

Report of the Directors

The Directors have pleasure in presenting herewith their report together with the audited accounts for the year ended 31st December 2002.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The principal activities of the subsidiaries are manufacturing, distribution and sale of personal hygiene products comprising sanitary napkins and disposable diapers, mainly in the People's Republic of China (the "PRC").

(a) An analysis of the Group's turnover and contribution to the operating profit by business segments is as follows:

| | 2002 | | 2001 | |
|---|----------------------|---|----------------------|---|
| | Turnover HK\$'000 | Contribution to operating profit HK\$'000 | Turnover HK\$'000 | Contribution to operating profit HK\$'000 |
| Sanitary napkins and disposable diapers | 1,047,852 | 198,568 | 1,140,345 | 230,770 |
| Hygiene materials and others | 67,552 | 5,182 | 77,409 | 7,948 |
| | <u>1,115,404</u> | <u>203,750</u> | <u>1,217,754</u> | <u>238,718</u> |

(b) The geographical analysis of the Group's turnover is shown as follows:

| | 2002 | | 2001 | |
|-----------------|----------------------------|------------------------------|----------------------------|------------------------------|
| | Turnover (HK\$ million) | Percentage of total sales | Turnover (HK\$ million) | Percentage of total sales |
| The PRC | | | | |
| Northern | 165 | 14.8 | 160 | 13.1 |
| Eastern | 139 | 12.5 | 145 | 11.9 |
| Fujian | 448 | 40.2 | 539 | 44.3 |
| Central | 155 | 13.9 | 159 | 13.0 |
| South-western | 197 | 17.7 | 209 | 17.2 |
| Overseas | <u>11</u> | <u>0.9</u> | <u>6</u> | <u>0.5</u> |
| | <u>1,115</u> | <u>100</u> | <u>1,218</u> | <u>100</u> |

RESULTS AND APPROPRIATIONS

The results for the year are set out in the consolidated profit and loss account on page 29.

The Directors had declared an interim dividend of HK 8 cents per share, totalling HK\$79,625,000, which was paid on 4th October 2002.

The Directors recommend the payment of a final dividend of HK 10 cents per share, totalling HK\$99,531,000.

RESERVES

Details of the movements in reserves of the Group and the Company are set out in note 24 to the accounts.

DONATIONS

Charitable and other donations made by the Group during the year amounted to HK\$3,777,000 (2001: HK\$1,286,000).

FIXED ASSETS

Details of the movements in fixed assets of the Group are set out in note 12 to the accounts.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 22 to the accounts.

FIVE-YEAR FINANCIAL SUMMARY

A summary of the consolidated results of the Group for the last five financial years and of its consolidated assets and liabilities as at the end of the last five financial years is set out on pages 4 and 5.

PURCHASE, SALE OR REDEMPTION OF SHARES

The Company did not redeem any of the Company's shares during the year. Neither the Company nor any of its subsidiaries had purchased or sold any of the Company's shares during the year.

DIRECTORS

The Directors during the year were:

Executive Directors

Mr. Sze Man Bok
Mr. Hui Chi Lin
Mr. Yeung Wing Chun
Mr. Hung Ching Shan
Mr. Zhang Shi Pao
Mr. Poon Fuk Chuen
Mr. Xu Da Zuo
Mr. Xu Chun Man

Independent Non-Executive Directors

Mr. Chan, Henry
Mr. Chu Cheng Chung (appointed on 19th June 2002)
Ms. Guan Tao
Ms. Wong Ying Kay, Ada

In accordance with Articles 99 and 116 of the Company's Articles of Association, Mr. Zhang Shi Pao, Mr. Xu Da Zuo, Mr. Xu Chun Man and Mr. Chu Cheng Chung retire, and being eligible, offer themselves for re-election.

DIRECTORS' SERVICE CONTRACTS

Each of the Executive Directors has entered into a service contract with the Company for an initial term of three years and continuing thereafter on an annual basis until terminated by not less than three months' notice in writing served by either party.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical details of Directors and senior management are set out on pages 16 to 18.

DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance in relation to the Company's business to which the Company or any of its subsidiaries was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

CONNECTED TRANSACTIONS

1) The related party transactions entered into by the Group during the year ended 31st December 2002 as disclosed in note 27 to the accounts constituted connected transactions under the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").

