

Chief Executive Officer's Report



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CHIEF EXECUTIVE OFFICER'S REPORT

OVERALL PERFORMANCE

The mainland China economy experienced sustainable and stable growth of approximately 9.5% in 2004, and the annual commodity price increased by approximately 3.9% as compared to 2003. Meanwhile, increases in domestic commodity prices and prices of imported raw materials led to a rise in production costs. Manufacturers proactively sought for appropriate sales and marketing strategies to minimize the impact of increase in costs and to maintain satisfactory sales performance.

The mainland China personal hygiene products industry continued to record stable growth in 2004. During the past two years, mainland China was shocked by various infectious diseases which led to enhanced public awareness of personal hygiene and expedited demand for quality personal hygiene and care products. This further intensified market competition. The Group endeavored to enhance product quality and implemented a series of flexible sales and marketing strategies during the year in order to successfully consolidate its leading market position.

During the year under review, the Group's turnover amounted to approximately HK\$2,334,293,000, representing a year-on-year increase of approximately 38.2%. Profit attributable to shareholders was approximately HK\$297,930,000, an increase of approximately 16.8% as compared to the previous year. The increase in sales revenue was mainly attributable to the remarkable growth in "Hearttex" tissue paper business and sales of diapers.

Price of petrochemical materials and wood pulp, which fuelled the Group's production costs, increased during the year. However, through continuous improvement in product quality, adjustments in sales mix, improvement in production efficiency and optimization of production process and discount of wood pulp attained by bulk purchases, the Group's average gross profit margin during the year under review only recorded a slight decrease to approximately 41.3% as compared to 2003 (2003: 42.3%).

In view of the keen market competition, the Group increased its distribution costs to develop modern distribution channels. During the year under review, distribution costs accounted for approximately 19.9% of the turnover (2003: 18.9%). The Group's management implemented appropriate measures to control distribution costs during the second half of 2004. Distribution costs in the second half of 2004 was approximately 19.7% of the turnover, which was improved from approximately 20.1% for the first half of 2004.

BUSINESS REVIEW

Tissue papers

The Group's "Hearttex" products are under the high-end tissue product category in the mainland China. Currently, "Hearttex" products include facial tissues, pocket handkerchiefs, toilet rolls, wet tissues and sterilized wet tissues etc. As the living standard of domestic consumers continued to improve, market demand for high-end tissues also increased. During the year under review, tissue paper products achieved strong sales performance with the sales revenue amounted to HK\$975,802,000, an encouraging increase of approximately 1.4 times. Since 2003, the proportion of wet tissues in tissue paper business increased from approximately 0.2% to approximately 5.2%.



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Price level of petrochemical materials and wood pulp, the major raw materials used for producing tissue papers, continued to rise during the year. By improving production efficiency, increasing sales of higher margin products such as wet tissues, "Lavender Series" and "Jimmy Series" and obtaining discount through bulk purchases of wood pulp to minimize the impact of the increase in wood pulp price, gross profit margin for tissue paper business recorded a slight increase from approximately 39.4% in the previous year to approximately 41.0%.

To satisfy the overwhelming demand in the future, the Group is building two paper raw material production bases in Shandong and Fujian provinces. It is expected that these two bases will commence operation by August 2005 and second quarter of 2006 respectively. Upon the establishment of the two production bases in 2006, each of which has a production capacity of approximately 60,000 tons per year, the Group's annual production capacity for tissue paper raw material production capacity will reach 180,000 tons, representing an increase of 200% of the existing production capacity.

Sanitary napkins

The penetration rate of the mainland China sanitary napkins market exceeded 60% and started to enter into a mature stage. With lower market entry barriers for low-end sanitary napkin products, the number of market entrants continued to increase. They offer low price products, intensified market competition and imposed pressures on the sales of the Group's low-end products.

To maintain satisfactory product sales and market share, the Group not only introduced numerous brand distribution and promotion strategies during the year, but also adopted various sales management measures and product structure adjustments.

During the year, the Group's mid-to-high-end brand "Anerle" sanitary napkins, especially the "Space 7" products and "Young lady" series, received well market response. On the other hand, sales of the Group's low-end brand "Anle" sanitary napkins continued to decrease during the year, mainly due to price competition. Overall, sales revenue of sanitary napkins slightly increased by approximately 1.4%. "Anerle" sanitary napkin products accounted for approximately 70.9% of the total sales revenue for sanitary napkins business (2003: 66.7%).

During the year, as there was an increase in sales of the Group's high-end sanitary napkin products which have higher profit margins, the gross profit margin of sanitary napkins business increased slightly from approximately 46.2% in 2003 to approximately 47.3%.



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With increasing demand for high-end female hygiene products in the mainland China market, the Group will keep an eye on changes in market demand, adjust sales mix appropriately to satisfy market needs and enhance the Group's sales performance and profitability. In addition, the Group will also strengthen the strategy of utilizing modern distribution channels to enhance the marketability and popularity of our products.

Disposable diapers

With increasing disposable income per capita, the mainland China market for diapers has flourished. Consumer demand for quality disposable diapers continued to rise. The Group's diaper business benefited from the market growth and recorded impressive results in 2004.

