Management Discussion and Analysis

Successful listing

The Company's successful Listing on the Main Board of the Stock Exchange on 26 March 2004 represented a major milestone for the Group. Upon the Listing, the Company issued 80,000,000 new Shares at HK$2.35 per share and raised gross proceeds of HK$188,000,000. The proceeds from the share offer will be dedicated to implementing the future plans stated in the Prospectus. As a result of the Listing, the Group is at a better position to explore the vast opportunities of the People's Republic of China (the "PRC") market and to further strengthen its leadership in the industry.

Results

For the year ended 31 December 2003, the Group achieved outstanding performance and reached its record high results. Turnover increased by 21.6% from approximately HK$190,762,000 in 2002 to approximately HK$232,027,000 in 2003. Profit attributable to shareholders increased by 34.0% from approximately HK$67,346,000 in 2002 to approximately HK$90,252,000 in 2003, exceeding the profit estimate as stated in the Prospectus of not less than HK$85,000,000.

Business review

The Group's satisfactory results were mainly attributable to the significant contributions from the Group's two core businesses – cigarette package printing and laminated paper manufacturing.

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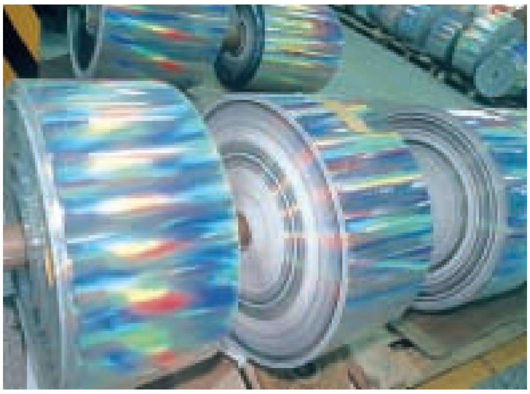
Cigarette package printing

The Group operates its cigarette package printing business through its wholly-owned subsidiary – Victory Shenzhen. For the year ended 31 December 2003, Victory Shenzhen's cigarette package printing business recorded a turnover of approximately HK$100,890,000, representing an increase of 106.4% over the previous year of approximately HK$48,878,000. This business accounts for approximately 43.5% of the Group's total turnover.

The significant increase in turnover was mainly attributable to the Group's success in securing new customers by applying its newly developed printing technologies, together with its advanced and innovative designs. These newly secured customers are mainly large state-owned cigarette manufacturers, such as Guangzhou No.1 Cigarette Factory, Mianyang Cigarette Factory and Meizhou Cigarette Factory, all of them provide profitable and steady orders and income streams to the Group. As at 31 December 2003, the Group has four long-term customers, namely Guangzhou No. 1 Cigarette Factory, Kunming Cigarette Factory, Qujing Cigarette Factory and Xinzheng Cigarette Factory, that are among the 36 key cigarette industrial enterprises identified and fostered by the State Tobacco Monopoly Administration ("STMA") of the PRC, establishing a large and solid customer base for the Group's long-term revenue generation.

Laminated paper manufacturing



The Group manufactures laminated papers through Victory Shenzhen. Victory Shenzhen currently produces two types of laminated papers – metallised laminated papers and laser laminated papers. Most of the products are sold to the Company's associated company, Nanjing Sanlong, and for the Group's own use, with the rest sold to other cigarette package printers in the PRC for printing of cigarette packages. The Group's laminated paper manufacturing business recorded a turnover of approximately HK$131,137,000 during the year (2002: approximately HK$141,884,000) which accounts for approximately 56.5% of the Group's total turnover.

In order to avoid vicious competition in the printing of cigarette packages, the Group has adopted a win-win strategy by supplying laminated papers to its competitors and this has proven to be a great success. In the last quarter of 2003, the Group secured stable orders from a few cigarette package printers which became a new contributor to the Group's turnover and net profit.

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Investment in Nanjing Sanlong

The Group is interested in 48% of the registered capital of Nanjing Sanlong, which is principally engaged in the printing of cigarette packages. As Nanjing Sanlong is an associated company of the Group, its turnover has not been consolidated into the Group's turnover. For the year ended 31 December 2003, profit contribution from the associated company amounted to approximately HK$47,901,000, representing an increase of 38.1% over the previous year of approximately HK$34,688,000. The satisfactory performance was mainly attributable to the increasing demand from Nanjing Cigarette Factory and Huaiyin Cigarette Factory, each of them is one of the 36 key cigarette industrial enterprises identified and fostered by STMA.

