

## GROUP RESTRUCTURING

Hop Fung Group Holdings Limited (the “Company” and together with its subsidiaries, the “Group”) was incorporated in the Cayman Islands on 28th March, 2003 as an exempted company with limited liability under the Companies Laws, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

Pursuant to a group reorganisation scheme (the “Group Reorganisation”) to rationalise the structure of the Group in preparation for the listing of the Company’s shares on the Main Board of the Stock Exchange, on 25th August, 2003, the Company issued shares in exchange for the entire issued share capital of the former holding company of the Company’s subsidiaries, and thereby becoming the holding company of the Group. Details of the Group Reorganisation and the public offer and placing of shares in the Company are set out in the prospectus dated 15th September, 2003 issued by the Company (the “Prospectus”).

The shares of the Company have been listed on the Stock Exchange with effect from 24th September, 2003 (the “Listing Date”).

The Group resulting from the Group Reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group have been prepared using the principles of merger accounting in accordance with the Statement of Standard Accounting Practice 27 “Accounting for Group Reconstructions” issued by the Hong Kong Society of Accountants.

## FINANCIAL SUMMARY

For the year ended 31st December, 2003, the Group’s turnover increased by approximately 50.6% to approximately HK\$592,554,000 (2002: HK\$393,574,000). Profit for the year increased by approximately 48.7% to approximately HK\$55,687,000, approximately 5.1% higher than the profit forecast of not less than HK\$53,000,000 as stated in the Prospectus. Basic earnings per share was approximately 18.8 HK cents. The Directors had recommended the payment of a final dividend of 1.26 HK cents per share for the year ended 31st December, 2003, represented approximately 30% of the distributable profits for the period from the Listing Date to 31st December, 2003.

## BUSINESS REVIEW

Despite that 2003 was an extremely challenging year, the Group had recorded satisfactory results with the dedication of its management team and staff.

The Severe Acute Respiratory Syndrome (“SARS”) outbreak and the Iraq war in the first half of the year had a dampening effect on the local economy. However, as the Group is principally engaged in the manufacture and sales of corrugated paper-ware products, and its customers mainly use the Group’s products for the packaging of their products for export purposes, the overall performance of the Group has not been affected materially. On the contrary, the recovery of the US and European economies provided a favorable operating environment for the Group’s corrugated paper-ware business.

## BUSINESS REVIEW *(Continued)*

Furthermore, the management has well recognised the increasing demand for corrugated paper-ware products. In order to capture the huge business opportunities arising from the continuing growth of the PRC export market, the management has been actively upgrading its production facilities since the end of 2002 to further enhance the Group's production and processing capacities. In 2003, the production capacity has increased by about 20%, boosting the Group's turnover and enhancing the competitive advantages of the Group in the industry.

The Group's success also leverages on its established and diversified customer base. At present, the Group has over 300 stable customers engaged in various businesses, including renowned consumer and industrial product manufacturers, paper-ware product distributors, suppliers and trading companies. Furthermore, the Group has always been dedicated to the development of high value-added and high quality corrugated paper-ware products so as to enhance its profit margins. During 2003, the Group successfully captured several new customers and obtained considerable orders. The Group also introduced heavy duty corrugated paper boards and large-sized corrugated carton boxes with high quality environmental friendly flexo-printing to provide high value-added and high quality corrugated paper-ware products to its customers.

During the second half of the year under review, the economy and the manufacturing sector recovered remarkably following the containment of SARS and end of the Iraq war, with the momentum of the export manufacturing sector being particularly strong, which drove up the prices of various raw materials. In face of the opportunities and challenges brought about by the thriving market and the price increase of raw materials, the Group has adopted stringent cost controls. Together with flexible sale strategies and a high value-added and high quality product mix, it has successfully minimized the impact of the price increase of raw materials on its profit margins. During the year under review, the Group's gross profit margin and net profit margin were approximately 21.1% (2002: 22.9%) and 9.4% (2002: 9.5%) respectively.

## PROSPECTS

With the rapidly developing global trend of outsourcing production, many multinational and domestic enterprises are setting up their own production facilities in the "World Factory" – the PRC. As a result, the PRC has quickly transformed into the production centre for various industrial products, pushing the continuing growth of demand for corrugated paper-ware products. This environment has created a market with enormous potentials for the Group's products. Leveraging on the supreme quality of its products and its renowned reputation, the management believes that the Group is well positioned to obtain more orders from different new customer groups, so as to expand the Group's customer base and further enhance its market presences.

As a Hong Kong-based company, the Group will continue to carry out prudent yet enterprising business strategies, with an aim to strengthening its existing market position as well as to explore and prepare for the expansion into other potential markets.

## PROSPECTS *(Continued)*

The PRC market continues to thrive since joining the World Trade Organisation, attracting foreign enterprises to invest in the country and to establish production and marketing bases in the PRC. In addition, the gradual increase in national income along with the blooming domestic economy has resulted in a strong growth in the spending power of its people. With the improvement in the standard of living and the availability of a wider range of more stylish consumer products, domestic consumers and manufacturers begin to look for packaging with better designs and qualities. As the demand for corrugated paper-ware products in the PRC is expected to increase following the establishment of new manufacturing and sales operations, the Group has established a wholly-owned foreign investment enterprise in Dongguan, Guangdong Province to explore the PRC domestic packaging market with a view to increase the Group's market penetration. This wholly-owned foreign investment enterprise has commenced full operations in March 2004, increasing the Group's production capacities by approximately 35%.

