manufacturing | 1,572,656 | 50 | +1 | 210,580 | 58 | -17 |
| Paper trading | 281,025 | 9 | +4 | 35,454 | 10 | +30 |
| Corrugated carton | 538,487 | 17 | +9 | 24,697 | 6 | -4 |
| Paper manufacturing | 749,817 | 24 | +18 | 79,814 | 22 | +43 |
| Eliminations | — | — | — | (610) | – | N/A |
| | 3,141,985 | 100 | +6 | 349,935 | 96 | -4 |
| Interest, dividend income and other gains | | | | 36,918 | 10 | +221 |
| Corporate and unallocated expenses | | | | (22,981) | -6 | -5 |
| | | | | 363,872 | 100 | +3 |

## PAPER AND CARTON BOX PRINTING AND MANUFACTURING

Our biggest division reported a slight increase in turnover of 1%, which was achieved largely on volume growth from existing as well as new customers. However, increases in material costs resulted in a decline of operating profit of 17%.

The division increased its production of traditional books and expanded its product range into premium packaging for high-end products such as cosmetics. This strategy helped improve margins through a focus on value-added business, as did a number of initiatives to reduce costs and improve efficiencies.

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Technician at work at our plant in Tai Po, Hong Kong

The division continued with its aggressive marketing efforts in Europe with appointment of new marketing agents and was successful in expanding its customer base to new geographic markets such as Ireland, Russia and Spain. The Group now has four agents in Europe based in the UK, Germany, Scandinavia and the Benelux region (Belgium, Netherlands and Luxembourg).

The Group also expanded capacity by adding new machinery in its Tai Po, Shenzhen and Heshan plants. The launch of the Heshan plant faced slight delays due to power supply and road construction. The factory commenced operations in March 2007 and has shown satisfactory progress, now employing 1,000 staff.

Steady progress has been made in terms of implementing sustainable business practices. The Group recycles over 60,000 metric tonnes of waste paper from all our printing plants each year, much of it through the paper manufacturing division.

## PAPER TRADING

This division was able to take advantage of the prevailing paper price adjustments across the globe to increase revenue and operating profit by 4% and 30% respectively.

The increase in revenue was also driven by sales of more high value items such as woodfree paper, art paper, ivory board and two-side coated board.

The Shenzhen distribution and logistic warehouse is now in its fourth year of operations and has built a reputation for a broad product range and the provision of value added services including paper cutting and slitting. The division achieved increases in revenues from local customers who purchased on credit terms.

The division distributed kraft liner and medium paper manufactured by the Group's paper manufacturing division, taking the Group's vertically integrated business strategy a step further. Strong demand from the Group's own printing division, especially conventional book printing, also boosted the division's operating profits.

The paper trading division has also achieved Forest Stewardship Council (FSC) certification for its sustainable practices, an achievement for the Group.

## CORRUGATED CARTON MANUFACTURING

The corrugated carton manufacturing division achieved steady revenue growth of 9%, in part by entering segments such as dairy products and electronics in mainland China.

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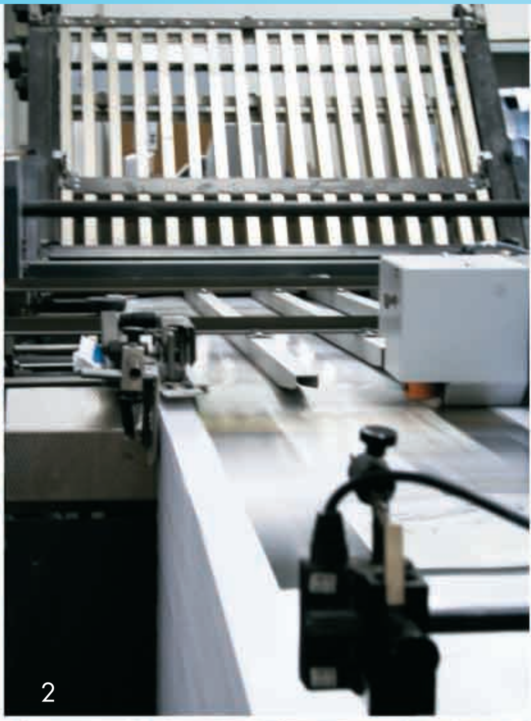

