Management Discussion and Analysis

Mr. Yum Chak Ming, Matthew
Managing Director

"Our continuing focus on innovation and the rollout of new printing applications enabled us to maintain our competitive edge."

Global economic fluctuations persisted, especially during the last few months of the year, but the Group achieved steady growth of 12% in revenue. Paper price fluctuations throughout the period, combined with the war on Iraq in the final quarter, impacted our cost of sales. Increases in paper, material and freight costs have resulted in pricing pressure and pressure on margins. However, the trend of manufacturers globally outsourcing their production to low-cost locations such as China continued, contributing to a significant increase in our export sales of printing and packaging products.

Our paper trading division was able to benefit from paper price adjustments and sound inventory policies to achieve a growth of 49% in operating profit. In addition, our marketing efforts in export markets such as the US and Europe resulted in an increase of 12% and 16% respectively in our revenues from these regions.

An analysis by business division is as follows:

	Turnover			Contribution to operating profit		
	2003 HK$'000	%	% change from 2002	2003 HK$'000	%	% change from 2002
Paper and carton box printing and manufacturing	1,112,078	61	+8	239,099	78	+6
Paper trading	267,608	15	+16	34,964	12	+49
Corrugated carton manufacturing	438,647	24	+20	41,063	13	-27
Elimination	—	—	—	286	—	-5
	1,818,333	100	+12	315,412	103	+3
Interest and dividend income				9,693	3	-32
Corporate and unallocated expenses				(19,686)	-6	+14
				305,419	100	+1

PAPER AND CARTON BOX PRINTING AND MANUFACTURING

Our largest division continued its trend of steady growth, with an increase of 8% in turnover over the previous year. Despite pricing pressure and fluctuations in material prices, this division recorded an increase of 6% in profit from operating activities.

This division diversified its customer base, both geographically and in terms of industry sector. Advances were made in the mainland China market as the local economy remained robust and demand for quality packaging for branded consumer products continued to increase. We were also able to secure projects in a wide range of industries including the processed food, health care, personal hygiene, consumer electronics and household appliance sectors, further expanding our customer base.

Paper consumption for this division showed a steady growth of 8%, reflecting customer demand in both China and export markets. With demand, particularly for children's books and packaging products, continuing to increase in overseas markets, our export sales showed an increase of 17%, accounting for 23% of the Group's turnover. Europe and the US remained our largest export markets, but we were successful in making further inroads into other markets such as Australia, Canada, Mexico and Korea.

Although demand stayed steady, this division faced strong pricing pressure and competition. We were able to deliver value to our customers at competitive prices due to our vertically integrated business and economies of scale achieved with our large-scale facilities in mainland China. Our continuing focus on innovation and the rollout of new printing applications also enabled us to maintain our competitive edge.

PAPER TRADING

This division capitalized on paper price adjustments to achieve an increase of 16% in turnover. Increased external sales and strong demand for paper from internal manufacturing divisions also contributed to the division's 49% increase in profit from operating activities.

Sales growth was mainly driven by the division's ability to offer paper at different grades to suit specific customer demands. Due to our prudent inventory management policies, this division was able to achieve growth from companies who were looking to increase their paper inventories during a period of paper price fluctuation.

Management Discussion and Analysis

Construction continues at our Shenzhen distribution and warehouse facility. The foundation has been completed and construction on the superstructure is under way. Due to new regulatory requirements, the facility's design plan was modified and we anticipate the construction will be completed in the third quarter of 2003. When completed, the facility will allow the division to enhance its service capabilities and sell directly to China's domestic market, further improving its competitiveness and the potential to grow its market share.

CORRUGATED CARTON MANUFACTURING

This division was positively impacted by the strong performance of the Chinese economy and registered an increase in turnover of 20%. However, paper price adjustments and aggressive competition resulted in a squeeze on margins, leading to a decline of 27% in profit from operating activities.

Competition intensified as more players entered the Pearl River delta market in southern China. The division countered the competition with aggressive marketing which included the recruitment of additional sales staff and the development of a wider selection of products tailored to the needs of the customers. As a result, the division was able to increase sales to both new and existing customers in sectors such as food and beverage, toys, electrical appliances and computer accessories. With the growth in sales volume, the division was able to achieve greater efficiencies and economies of scale, enabling it to relieve some of the pricing pressure.



