



In a market of dynamic competition, we will pay unremitting effort in a view of strengthening our competitive edges, seeking new business opportunities and bring better returns for our shareholders.

"Growing with you for a better life"

OVERALL PERFORMANCE

The Chinese personal hygiene product industry faced a year with challenges and opportunities. The challenge was from China's accession into the WTO, and both multinational enterprises and small local manufacturers strive to keep themselves ahead of the game, and market competition has become even more intense. At the same time, the industry also encountered numerous opportunities coming from the change in domestic consumption pattern and increasing demand for both quality and quantity for personal hygiene products. Existing within this dynamic market environment, the Group continuously made changes to its products, enhanced its innovativeness and improved quality. Through simplifying our production processes, developing stronger sales and marketing methods as well as enhancing brand name and product image, the Group strive to improve its competitiveness.

The Group completed substantially during the year the process improvement project that was conducted through the assistance of a professional consulting firm. After sixteen months' of hard work and effort, not only internal control, but also communication between the management team and employees improved significantly. Furthermore, the smoothed operation we now have is attributable to the reorganization of the Group's human resources. We believe the Group has built itself a solid foundation following the company-wide restructuring, and is ready to face new challenges.

During the year, the Group's turnover amounted to HK\$1,115,404,000 and profit attributable to shareholders was HK\$199,710,000, decreased 8.4% and 12.1% respectively as compared to last year. The drop in the Group's overall results was mainly due to the fierce domestic competition within the sanitary napkin and diaper markets. Decline in sales volume of the Group's products in certain regions, together with a decrease in prices we charged on certain of our products, caused a decline in sales revenue. Average gross profit margin however increased 4.4 percentage points, having benefited from lower material costs, improvement in production and purchasing logistics which lead to a decrease in production cost. During the year, the Group strengthened its sales and marketing program in order to enhance its sales and distribution capability, causing the sales and distribution costs to increase to 18.5% of the turnover (2001: 15.7%). In terms of general and administration costs, the Group paid consultancy fee in addition to related costs arising as a result of the organization restructuring, overall expense level increased when compared to the year before. We believe that following our internal corporate management system being gradually strengthened, general and administrative costs would be under better control in the future.

BUSINESS REVIEW

During the year, sales of sanitary napkins recorded a decline to HK\$783,259,000 (2001: HK\$862,355,000). Sales of baby diapers saw a slow down after two years of rapid growth, sales declined slightly to HK\$253,561,000 (2001: HK\$268,222,000). Sanitary napkins and baby diapers accounted for 70.2% and 22.7% of the Group's turnover respectively.

Sanitary napkins

After over ten years of rapid expansion, China's sanitary napkins market has become relatively matured, and market penetration has reached 53%. Market growth slowed down to 3-4% per annum. Because of the relatively low entry barrier for this business segment, many companies, large and small, entered the market. With supply outgrowing demand, market competition was intense. In view of this market environment, the Group believes that effective promotion and distribution channel remain the crucial factors for a company's success. Therefore, during the year, the Group consolidated its sales team and strengthened its distribution channel and dealer management, in order to establish an efficient product distribution system.

Facing fierce market competition, the Group continued to fight off competition with its diverse and high quality product series, together with its established brand name effect. Sales of winged sanitary napkins under the "Anle" brand recorded significant growth and that "Space 7" of the "Anerle" sanitary napkins also performed strongly, offsetting partly the decline in the sales of ordinary sanitary napkins. The Group will continue to keep itself alert of market changes and consumer needs, and at the same time modify product function and style when appropriate, in order to stay competitive in this market. During the year under review, major raw materials prices like fluff pulp was on average lower than the previous year. Furthermore, appropriate adjustments in the use of materials greatly reduced our production cost. Gross profit margin of sanitary napkin products improved by 6 percentage points over the year before.

As the market demand for pantliners grows, the Group has grasped on to the opportunities and sped up in developing new pantliner products. The all-cotton pantliner series launched during the year was widely accepted by the market. Revenue from pantliner sales achieved satisfactory results, increased 5.7% to HK\$133,365,000.

Disposable diapers

Following an impressive sales growth in "Anerle" disposable diapers the year before, this business segment saw a consolidation in the year under review. Since average household income level varies from region to region, growth in the baby diaper market has been somewhat uneven. Moreover, with the aggressive sales strategies of multinational brands, and more and more smaller local manufacturers entering the market, competition continued to grow. During the year under review, the Group's disposable diaper business saw a slight drop in sales to HK\$253,561,000.

Given the fact that the market penetration rate of baby diapers in China remains low, as household income increases, the baby diaper market will still have ample room for growth. The Group will continue improving its product quality and functions and with our increased resources being put in promoting our products at the retail level coupled with an enhanced brand positioning, we are confident that our baby diaper sales will attain satisfactory growth in the coming years.

On the other hand, as domestic demand for adult diapers is still relatively mild, "ElderJoy" contributes only an insignificant amount to the Group's revenue. Sales of adult diapers amounted to HK\$10,827,000 during the year, of which HK\$5,747,000 were export sales. As the Chinese social welfare and healthcare system gradually improves, demand for adult diapers is believed to grow, and the Group is optimistic about the future of this market. In addition, the Group will develop further the Group's export business in order to increase the sales of adult diapers.

Skin Care products business

During the year, the Group formally entered into the skin care products business by establishing Hengan Li Ren Tang (Jian) Cosmetics Co., Ltd. (恒安麗人堂(吉安)日化有限公司). The products are traded under the brand name "Missmay" that broadens the Group's product line into skin cleansing and care area.

Distribution business

In order to take full advantage of the established domestic distribution network set up by the Group, it continued to act as a distributor for a related tissue paper manufacturer throughout China. With the gradual improvement in living standards, the demand for high-end tissue paper products increased. Having benefited from the impressive sales of the tissue paper products during the year under review, commission income for the Group increased to HK\$15,759,000 (2001: HK\$6,562,000).