Production plant and facilities

The Group operates two comprehensive production plants in the PRC. Strategically located in Shenzhen and Nanjing, the Group enjoys cost effective benefits from operating in the PRC. During the year under review, the Group continued to expand its production capacity to meet the increasing market demand. The Shenzhen plant's annual cigarette package production capacity is approximately 300,000 cartons, while its annual laminated paper production capacity has reached approximately 18,000 tonnes. On the other hand, the associated company, Nanjing Sanlong, completed the expansion of its production facilities in December 2003, which doubled the annual production capacity to approximately 600,000 cartoons. It is expected that utilisation rate of the production plants will continue to increase to meet the growing market demand.

Research and development

In order to enhance competitiveness and attract more customers, the Group's R&D team has been dedicated to the R&D of cigarette package printing and laminated paper manufacturing technologies. With anti-counterfeit and environment-friendly technologies as major elements, the Group develops innovative products incorporating attractive designs. With its R&D capabilities continuously improving throughout the years, the Group has fully developed new technologies in cigarette package printing and is currently applying for invention patents for its various printing and laminating technologies. During the year under review, the Group successfully incorporated environment-friendly elements into the production of laminated papers. These include the substitution of imported materials with domestic raw materials; transferring only the aluminium layer of metallised or laser films onto papers thus eliminating the need for plastic layers; and the use of environment-friendly UV ink as raw materials and reusable holographic films as production tools. With the expected full-scale application of these technologies in 2004, the Group anticipates huge savings on production costs as well as a broadening of its customer base, injecting growth momentum to the Group's operation.

Prospects

Looking ahead, the Directors are confident that the Group will have great growth potential in respect of its two core businesses – cigarette package printing and laminated paper manufacturing. Leveraging on its vertically-integrated production process, well-established customer relationships, strategic relationship with Nanjing Sanlong (which in turn has strategic relationships with Nanjing Cigarette Factory and Huaiyin Cigarette Factory) and advanced technologies, the Group is well positioned to capture future business opportunities and expand its market share in the cigarette packaging industry.

Cigarette package printing

The Group is committed to broadening its customer base through focusing its sales and marketing efforts on large cigarette manufacturers in the PRC, particularly the 36 key cigarette industrial enterprises identified by STMA for on-going development and cigarette manufacturers which plan to launch new designs of packages for their cigarettes or new brands of cigarettes. During the first quarter of 2004, the Group has received increasing orders from both existing and new customers. As a result of well-established market recognition of the Group's capability of producing advanced and innovative cigarette packages, a significant

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number of sample making orders have been received from potential customers. In addition, with Nanjing Sanlong's new production plant commencing operation in late 2003, which have doubled production capacity as compared to the old plant, the Group believes profit contribution from Nanjing Sanlong will increase substantially in 2004. Apart from consolidating of current market share, the Group is planning to further expand its sales in Guangdong Province, Yunnan Province and Jiangxi Province, the PRC. After securing more large and prominent cigarette manufacturing customers, the Directors believe that the Group will be able to enjoy the benefits of economies of scale.

Laminated paper manufacturing

In order to enhance the Group's market penetration, the Group continuously expands its customer base for the laminated paper manufacturing business. Along with the expected increase in output of Nanjing Sanlong and the substantial increase in sales to other cigarette package printers in the first quarter of 2004, the Group's unique sales strategy has proven to be a success. The Group believes that selling self-made laminated papers to other large-scaled cigarette package printers in the PRC not only broadens its revenue stream and improves profitability, but also creates a win-win situation for both parties. In addition, with the substitution of imported raw materials with domestic raw materials, production costs in 2004 are expected to further decrease, further enhancing the Group's profitability.

Research and development

With the success in the past, the Group believes advanced technology and professionalism will generate growth momentum to support its future expansion. The Group will therefore continue to strengthen its R&D capabilities and to design new cigarette packages with advanced features and improved quality. The Group will also keep itself ahead of the PRC cigarette package printing industry where the importance of environment-friendly and anti-

counterfeit features are gradually increasing, so as to enhance its competitiveness through the development of new and advanced printing and production technologies. The Group's objectives are to further develop production technologies to minimise production costs, develop new features, as well as improve product quality to attract new customers.