The new German corrugator became operational in the second half of last year, greatly enhancing the division's ability to offer top quality products to high-end customers. With increased capacity and volumes, the division is well poised to meet the growing demand in the mainland China market. We will continue with our marketing efforts in order to increase the volumes of this division further, combined with effective cost controls to maintain our margins.

ASSOCIATES

Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited
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The Group's associates, Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited and Zhongshan Ren Hing Paper Manufacturing Company Limited, were able to benefit from paper price adjustments to increase the Group's share of the associates' profits by 82% to HK$9.7 million. In addition, the strong demand from the Chinese domestic market for corrugated paper also had a positive impact on the volumes of these associates.

Zhongshan Ren Hing Paper Manufacturing Company Limited became operational towards the middle of last year. Our fourth paper-making production line at their facility is now operational and has resulted in an enhancement of our capacity. Planning is underway to upgrade one of the paper-making production lines at Zhongshan Rengo Hung Hing Paper Manufacturing Company Limited to enhance our technical capabilities further.

Management Discussion and Analysis

NEW PRINTING AND CORRUGATING FACILITY IN WUXI

Construction at our new printing and corrugating facility in Wuxi has been completed and machinery is in the process of being installed. Bad weather conditions at the end of 2002 had affected the progress of the construction. The outbreak of SARS in March 2003 also resulted in overseas engineers postponing their trips to China, causing a delay in the installation of machinery at the plant. Therefore, completion of the facility has been rescheduled to the third quarter of 2003.

The Wuxi plant is a significant investment that will help the Group diversify its customer base and penetrate further into the China domestic market. Once it becomes operational, we will be able to supply quality packaging to the eastern and northern China markets, areas which offer huge growth potential.

FINANCIAL AND CAPITAL RESOURCES

The Group's capital expenditure during the year amounted to HK$125 million, of which HK$84 million was spent on land acquisition and plant construction and HK$41 million was spent on machinery and equipment.

The Group invested HK$50 million and HK$27 million in the Wuxi plant and the Shenzhen distribution and warehouse facility respectively. This constituted the bulk of the Group's spending on land acquisition and plant construction. With regard to investments in machinery and equipment, we added two flexo printers and one offset press at our plants in Zhongshan and Shenzhen.

We have committed HK$61 million for machinery and equipment for our Wuxi plant and we expect that our total capital expenditure for the next fiscal year will be approximately HK$150 million.

As of 31 March 2003, our total bank borrowings were HK$185 million, of which HK$95 million was in short term borrowings repayable within one year and HK$90 million was in long term borrowings repayable within two to five years. To take advantage of the prevailing low interest rates in Hong Kong, we utilized more of our Hong Kong dollar loan facilities on a long term basis, and borrowed mainly in Hong Kong dollars. Of our total bank borrowings, HK$132 million was in Hong Kong currency and HK$53 million was in U.S. dollars and Renminbi.

Overall, the Group had a higher level of borrowings throughout the year under review, and despite the decline in interest rate, our interest expenses declined only slightly by 14% to HK$6.12 million. On the other hand, the decline in interest rate negatively impacted our interest income from surplus cash placed on short term deposit, which decreased by 32% to HK$9.44 million.

As a result of our effective financial management, we were able to maintain a strong cash position. At 31 March 2003, we had cash on hand of HK$385 million, and after deducting our bank borrowings of HK$185 million, we had cash net of debt of HK$200 million. Our total bank borrowings as a ratio to shareholders' equity was 11%, representing a low gearing ratio.

Our strong financial position has allowed the Board to recommend to distribute the same dividend to our shareholders as last year.

EMPLOYEES

As at 31 March 2003, the Group (excluding its associates) employed a total of 9,156 staff in Hong Kong and China. Of the total, 267 were employed in Hong Kong and 8,889 in China.

The Group continued to train its employees in technical and safety skills and provide all-round employee development. In response to the SARS outbreak, we have already put new safety policies and plans for business continuity into place at our facilities in mainland China and Hong Kong. The management will make it a top priority to ensure that all members of our staff are well protected and appropriate preventive measures are put into place wherever required.

The management gratefully acknowledges the commitment and skill of Hung Hing's staff, without which it would not be possible to grow or perform in this competitive marketplace. We look forward to continuing to work with them in the coming years.

Yum Chak Ming, Matthew
Managing Director

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