



## Chief Executive Officer's Report

*We are fully aware of the needs of our customers and are able to provide the highest quality products on a timely manner.*





*“Growing with you for a better life”*

## OVERALL PERFORMANCE

In 2001, Hengan International focused on quality assurance, together with continuous efforts on product mix adjustment, stringent cost control, optimizing distribution channels and reinforcing its brand image. The business as a whole grew steadily in a market that was full of opportunities and challenges.

Following China's accession into the WTO, multinational enterprises are becoming even more aggressive in chasing after the huge China market. Coupled with the fact that it is flooded with small local manufacturers, the sanitary napkins market is becoming more competitive. Facing such a market, Hengan International aggressively develops new products and during the year under review, the Group launched the “Anerle” “Space 7” sanitary napkin series, for young females in the large and major cities, and the new “Anerle” baby diapers, featuring ultra-thin and softness. While we are sharpening our competitive edges in terms of products and market, we are also improving our internal control and business processes by engaging Thomas Group to provide management consultancy services. These together will prepare the Group for further growth in the future.

During the year under review, the Group's turnover reached HK\$1,217,754,000 and profit attributable to shareholders increased by 8.6% to HK\$227,232,000. Improvement in net profit of the Group was due to the increase in the sales of higher margin products, coupled with the decline in the prices of fluff pulp and other materials that led to a reduction in the production costs. Gross profit margin was improved to 38.6% (2000: 38%).

Increase in selling and distribution costs during the year was mild and accounted for 15.7% (2000: 15.8%) of the total sales. To respond to market changes, the Group implemented necessary promotional activities to maintain its market share. During the year under review, the Group was able to contain its general and administration expenses as a result of the gradual improvements in the overall management control.

13

## BUSINESS REVIEW

During the year under review, sales of sanitary napkins (including pantliners) was steady, with turnover amounting to HK\$862,355,000 (2000: HK\$877,215,000). Sales of baby diapers recorded significant growth and total sales reached HK\$268,222,000 (2000: HK\$185,144,000). These two categories accounted for 70.8% and 22% of the Group's turnover respectively.

### Sanitary napkins

In the early 1990's, the sanitary napkins market in China experienced a high growth period until market penetration has become relatively high in recent years and as a result, the overall growth of the market continued to slow down. During the year under review, the sanitary napkins market was flooded with small local manufacturers. Coupled with the increasing aggression of multinational brands, Hengan International faced intense competition in both the high-end and low-end market.

Due to the influx of small local manufacturers in the low-end market, the issue of demand over supply became highly conspicuous. Sales of the Group's ordinary sanitary napkins continued to decline but the rate of decline has slowed down significantly as compared to the previous two years. Nevertheless, sales of the Group's medicated sanitary napkins recorded significant improvements in certain markets.



## Chief Executive Officer's Report

Sales of winged sanitary napkins remained steady during the year. The Group launched a series of new products in the second half of the year that received positive feedback from the market. Other series of winged sanitary napkins also achieved satisfactory sales and the gross profit margin was maintained.

During the year under review, Hengan International maintained its leading position by diversifying its products series. New products launched included the “Anerle” “Space 7” sanitary napkins that are mainly targeting at young females in large and major cities. The product, distinctive from the traditional sanitary napkins in terms of product positioning, packaging, promotion, distribution and design, has been well received by the market.

In addition, sales of pantliners also recorded significant growth and turnover amounted to HK\$126,199,000 in 2001, or a 21% increase over the corresponding period in 2000.

### **Disposable diapers**

The gradual increase in domestic household incomes, coupled with the rising number of young parents in China, indicated that the disposable baby diapers market has immense room for further expansion and growth. In 2001, the Group's “Anerle” series of baby diapers recorded a growth of 44% to achieve a total sales of HK\$268,222,000 (2000: HK\$185,144,000), and will continue to be the growth driver of the Group's future revenue and profit. The baby diapers market continues to be on the rise with the penetration rate estimated to be below 3%. During the year under review, the Group imported an advanced diaper production line from Japan and a new series of baby diapers that features ultra-thin and softness was launched that further enhances its market competitiveness.

Sales of the new adult diapers under the “ElderJoy” brandname increased significantly during the year, most of which were export sales. Although the product has yet to bring to the Group significant revenue and profit contribution, it enriches the Group's product range. Further, with China's improving living standards and rise of the aging population, Hengan International is highly optimistic about the future of the adult diapers market.