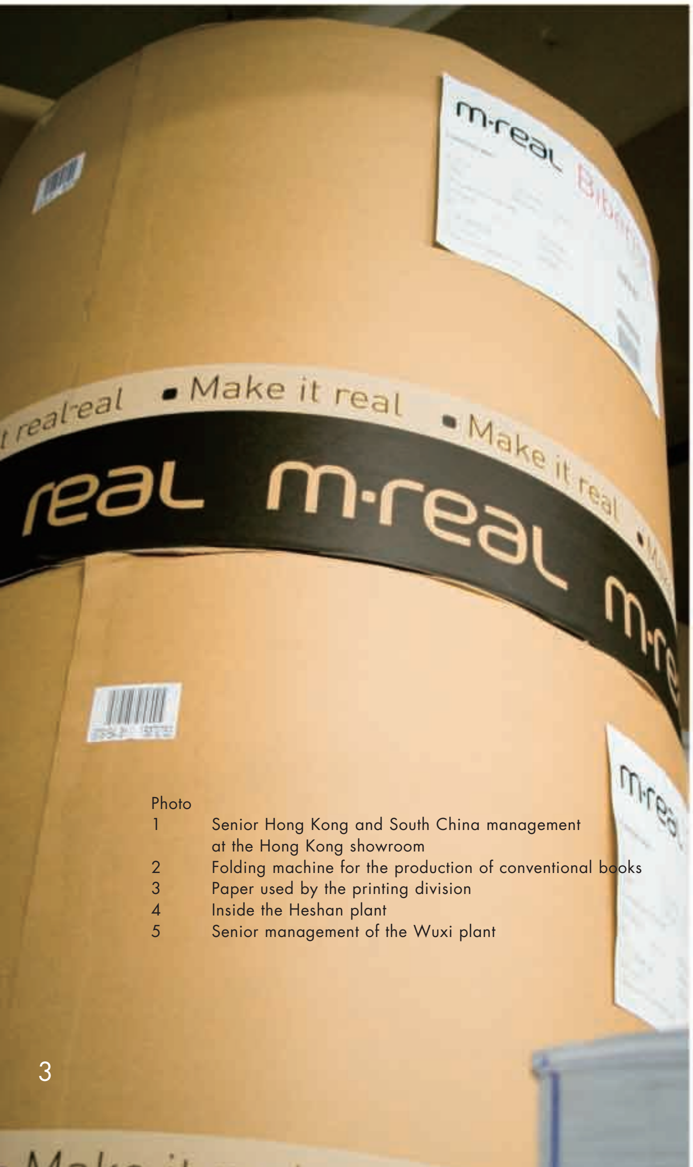



Photo
1 Senior Hong Kong and South China management at the Hong Kong showroom
2 Folding machine for the production of conventional books
3 Paper used by the printing division
4 Inside the Heshan plant
5 Senior management of the Wuxi plant

Despite revenue growth, the division incurred depreciation charges on the new corrugator at the Zhongshan plant. Intense competition continued to persist in the industry together with increases in labour as well as material costs, exerting pressure on margins. As a result, operating profit declined by 4%.

The division will continue to focus as much as possible on higher-margin business and diversify its customer base to enhance profitability.

## PAPER MANUFACTURING

The paper manufacturing division capitalised on strong domestic demand to achieve an increase of 18% in sales. Global paper price adjustments and continued emphasis on operating efficiencies led to an increase of 43% in operating profit.

The Group plans to further upgrade the division's machinery and acquire additional land. This will enable the division to expand its capacity and position itself to capitalize on future growth opportunities.

The division continued to spearhead the Group's practice of implementing environmentally conscious measures across the board. The paper manufacturing division alone recycled over 400,000 metric tonnes of waste paper last year, which were used to produce kraft liner and medium paper for the corrugating paper market.