Turnover by Regions



Fujian	2002	2001
Sales Value: (HK\$ million)	448	539
Percentage of Total Sales:	40.2%	44.3%

Eastern	2002	2001
Sales Value: (HK\$ million)	139	145
Percentage of Total Sales:	12.5%	11.9%

Northern	2002	2001
Sales Value: (HK\$ million)	165	160
Percentage of Total Sales:	14.8%	13.1%

Central	2002	2001
Sales Value: (HK\$ million)	155	159
Percentage of Total Sales:	13.9%	13%

South-western	2002	2001
Sales Value: (HK\$ million)	197	209
Percentage of Total Sales:	17.7%	17.2%

Sales and Marketing Strategies

Having to face such a competitive market environment, the Group puts much effort in increasing its alertness when it comes to modifying its sales strategies. Already set foot in a nationwide sales network, the Group further enhanced its distribution channels. On the one hand, we strived to perfect our existing traditional distribution channels by balancing our sales teams and building better partner relationship with distributors. In order to distinguish our unique brand image and product quality, the Group engaged Ms. Wang Nan, a table tennis Olympics champion, as our product spokesperson. Driven by advertisements and promotions, the quality of our products was clearly brought out and that product image also drilled deep into the consumers' minds as well as being recognized.

Furthermore, the Group will continue to build and establish a modern sales channel, focusing on management and collaboration with the key accounts, strengthening shop and shelf space management and increasing sales through the modern distribution channels. In addition, the Group will seek to alter all existing product packaging, with the aim of strengthening product image and branding effect.

Human resources and management

As at 31st December 2002, the Group employed 7,650 employees. Staff cost was 6.8% of the total turnover (2001: 6.7%). The Group has long been committed to providing employees with comprehensive staff training, including new staff training and continual skill development courses. Employee remuneration are given and reviewed based on market norms, individual performance and experience. Awards and bonuses are considered based on the Group's business results and the employees' individual contributions to the Group. The Group has set up a stock option plan for its executive directors and employees. However, during the year under review, no stock options were granted.

Financial position and use of funds

The Group's financial position remained healthy. As at 31st December, 2002, the Group's bank balances and cash amounted to HK\$709,751,000 with no borrowings. During the year under review, the Group applied approximately HK\$31,482,000 in the acquisition and upgrade of production equipment, office automation and construction of production plants.

Future Prospects

China's economy is growing with much anticipated opportunities arising. With a government that focuses on the force brought in by China's accession into the WTO and country stability, we believe the Chinese market will remain strong. Moreover, the continuous economic development of most cities in China will help boost the consumer market. In the past year, from product concept to distribution of final products to consumers, Hengan International has made various improvements in the operation processes. All these were done with the aim of building a more effective and solid foundation in order to continue to survive in the competition and to grab onto the opportunities that arise so as to stay ahead of the game.

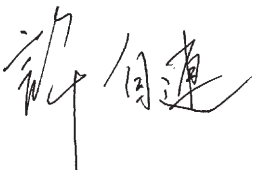
In an effort to expand its product range and capture the immense market potential of family hygiene products in the PRC, the Company has entered into an acquisition agreement with Mr. Sze Man Bok, Mr. Hui Chi Lin and Mr. Yeung Wing Chun ("Vendors") to acquire from the Vendors the shareholders' loans and the entire issued share capital of United Wealth International (Holdings) Limited ("United Wealth") on 25th March 2003. The principal asset of United Wealth is an approximate 68.9% equity interest in Changde Hengan Paper Joint Stock Company Limited, who, including its subsidiaries (together known as the "Heartex Group"), are principally engaged in the

manufacture and sale of packaged tissue paper products under a well-recognized trademark of "Hearttex" (心相印). Hearttex facial tissue paper products and hygiene tissue paper products were ranked No. 1 in terms of market share (about 17%) in 2001. The executive directors believe that the acquisition represents an invaluable opportunity for the Company to expand its product range and capture the market potential in the tissue paper industry in the PRC. Completion of this acquisition is subject to independent shareholders' approval in an extraordinary general meeting to be held on 2nd May 2003.

In order to cope with future competition, the Group's strategy for the following year is as follows:

- Continue to launch products that satisfy market demand, to increase the role of technology in our products, to raise product competitiveness, in order to bring new energy into the Group
- Strengthen product image and brand name effect. The Group fully understands product design and superior quality that satisfy consumer demands are important factors in the consumer product industry. The Group will continuously implement strategies that would raise brand awareness, in order for our products to hold a place in consumers' minds
- Continue to enrich our parallel distribution strategy in adopting both traditional and modern distribution channels, in order to distribute the Group's products in the most effective way
- Continue to strengthen our approach in product advertising, to bring out the uniqueness and quality of the Group's products. Our marketing department will systemize the management of nationwide and regional promotion of our products, so as to achieve higher promotion efficiency
- To further make use of the skills and expertise brought in by the consultants with whom we worked over the past year on process improvement. We will strive to reinforce internal control and corporate governance and to implement effective cost and operation efficiency, so as to improve the Group's overall efficiency and increase return for shareholders

Pro-active implementation of "new products, new market" will be a significant turning point for Hengan International's business. Being in a market filled with forceful competition, the Group will do everything it can to strengthen its core competitiveness, and at the same time seek for new business opportunities through synergetic mergers and acquisitions that can enhance the Group's product range. In addition, the Group will continue its efforts in developing its exporting business, to better position its products in the integrated global market, and to bring even better returns for Hengan International's shareholders.



Hui Chi Lin

Chief Executive Officer

Hong Kong, 25th March 2003