MANAGEMENT DISCUSSION AND ANALYSIS

The Group continued with its trend of steady progress during the period under review.

For the six months ended 30 September 2003, total turnover was HK$1,118 million, an increase of 9 per cent over the comparable period last year. Profit from operating activities grew by 7 per cent to HK$208 million, as a result of the improved economic outlook, which resulted in increased turnover, as well as prudent cost management policies.

The Group's tax expenditure was higher by 49 per cent than previous period, mainly because the preferential tax period came to an end for its China subsidiaries classified as "Advanced Technology Enterprises". The Group also made additional provision for Hong Kong profits tax as a result of the growth in the Group's profit and the increase in Hong Kong profits tax rate from 16 per cent to 17.5 per cent. These items resulted in profit attributable to shareholders declining marginally by 1 per cent from the previous period to HK$164 million.

The Board of Directors has declared an interim dividend of HK9.5 cents per share for the current financial period.

During the period from April to June 2003, the Group's business faced the short-term impact of regional macro-economic issues such as the SARS crisis and its resultant economic slowdown, which led to a lag-effect on orders. However, as the SARS crisis abated, the second quarter of the period under review saw a revival in business volumes. Paper price adjustments persisted throughout the period under review and this factor, coupled with increased competition in mainland China, led to pressure on margins.

The Group also continued to make ongoing investments for future growth by investing in additional facilities in Wuxi, near Shanghai, and by making enhancements to its existing factories and warehouses in China.

Gaining share in China and export markets

As the global business environment began to show signs of a recovery in the short term, the Group continued its aggressive marketing efforts, resulting in an improvement in sales from mainland China, as well as the export markets of the US and Europe, by 19, 23 and 15 per cent respectively. The Group has been able to take advantage of two favourable macro-economic trends — the growing trend of multinational companies looking to benefit from outsourcing, and the robust mainland China economy which continues to provide a wide range of business opportunities, particularly in the more northern areas.

China: The mainland China economy continues to benefit from positive developments such as its WTO accession and the 2008 Beijing Olympics. Consumer demand remains strong, particularly in branded consumer products such as in the food and personal hygiene sectors, resulting in growth opportunities for the Group's printing and packaging products. The Group has followed an aggressive marketing and expansion strategy to tap into this market, with facilities set up in Wuxi, a city near Shanghai, to supply products into the interior Chinese market.

Gaining share in China and export markets *(continued)*

The US: More and more multinational companies are interested in pursuing centralized packaging programs to achieve better control of quality and costs. As a result of this, the Group has seen a strong increase in demand from the US, particularly for children's books and contracts from large multinationals headquartered there. The Group's focus on delivering value-added and "single window" service is proving effective to maintain a foothold in this market.

Europe: The Group has seen a strong increase in demand, particularly from European Union markets such as Germany. The Group stayed very competitive in terms of exports to Germany because of a strong Euro, and has also appointed a new local agent to better capitalize on the opportunities offered by this market.

Paper and Carton Box Printing and Manufacturing

This division capitalized on volume growth in both mainland China and overseas export markets to record an increase of 16 per cent in turnover. This growth was driven by orders from new clients as well as by increased volumes from existing clients. The first quarter, which was directly influenced by the SARS crisis in Hong Kong and mainland China, was a relatively "low" period, with the second quarter seeing a revival in business volumes.

The division recorded an increase in volume of 10 per cent over the same period last year and accounted for 65 per cent of the Group's turnover for the period. The division's contribution to the Group's profit from operating activities was 81 per cent, an increase of 13 per cent from the same period last year.

Paper Trading

Paper prices remained high and fluctuating during the period under review. Slow demand levels during the first quarter, as well as pricing pressure from paper mills in China, resulted in this division recording a turnover of HK$149 million, a decrease of 9 per cent from the corresponding period last year.

The Group is presently following a long-term inventory management strategy of reducing its stock levels in Hong Kong, which again contributed to the lower turnover levels, and building them up at the Shenzhen distribution and warehouse facility. This facility, equipped with slitting and sheeting machines, is due for completion in the fourth quarter of this year. The Group is cautiously confident that this division would be able to achieve growth once the Shenzhen facility is in operation.

Prudent inventory policies during earlier months proved useful, allowing this division to profitably sell stock acquired at lower prices.

Corrugated Carton Manufacturing

This division recorded an increase in turnover of 5 per cent. This was driven in part by volume growth of 9 per cent. The emergence of low-priced competition in China, combined with adjustments in paper prices throughout the period under review, served to put pressure on margins.

The new corrugator installed at the Shenzhen facility has become fully operational. As part of the Group's overall marketing strategy to enhance its competitiveness, the Group will further augment its capacity by adding a new corrugator facility in Zhongshan.

Associates

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

The Group's 35 per cent-owned joint ventures in Zhongshan were impacted by paper price fluctuation, combined with lower levels of demand particularly during the SARS period. As a result, the Group's share of profits from these associates dropped by 35 per cent during the period under review.

The Group has strengthened the management team which can be expected to lead to improved performance for the remainder of the financial year.

Liquidity and Capital Resources

During the period under review, the Group's capital expenditure amounted to HK$118 million, of which HK$76 million was invested in the new plant in Wuxi.

The Group continued to leverage its Hong Kong dollar loan facilities. Total bank borrowings at 30 September 2003 amounted to HK$190 million, of which HK$160 million was in Hong Kong currency and HK$30 million was in US dollars. With a higher level of borrowings, interest expenses increased by 2% to HK$2.98 million.

As at 30 September 2003, the Group had cash on hand of HK$231 million and, after deducting bank borrowings of HK$190 million, held cash net of debt amounting to HK$41 million.

With the ongoing expansion plans in China, and in order to take advantage of the low interest rate environment in Hong Kong, the Group anticipates the increased use of its Hong Kong dollar loan facilities.

Prospects

Encouraging signs in macro-economic performance and improved consumer confidence in key export markets enabled the Group to face the second half of the current financial year with cautious optimism.

In the near future, the Group expects paper prices to face a further period of adjustment before they stabilize. This has both positive and negative implications on the different business divisions. The Group will continue to provide value-added services, build upon its reputation for quality and reliability, and continue with its policies of prudent management and stringent cost controls.

The Group continues to invest in facilities for the future. Programs in place include a new planned factory building in Shenzhen, extension of existing facilities in Zhongshan, and the acquisition of new equipment for its paper distribution and warehouse facility in Shenzhen.

With the recovery in consumer confidence globally and its emphasis on high-quality and reliable partners, the Group believes that its excellent products, efficient processes and strong capacity render it well-placed to benefit from new opportunities.