Meanwhile, the Group will continue to invest in production machinery and facilities, especially for corrugated carton boxes, in order to further enhance its production volume, quality and efficiencies. The Group looks forward to providing better corrugated paper-ware products to its customers to fulfil the huge and growing demand in the market.

In order to strengthen its vertical integration operation and with a view to lowering the cost of raw materials and improving overall profit and efficiency, the Group will further expand into upstream production operation for medium paper, so as to improve the Group's raw material supply and cost controls. It is intended that the medium paper production operation will be located at Qingyuan, Guangdong Province, which is expected to commence operation in the first half of 2005. It is anticipated that its output of medium paper will cover approximately 30% to 40% of the Group's internal aggregate demand for medium paper.

## LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The shareholders' funds of the Group amounted to approximately HK\$224.9 million (2002: HK\$107.7 million). The increase was mainly due to the net proceeds raised through the Share Offer (as defined in the Prospectus) (including the exercise of the Over-allotment Option (as defined in the Prospectus)) during the year.

The Group recorded total current assets of approximately HK\$247.6 million as at 31st December, 2003 (2002: HK\$132.4 million) and total current liabilities of approximately HK\$100.4 million as at 31st December, 2003 (2002: HK\$119.6 million). Current assets included pledged bank deposits and cash and bank deposits amounted to approximately HK\$96.5 million (2002: HK\$41.4 million) which were mainly denominated in Hong Kong dollars and United States dollars. The Group's bank borrowings amounted to approximately HK\$68.2 million as at 31st December, 2003 (2002: HK\$98.0 million). The maturity of bank borrowings comprised approximately HK\$26.5 million (2002: HK\$78.8 million) and HK\$41.7 million (2002: HK\$19.2 million) repayable within one year and repayable more than one year as at 31st December, 2003 respectively. The bank borrowings of the Group are predominantly subject to floating interest rates.

## LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE (Continued)

As at 31st December, 2003, the Group was at a net cash position and the gearing ratio, calculated as bank borrowings less pledged bank deposits, cash and bank deposits, pledged investments in securities and pledged investment in equity-linked deposit, where applicable, divided by shareholders' equity, was approximately -16.7% (2002: 46.2%).

The current ratio of the Group, calculated by dividing the total current assets by the total current liabilities, was approximately 2.47 times as at 31st December, 2003 (2002: 1.11 times).

The improvement in both gearing ratio and current ratio during the year was mainly arising from the continuous improvement in working capital management through controls implemented on inventory level and trade debts collection period and the raising of net proceeds through the new shares issued under the Share Offer (as defined in the Prospectus) (including the exercise of the Over-allotment Option (as defined in the Prospectus)) during the year.

Transactions of the Group were mainly denominated in Hong Kong or United States dollars and so the Group did not have significant exposure to foreign exchange fluctuation and no hedging for the foreign currency transaction had been carried out during the year under review.

## CHARGES ON ASSETS

As at 31st December, 2003, pledged bank deposits, investments in securities, investment in equity-linked deposit and machinery with carrying value of approximately HK\$16.5 million (2002: HK\$13.5 million), HK\$7.3 million (2002: HK\$6.9 million), HK\$2.0 million (2002: Nil) and HK\$15.9 million (2002: HK\$29.2 million), respectively were pledged to certain banks to secure certain banking facilities granted to the Group.

## CONTINGENT LIABILITIES

As at 31st December 2003, the Group did not have any significant contingent liabilities.

## EMPLOYEES AND REMUNERATION POLICIES

As at 31st December, 2003, there was a total workforce of 554 full time staff for the Group and the processing factories.

The Group remunerated its employees mainly with reference to the prevailing industrial practice, individual's performance and experience. Apart from the basic remuneration and statutory retirement benefit scheme, discretionary bonus may be granted to eligible employees by reference to the Group's performance as well as individual performance. In addition, share options may also be granted from time to time in accordance with the terms of the Company's approved share option scheme to provide incentives and rewards to the employees.

## USE OF NET PROCEEDS FROM THE COMPANY'S INITIAL PUBLIC OFFERING

The shares of the Company were listed on the main board of the Stock Exchange on 24th September, 2003. Through the issue of 95,042,000 new shares at HK\$1.10 each, the Group had raised approximately HK\$91.5 million, after deduction of related expenses. These proceeds were partly applied during the year ended 31st December, 2003 in accordance with the proposed applications set out in the section headed "Use of Proceeds from the New Issue" of the Prospectus, as follows:

- as to approximately HK\$0.6 million for the expansion of existing manufacturing facilities for corrugated carton boxes at the processing factories;
- as to approximately HK\$10.0 million for setting up of the manufacturing operations mainly for domestic sales in the PRC; and
- as to approximately HK\$31.5 million as general working capital of the Group.

The remaining net proceeds as at 31st December, 2003 of approximately HK\$49.4 million were placed in deposit with a bank in Hong Kong. The directors of the Company (the "Directors") are of the opinion that the remaining proceeds will be applied in the coming year for their intended uses as set out in the Prospectus.