Upon the completion of numerous quality enhancement procedures for baby diaper products, the Group launched various product series, such as "slim and comfort" as well as "dry and breathable", to meet the demand for quality baby diapers. In addition, the Group implemented various sales and marketing strategies to strengthen product promotion and effective marketing. As such, sales revenue for baby diapers attained a year-on-year increase of approximately 23.4% to approximately HK\$394,145,000. The sales of adult diapers also achieved encouraging growth with sales revenue increased by approximately 52.9% to approximately HK\$25,372,000. The gross margin of diapers business was approximately 32.1% which declined mildly when compared with that of 2003 (34.2%) due to the increase in raw material costs during the year.



As for the export business, disposable diapers accounted for 95.7% of total export sales (2003: 99.6%) of the Group.

Skin cleansing and care products

The mainland China skin cleansing and care products market experienced intense market competition. Besides, the packaging and quality of "MissMay" products are not as attractive as those of the imported skin care products. During the year under review, sales of "MissMay" products dropped by approximately 45.6% to approximately HK\$40,230,000. The Group, therefore, introduced numerous packaging and product quality improvement during the year, and by adopting new marketing strategies, the Group endeavored to attract more customers and propel product sales in the future.

First-aid products

Hengan Pharmacare Company Limited ("Hengan Pharmacare"), which is principally engaged in the manufacturing and distribution of personal care and pharmaceutical products under the brand names "Banitore", "Bandi" and "Comfitore", contributed sales revenue of approximately HK\$17,411,000 with a gross profit margin of approximately 41.3%. It is expected that the business will bring stable income for the Group.

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DISTRIBUTION AND MARKETING STRATEGIES

The Group has a nationwide distribution network. During the year, the Group proactively established sample stores in the mainland China to promote an innovative corporate image, further expand sales volume and enhance customers' confidence in our products.

In addition, the Group will continue to expand modern distribution channels. The Group will, in addition to focusing on managing the few existing national chainstores, establish business cooperation with selected influential regional hypermarkets to strengthen its modern distribution network. Meanwhile, in order to strengthen product promotion and increase face-to-face sales promotion with clients, the Group has employed numerous temporary sales and marketing professionals to promote its products in different supermarkets and hypermarkets.

Sales promotion in supermarkets and hypermarkets involved additional charges. As the Group has increasingly placed more reliance on modern distribution channels, distribution costs increased accordingly. Distribution costs of 2004 were approximately 19.9% of the total sales revenue (2003: 18.9%). The Group's management has implemented appropriate cost control measures in the second half of 2004, with a view of maintaining reasonable distribution costs and remarkable profitability.

HUMAN RESOURCES MANAGEMENT

As at 31st December 2004, the Group employed approximately 15,000 full-time and temporary employees. The Group's remuneration package is determined with reference to the experience and qualifications of the individual employee and general market conditions. Bonus is linked to the Group's financial results as well as individual's performance. The Group also ensures that all employees are provided with adequate training and continued professional opportunities according to their needs.

LIQUIDITY, FINANCIAL RESOURCES AND BANK LOANS

The Group's financial position remained healthy during the year. As at 31st December 2004, the Group's bank balances and cash amounted to approximately HK\$543,807,000 (2003: HK\$643,771,000), with short-term and long-term bank loans of approximately HK\$776,743,000 (2003: HK\$348,450,000). The Syndicated Loan Facility obtained during the year principally for financing the construction of new tissue business production facilities and for working capital purposes amounted to HK\$550,000,000 in which approximately HK\$260,000,000 was drawn as at 31st December 2004. During the year under review, the Group's capital expenditure in terms of installation and improvement of production facilities was approximately HK\$193,081,000.



The annual interest rate of bank loans ranged from approximately 0.8% to approximately 4.7%. All bank loans are unsecured (2003: approximately HK\$18,767,000 was secured by certain production facilities and raw materials of the Group). As at 31st December 2004, the Group's gross gearing ratio was approximately 37.2% (2003:19%) which was calculated on the basis of the percentage of bank loans to the total shareholders' equity. The net gearing ratio, which was calculated based on the amount of bank loans less bank balance and cash to the total shareholders' equity, was approximately 11.2% (2003: not applicable).

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FOREIGN CURRENCY RISKS

Approximately 99% of the Group's income is in Renminbi while certain of its raw materials and equipment purchases are required to be settled in US dollar, Japanese Yen or Euro dollar. The Group has never any difficulties in getting sufficient foreign currencies for settlement of the purchases or repatriation of profits declared by the subsidiaries in mainland China to the holding company in Hong Kong. As at 31st December 2004, the Group had not issued any financial instruments or entered into any contracts for foreign currency hedging purposes.

FUTURE PROSPECTS

The Group expects the mainland China economy will continue to grow and market demand for high quality consumer goods will continue to increase. With increasing consumer demand for higher product quality, the Group endeavors to enhance product quality, design and packaging and to develop more modern distribution channels, with the view of satisfying consumer demand, strengthening product popularity and reputation as well as increasing the Group's sales and market share.

Looking ahead, the Group will continue to seek and acquire appropriate products and brands, and utilize its nationwide distribution network to expedite business growth. On the other hand, the Group will tap further into overseas markets outside the mainland China.

The consumption pattern in the mainland China has entered into a new era. Consumers impose strict requirements on product quality, price and brand image. Leveraged on its distinguished product quality, extensive distribution network, renowned brand and reasonable selling prices, the Group is confident in maintaining its leading position in the competitive personal hygiene and care products market and bringing more fruitful returns to our shareholders.



Hui Lin Chit

Chief Executive Officer

Hong Kong, 22nd March 2005