The transactions disclosed in note 27 to the accounts were conducted by the Group in accordance with the waiver granted by the Stock Exchange. In respect of these transactions:

(a) The Independent Non-Executive Directors of the Company have reviewed and confirmed that:

- (i) the transactions have been entered into in the ordinary and usual course of business of the Group;
- (ii) the transactions have been entered into on an arm's length basis and on normal commercial terms;
- (iii) the transactions are on terms that are fair and reasonable so far as the shareholders of the Company are concerned;
- (iv) the transactions have been entered into either (1) in accordance with the terms of the agreements governing such transactions, or (2) where there is no such agreement, on terms no less favourable than terms available to third parties so far as the shareholders of the Company are concerned;
- (v) in the year ended 31st December 2002, the aggregate amounts of tissue paper purchased by the Group do not exceed 3% of the total cost of sales of the Group for that year; and
- (vi) in the year ended 31st December 2002, the aggregate commission receivable by the Group from the distribution of packaged tissue paper products does not exceed 3% of the Group's consolidated audited net tangible assets for that year.

(b) In the opinion of the Directors, the transactions have been entered into in the manner as stated in paragraph (a)(i) to (vi) above.

- 2) Pursuant to an acquisition agreement dated 25th March, 2003 ("Acquisition Agreement") entered into between the Company and Messrs. Sze Man Bok, Hui Chi Lin and Yeung Wing Chun ("Vendors"), the Company shall acquire from the Vendors the shareholders' loans and the entire issued share capital of United Wealth International (Holdings) Limited, principal assets of which is the holding of approximately 68.9% equity interest in Changde Hengan Paper Joint Stock Company Limited, a group of companies engaging in the manufacture and sale of packaged tissue paper products in the PRC.

Under the terms of the Acquisition Agreement, the consideration for the acquisition comprises an initial consideration of HK\$375,000,000 and an earn-out payment of up to HK\$41,130,000. The initial consideration will be satisfied by cash payment of HK\$262,500,000 and the issue of a total of 44,554,455 consideration shares of the Company at HK\$2.525 per share. The initial consideration represents a price-earnings multiple of 6.884 times of the guaranteed 2003 profit of HK\$54,472,000 undertaken by the Vendors.

The Executive Directors believe that this acquisition represents an invaluable opportunity for the Group to expand its product range and capture the market potential in the tissue paper industry in the PRC. The Acquisition constitutes a discloseable transaction for the Company under the Listing Rules and as the Vendors are also Directors and, except for Mr. Yeung, substantial shareholders of the Company, the acquisition also constitutes a connected transaction for the Company. Completion of this transaction is, amongst other things, subject to approval by the independent shareholders in an extraordinary general meeting to be held on 2nd May, 2003.

DIRECTORS' INTERESTS IN EQUITY OR DEBT SECURITIES

At 31st December 2002, the interests of the Directors in the shares, warrants and options of the Company, as recorded in the register maintained by the Company under Section 29 of the Securities (Disclosure of Interests) Ordinance or as notified to the Company were as follows:

Ordinary share of HK\$0.10 each of the Company

| Name of Directors | Number of shares | Nature of interest | Percentage of interest |
|---------------------|------------------|--------------------|------------------------|
| Mr. Sze Man Bok | 220,286,000 | Personal interest | 22.1324% |
| Mr. Hui Chi Lin | 200,000,000 | Personal interest | 20.0942% |
| | 6,630,224* | Family interest | 0.6661% |
| Mr. Yeung Wing Chun | 41,250,000 | Personal interest | 4.1444% |
| | 45,619* | Family interest | 0.0046% |
| Mr. Hung Ching Shan | 9,120,000 | Personal interest | 0.9163% |
| Mr. Zhang Shi Pao | 14,644,027* | Personal interest | 1.4713% |
| Mr. Xu Da Zuo | 20,270,135* | Personal interest | 2.0366% |
| Mr. Xu Chun Man | 19,783,445* | Personal interest | 1.9877% |

* These interests were held by Hengan International Investments Limited, a nominee company holding shares of the Company on behalf of certain directors and senior management of the Group and their family members.

Apart from the above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the Directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures, of the Company or any other body corporate.