## FINANCIAL AND CAPITAL RESOURCES

Ongoing investment in machinery and facilities is an important part of the Group's plan to support its strategic growth plans. The expenditure incurred during the year was as follows:

| | HK$ million |
|---|---|
| Buildings and machinery at the Heshan plant | 101 |
| Machinery and equipment at the Shenzhen plant | 39 |
| Machinery and equipment at the Tai Po plant | 39 |
| Buildings and machinery upgrade at the paper manufacturing facilities in Zhongshan | 16 |
| Buildings and machinery at the printing and corrugating facilities in Zhongshan | 14 |
| Buildings and machinery at the Wuxi plant | 8 |
| Total | 217 |

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The Group plans to invest further in machinery for the Heshan plant and land acquisition in Zhongshan to facilitate expansion of the paper manufacturing facilities.

At 31 March 2007, the Group had total bank borrowings including structured borrowings of HK$515 million of which HK$347 million was repayable within 1 year and HK$168 million was repayable within 2–4 years. Of the Group's total bank borrowings, 71% was borrowed in Hong Kong dollars, 15% in Renminbi and 14% in U.S. dollars.

With the appreciation of the Renminbi, the Group's paper manufacturing companies in China took steps to reduce their RMB borrowings and turned to Hong Kong dollar borrowings.

The Group accrued loan interest of HK$38 million on the convertible bonds (CB) at an interest rate of 5.9% which was then the market rate for straight bonds when the Group issued the CB in March 2006. This led to an increase of the Group's interest expenses by 118% to HK$61 million.

Excluding the loan interest on the CB, interest expenses declined by 18% to HK$23 million.

During the year, the Group made total loan repayments of HK$316 million but also drew down and made arrangements for new loans of HK$235 million. Some of the new loans were arranged in Hong Kong dollars for its mainland China subsidiaries. Net loan repayment during the year amounted to HK$81 million.

The Group had a net cash inflow from operating activities of HK$158 million. The cash inflow was impacted by increases in accounts receivable and inventory.

Compared to last year, the Group had a stronger fourth quarter as sales surged. This seasonality factor coupled with longer trade terms in conventional book printing, as well as an increased number of credit term customers for the paper trading and paper manufacturing divisions, led to a higher level of accounts receivable.

Inventory also increased as a result of the Group's long-term inventory strategy in anticipation of global paper price adjustments.

As at 31 March 2007, the Group had total cash on hand including structured deposit of HK$979 million of which HK$795 million was placed on deposits with bank. Of the total cash on hand, 40% was in Hong Kong dollars, 36% was in Renminbi, 22% in U.S. dollars and 2% in Euro and Sterling Pound.

The total debt of the Group including the loan component of the CB, was HK$1,195 million. Net debt (total debt net of cash on hand) was HK$216 million which as a ratio to shareholders' equity was 10%.

## BUSINESS SUSTAINABILITY

The Group has implemented a number of measures across the board to ensure its business model is environmentally and socially sustainable. Some of our recent achievements in this regard include:

- Reducing the cost of water heating in our staff dormitories by about 60% through the use of solar power.

- Achieving savings of 50,000 kilowatt hours of electricity per month by using energy-saving fluorescent lights in our factories.

- Conserving about 60 metric tonnes of fuel per month used in steam generators by installing a waste steam collection facility.

The Group's entire supply chain is fully FSC certified. The Group is committed to sustainable business practices and meeting the environmental standards of our customers as well as local regulations.

## EMPLOYEES

As of 31 March 2007, the Group employed a total of 16,732 staff in Hong Kong and China. Of the total, 362 were employed in Hong Kong and 16,370 in China. During the year the Group continued to conduct training, safety and employee care programs, to motivate staff, boost morale and loyalty, build strong career paths, and foster productivity and efficiency.

As always, I would like to take this opportunity to thank our talented and dedicated staff whose commitment and efforts have been central to our continued success over the years.

**Yum Chak Ming, Matthew**
*Managing Director*

Hong Kong, 9 July 2007