### **Distribution business**

During the year under review, the Group continued to act as the distributor for a related tissue paper manufacturer. This enabled the Group to utilize its resources more effectively and capitalized on its nation-wide distribution network, thereby achieving greater cost effectiveness. Benefiting from its strong brandname, sales of the tissue paper products increased dramatically during the year that brought an increase in commission income for the Group, amounting to HK\$6,562,000 (2000: HK\$3,024,000). Due to the fact that the tissue paper market in China still has room for further growth and development, it is expected that the business will continue to bring to the Group a significant amount of commission income.

## **SALES STRATEGIES**

One of Hengan International's competitive advantages is that it owns a nation-wide distribution network. During the year under review, the Group continued to enhance the management of its distribution network, restructuring and fine-tuning its distribution strategies as well as strengthening its commitment in building an efficient and effective modern distribution channel in order to maintain its leading position in the market.

# Chief Executive Officer's Report



## HUMAN RESOURCES AND MANAGEMENT

At 31st December 2001, the Group employed approximately 7,400 staff and the payroll accounted for 6.7% of the Group's total sales (2000: 6.8%). The Group provides comprehensive training programs to staff including an orientation course as well as continuing development programs.

Remuneration packages are

determined with reference to the experience and qualification of individual staff and general market conditions. Year-end bonus are linked to the financial results of the Group as well as performance of the individual. The Group also has a share option scheme available for Executive Directors and employees but no options have been granted under the scheme during the year.

## Turnover by Regions



Northern	2001	2000
Sales Value: (HK\$ million)	160	172
Percentage of Total Sales:	13.1%	14.8%

Eastern	2001	2000
Sales Value: (HK\$ million)	145	146
Percentage of Total Sales:	11.9%	12.6%

Fujian	2001	2000
Sales Value: (HK\$ million)	539	494
Percentage of Total Sales:	44.3%	42.4%

Central	2001	2000
Sales Value: (HK\$ million)	159	152
Percentage of Total Sales:	13%	13.1%

South-western	2001	2000
Sales Value: (HK\$ million)	209	198
Percentage of Total Sales:	17.2%	17.0%



## Chief Executive Officer's Report

One of the key factors of Hengan International's continued success is the bold changes we took when we faced challenges. Since the second half of 2001, the Group has engaged Thomas Group, a management consultancy firm specializing in smoothing out enterprises' operation processes and enhancing efficiency, to be the Group's management consultant for a period of three years. Thomas Group coaches and provides training for the management of the Group and through reducing operating cycle time and better deployment of resources, the Group will be able to enhance its competitive edges. We believe that this program will lay a solid foundation for Hengan International's future development.

### FINANCIAL POSITION AND USE OF FUNDS

The Group's financial position remained healthy and as at the end of 2001, the Group's bank balances and cash amounted to HK\$546,782,000 with no borrowings. During the year under review, the Group applied approximately HK\$80,000,000 in the acquisition and upgrading of production equipment, approximately HK\$15,000,000 in the office automation and logistics, and approximately HK\$22,000,000 in the construction and acquisition of production plants and office premises.

### FUTURE PROSPECTS

China's accession into the WTO, the "Go West" project and Beijing's 2008 Olympics will all fuel new momentum into China's consumer market. Hengan International is ready for the challenges and opportunities ahead.

In the coming year, we will continue to focus on the development of the Group's sanitary napkin and diaper business. The Group will strengthen the management of its sales teams and implement effective sales strategies so as to increase our market share in all regions and reinforce the Group's leadership position in the market.

We understand very well that competition nowadays is no longer on product but branding and we also understand in the future companies will be competing with each other on people but nothing else. We strongly believe that people are our asset and we will be establishing an effective human resources management process within the organization to ensure that our staff is being respected, developed, trusted and motivated so as to provide a backbone for the Group's continuous growth.

Hengan International is to become a market-driven consumer products enterprise. We will strive to build Hengan International a specialist in household and personal care products. The Group has established a new marketing department responsible for the management of all the Group's brands, formulation of market strategies and planning and its subsequent implementation. Through analysis of market data and intelligence, the Group will have a better understanding of the consumer needs and churn out new and appropriate products for different markets segments in a the shortest time possible.

The Group will continue to work closely with the consultants to enhance our skills and strengthen management control. We will strive to control our costs through improving operation efficiency that leads to improvement in overall profitability and enhancement in returns to shareholders.

In light of the competitive personal care products market, 'new products, new market' will be key to Hengan International's continued success. The Group is cautiously active in looking for new business opportunities with a view to enhance the Group's product range through synergistic mergers and acquisitions. The Group will become more pro-active in developing new markets so as to bring the Group's products to outside of China, creating more room for future growth.

**Hui Chi Lin**

Chief Executive Officer

Hong Kong, 8th March 2002