Capital structure, financial resources and liquidity

Borrowing and banking facilities

As at 31 December 2003, the Group had aggregate banking and loan facilities, including those facilities from banks and finance lease creditors, of approximately HK$215.3 million of which approximately HK$143.2 million was utilised. The Group generally finances its operation with finance leases and banking facilities provided by its banks and finance lease creditors in Hong Kong and the PRC.

As at 31 December 2003, the short term borrowings of the Group of approximately HK$117.0 million were repayable within one year.

As at 31 December 2003, the obligations under finance leases of the Group amounted to approximately HK$26.2 million, of which approximately HK$11.3 million was repayable within one year, approximately HK$9.0 million was repayable after one year but within two years, and approximately HK$5.9 million was repayable after two years but within five years.

As at 31 December 2003, all short term borrowings and over 28% of the obligations under finance leases of the Group bore interest at fixed rates.

The short term borrowings and obligations under finance leases of the Group are either denominated in Hong Kong dollars or Renminbi.

Net current assets

As at 31 December 2003, the Group had net current assets of approximately HK$2.0 million. The current assets comprised inventories of approximately HK$49.1 million, trade and other receivables of approximately HK$95.1 million, prepayments and deposits of approximately HK$9.4 million, bank and cash balances of approximately HK$11.1 million and pledged bank deposits of approximately HK$25.8 million. The current liabilities comprised trade and other payables of approximately HK$60.2 million, short term borrowings of approximately HK$117.0 million and current portion of obligations under finance leases of approximately HK$11.3 million.

Capital structure

As at 31 December 2003, the Group had net tangible assets of approximately HK$139.7 million comprising non-current assets of approximately HK$152.6 million (comprising fixed assets of approximately HK$83.9 million and investment in an associated company of approximately HK$68.7 million), net current assets of approximately HK$2.0 million and non-current liabilities of approximately HK$14.9 million (comprising entirely obligations under finance leases).

Capital commitments

As at 31 December 2003, the Group had capital commitments contracted but not provided for in respect of acquisition of plant and machinery of approximately HK$6.7 million.

Working capital

Taking into account the financial resources available to the Group, including internally generated funds, the available banking facilities and the estimated net proceeds from the share offer, the Directors are of the opinion that the Group has sufficient working capital for its present requirements.

Remuneration policies and employee information

As at 31 December 2003, the Group had over 350 full time employees in Hong Kong and the PRC. Total staff costs (including directors' emoluments) amounted to approximately HK$13.1 million (2002: approximately HK$9.1 million) for the year. All full time salaried employees, except for factory workers and contract employees, are being paid on a monthly basis, plus a discretionary performance bonus. Factory workers are being remunerated based on a basic wage plus production incentive. The Group ensures that the pay levels of its employees are competitive and employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system.

In addition to salaries, the Group provides staff benefits including medical insurance and contributions to staff's provident fund. Share options and bonuses are also available to employees of the Group at the discretion of the Directors and depending upon the financial performance of the Group.

Significant investments and material acquisitions

During the year under review, the Group has no new investment or material acquisitions.

Gearing ratio

As at 31 December 2003, the Group's gearing ratio, expressed as a percentage of total borrowings over total assets was 41.7% (2002: 44.2%). The management believes that the gearing ratio is at an acceptable level for the Group and the Group would be able to create sufficient financial resources to discharge its debts.

Foreign exchange exposure

The Group does not currently have any hedging activities against its foreign exchange exposure nor does it adopt any formal hedging policies. During the year ended 31 December 2003, all of the Group's sales and purchases were settled in United States of America dollars, Hong Kong dollars and Renminbi. The Directors consider the Group's risk exposure on foreign exchange as minimal.

Contingent liabilities

At 31 December 2003, the Group has executed corporate guarantee to a bank to secure general banking facilities granted to Victory Go Group Company Limited ("Victory Go"). Pursuant to Section 161B of the Hong Kong Companies Ordinance, the maximum liability in respect of the guarantee was approximately HK$10 million, out of which approximately HK$8 million has been utilised by Victory Go as at 31 December 2003. There was no loss incurred by the Group in fulfilling its obligations under the corporate guarantee. The underlying bank had agreed to release and terminate the corporate guarantee on 26 March 2004.

Save as disclosed above, the Group did not have any other significant contingent liabilities as at 31 December 2003.