SHARE OPTION SCHEME

Under the existing share option scheme ("Existing Scheme") approved by the shareholders of the Company on 10th November 1998, the Directors may, at their discretion, within a period of ten years from 10th November 1998, make offers to Executive Directors or employees of the Group to take up options to subscribe for shares of the Company, subject to the terms and conditions stipulated therein. Up to the date of this report, no options had been granted under the Existing Scheme.

The Board considers that it is not appropriate (and can be misleading) to state the value of all options that can be granted under the Existing Scheme as if they had been granted on the latest practicable date as a number of variables which are crucial for the calculation of the option value cannot be determined. Such variables include the exercise price, exercise period, lock up period (if any), performance targets set (if any) and other relevant variables.

Consequential upon the amendments made to Chapter 17 of the Listing Rules which came into effect on 1st September 2001, the Existing Scheme no longer complies with the amended rules governing the share option scheme. In order to enable the Company to reward or provide incentives to employees by way of having them acquiring ownership interests in the Company, the board of directors proposes to adopt a new share option scheme ("New Scheme") that will be in compliance with the amended rules and at the same time, terminate the Existing Scheme. The New Scheme will become effective upon approval being obtained in the forthcoming annual general meeting. The New Scheme will remain in force for 10 years commencing on 2nd May 2003, the day of passing of the ordinary resolution. The major change in the terms of the rules, amongst other things, is the broadening of the class of participants to include independent non-executive directors and employees working on a part-time basis.

SUBSTANTIAL SHAREHOLDERS

At 31st December 2002, the register of substantial shareholders maintained under Section 16(1) of the Securities (Disclosure of Interests) Ordinance shows that the Company had not been notified of any substantial shareholders' interests, being 10% or more of the Company's issued share capital, other than those of the Directors as disclosed above.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

MAJOR CUSTOMERS AND SUPPLIERS

During the year, the Group purchased less than 30% of its goods and services from its five largest suppliers and sold less than 30% of its goods and services to its five largest customers.

CORPORATE GOVERNANCE

The Directors are of the opinion that the Company has been in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules throughout the year, except for Guideline 7 that non-executive directors of the Company were not appointed for a specific term as they are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Company's Articles of Association.

AUDIT COMMITTEE

The written terms of reference which describe the authority and duties of the Audit Committee were prepared and adopted with reference to "A Guide for the Formation of an Audit Committee" published by the Hong Kong Society of Accountants.

The Audit Committee provides an important link between the Board and the Company's auditors in matters coming within the scope of the group audit. It also reviews the effectiveness of both the external and internal audit and of internal controls and risk evaluation. The committee comprises four independent non-executive directors, namely Mr. Chan, Henry, Ms. Guan Tao, Ms. Wong Ying Kay, Ada and Mr. Chu Cheng Chung. Two meetings were held during the current financial year.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association and there is no restriction against such rights under the laws of the Cayman Islands.

PENSION SCHEME

The Group participates in defined contribution retirement schemes administered by local government in different part of China ("Central Schemes"). The Group also maintains a defined contribution pension scheme ("Hengan Scheme") for those full time employees who wish to participate in the Hengan Scheme on a voluntary basis. Both the Group and the employees are required to make cash contribution calculated as a percentage of the employees' basic salaries to either the Central Schemes or the Hengan Scheme. The funds of the Hengan Scheme are placed with a local financial institution and are managed by a representative committee of the Group's employees.

With effect from 1st December 2000, the Group also operated the mandatory provident fund scheme (the "MPF Scheme") for its Hong Kong staff. The MPF Scheme is a defined contribution retirement benefit scheme administered by independent trustees. The employer and the employee have to contribute in total an amount equal to 10% of the relevant income of the employee to the MPF Scheme. The maximum contribution by the Group and each relevant employee is subject to a cap of HK\$1,000 per month. Contributions from the employer are vested in the employees as soon as they are paid to the relevant MPF Scheme but all benefits derived from the mandatory contributions must be preserved until the employee reaches the retirement age of 65 subject to a few exceptions.

The aggregate employer's contributions under the above schemes dealt with in the profit and loss account of the Group for the year ended 31st December 2002 amounted to approximately HK\$1,718,000.

AUDITORS

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Sze Man Bok

Chairman

Hong Kong, 25th March 2003