MANAGEMENT DISCUSSION AND ANALYSIS

The Group has maintained steady business and volume in difficult global economic conditions during the period. For the six months ended 30 September 2001, profit attributable to shareholders was HK$155 million, against a turnover of HK$966 million. This represents a 9% diminution on the first half of last year. However, profits from operating activities were HK$198 million, down 6% compared to same period in 2000/2001.

The Board of Directors has declared an interim dividend of HK9.5 cents per share, which is the same as last year.

During the six months under review, the continuing economic deceleration has impacted on the business of the Group. Less business has been taking place and deals that bring orders are taking longer to conclude. Neverthless, volume within the Group's largest division, paper and carton box printing has remained steady and margins have been maintained. However, our paper trading and paper manufacturing operations were adversely affected by the continued paper price adjustments.

The adjustments in paper prices have a twofold effect on our business. The price of raw material is less, but this lower base price is passed on to customers with resulting diminished sales figures.

We were very pleased and honoured by the recognition given to the performance of the Group in a recent Forbes magazine (29 October, 2001 issue). Hung Hing was placed among the world's best 200 small companies.

Investment for the Future

We are constantly expanding each and every division, although economic conditions are not at present their most favourable. This reflects the Group's commitment to long-term measured development and our faith in our company's ability to respond to, learn from and build in all business environments. Our expansion in both capacity and markets is made possible and supported by our financial strength and confidence in our business.

Our most significant new investment is the acceleration of our China strategy. While we have experienced reduced turnover in other markets due to global conditions, mainland China provided turnover growth and contributed 13% to profit from operating activities in the first six months of this year. We plan to develop our own printing and corrugating facility on a 1.5 million square feet site near Shanghai. Located in a technology and industrial park in Wuxi, in Jiangsu province, we expect the plant will be operational by the first quarter of 2003. It is intended to serve the domestic and overseas market. We are also building a new paper distribution and logistic warehouse in Shenzhen. The facility, which should be fully functional by the third quarter of 2002, will enable the division to increase competitiveness and add value by converting paper to suitable sizes before sale.

Other expansion work is already in progress and nearing completion. We are installing a corrugator, capable of doubling present capacity, at our Shenzhen plant. The machine, the only one of its kind in China, will be in operation by the end of 2001. And our fourth paper making production line at our joint venture Zhongshan Ren Hing Paper Manufacturing Company Limited will be on stream by the end of April 2002. These investments will assist in capturing anticipated future growth in China, as well as opportunities in other markets when the global economy rebounds.

Investment for the Future *(continued)*

In addition, we recognise the need to develop sales within China by strengthening our marketing arrangements. At the same time, we are also keeping a significant marketing presence in the already established and significant markets of the United States and Europe.

Looking further ahead, we anticipate China's accession to the World Trade Organisation will have longer-term business benefits for the Group by enabling a better operating environment, and encouraging more new companies to establish themselves.

Our capital investment is HK$87 million so far this year. With the acquisition of land in China, we expect our total capital investment for the year will increase to HK$160 million.

Paper and Carton Box Printing and Manufacturing

The Group's largest division has held up well given the adverse economic conditions. It recorded an increase in volume of 10% and accounted for 63% of turnover for the period. Its contribution to profit from operating activities was 74%. During the first half of this year, orders and volume remained stable. In particular, the Group benefited from increased demand from Chinese domestic consumer brand manufacturers while orders for other markets stayed steady.

Paper Trading

Sales for this division were adversely affected by the adjustment in paper prices. Sales volume dropped by 5%, reflecting a general decline in demand particularly from smaller customers. The division recorded the largest reduction in turnover of 27%. As we kept inventory to a minimum, the fluctuation in paper prices also had an impact on the range of paper we could offer customers. However, the cyclical nature of these prices may now be set to turn, which would chime well with our proposed value-adding logistic warehouse and converting facility at Shenzhen.

Corrugated Carton Manufacturing

With a 3% drop in volume for this division, the 21% reduction in turnover is again due to further adjustments in paper prices. We have tightened credit control and sold less corrugated board. As a result overall margins have been affected and profit from operating activities dropped by 11%. Despite these conditions, we did see some growth in corrugated carton from our toy, food and beverage customers. Our increased sales effort in the China domestic market and the installation of our new corrugator, which begins production at the end of 2001, will provide scope for improvement.

Associates

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

Ongoing high competition and paper price adjustments have further affected the performance of this 35%-owned joint venture, Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited. The previously noted trend continues, and in the first half of the year the associate recorded a drop of 77% in the share of profit. However, we are consistent in our efforts to strengthen the management in a bid to reinforce the associate's competitive position. The fourth paper production line is being installed and a trial run is expected to start by the end of April 2002.

Liquidity and Capital Resources

During the period under review, we strengthened our receivable collection and reduced our inventory level. This increased our incoming cash, which benefited us in two ways. On one hand it reduced our short-term borrowings and on the other hand it increased our time deposits.

To take advantage of the lower interest rate in Hong Kong, we have made more use of the Hong Kong Dollar loan facilities to repay the Renminbi borrowings of our China subsidiaries. With a lower interest rate and reduced borrowings, our interest expenses have gone down by 39% to HK$4.38 million.

At 30 September 2001, we had cash on hand of HK$266 million and bank borrowings of HK$128 million. We had cash net of debt of HK$138 million, adequate to finance our capital investment plan and to meet our working capital requirement.

Prospects

We remain cautiously optimistic for the immediate future as well as for our long-term growth strategy. The Group is in a sound financial position, and sees many opportunities within the immediate challenges now presenting themselves. We retain a clear and unswerving focus on competitiveness, quality, efficiency and customer service. We will continue to make the most of the vertical integration within the Hung Hing business and of the scale of our operations to further these four goals. Our approach is neither aggressive nor conservative, but consistent and prudent. We are making the best of all growth potential — such as in China — and are taking advantage of low interest rates. But we are also looking forward to a general economic turnaround, sooner rather than later, and are well prepared to capture any new business opportunities brought by that upturn.

In the meantime we continue to build on our strengths of shrewd management and good cost controls to implement the best methods now. But we are also building for the longer-term. In addition to our ongoing Group expansion plans, we are maximising the growth offered within China, by a prudent acceleration in our level of operations.