

## REPORT OF THE DIRECTORS

The Directors have pleasure in presenting herewith their report together with the audited accounts for the year ended 31st December 2004.

### PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The principal activities of the subsidiaries are manufacturing, distribution and sale of personal hygiene products comprising sanitary napkins and disposable diapers, tissue paper products and skincare and cleansing products, mainly in the People's Republic of China (the "PRC").

(a) An analysis of the Group's turnover and contribution to operating profit by business segment is as follows:

	2004		2003	
	Turnover HK\$'000	Contribution to operating profit HK\$'000	Turnover HK\$'000	Contribution to operating profit HK\$'000
Sanitary napkins and disposable diapers	1,232,135	229,522	1,137,730	207,578
Tissue paper products	975,802	165,908	409,846	78,028
Skincare and cleansing products, hygiene materials and others	126,356	4,927	140,936	28,181
	<b>2,334,293</b>	<b>400,357</b>	<b>1,688,512</b>	<b>313,787</b>

(b) The geographical analysis of the Group's turnover is shown as follows:

	2004		2003	
	Turnover (HK\$ million)	Percentage of total sales	Turnover (HK\$ million)	Percentage of total sales
PRC				
Fujian and Guangdong	471	20.2	353	20.9
North-western	107	4.6	91	5.4
South-western	152	6.5	132	7.8
Sichuan	207	8.9	175	10.4
North-Eastern	191	8.2	120	7.1
Northern	244	10.4	153	9.1
Shandong	212	9.1	147	8.7
Eastern	354	15.2	228	13.5
Central	349	14.9	269	15.9
Overseas	47	2.0	21	1.2
	<b>2,334</b>	<b>100</b>	<b>1,689</b>	<b>100</b>

# REPORT OF THE DIRECTORS

## RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated profit and loss account on page 34.

The Directors have declared an interim dividend of HK 10 cents per ordinary share, totalling HK\$108,077,000, which was paid on 5th October 2004.

The Directors recommend the payment of a final dividend of HK 12 cents per ordinary share, totalling HK\$129,692,000.

## RESERVES

Details of the movements in the reserves of the Group and of the Company during the year are set out in note 24 to the accounts.

## DONATIONS

Charitable and other donations made by the Group during the year amounted to approximately HK\$847,000 (2003: HK\$4,674,000).

## FIXED ASSETS

Details of the movements in fixed assets of the Group are set out in note 12 to the accounts.

## SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 22 to the accounts.

## DISTRIBUTABLE RESERVES

The Company's reserves available for distribution comprise the share premium account and retained profits. At 31st December 2004, the reserves of the Company available for distribution to shareholders amounted to HK\$1,665,731,000 (2003: HK\$1,446,640,000), subject to the restrictions stated in note 24 (d) to the accounts.

## FIVE-YEAR FINANCIAL SUMMARY

A summary of the consolidated results of the Group for the last five financial years and of its consolidated assets and liabilities as at the end of the last five financial years is set out on pages 4 and 5 respectively.

## PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not redeemed any of the Company's shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

# REPORT OF THE DIRECTORS

## DIRECTORS

The Directors during the year and up to the date of this annual report were:

### Executive Directors

Mr. Sze Man Bok  
Mr. Hui Lin Chit (formerly known as Mr. Hui Chi Lin)  
Mr. Yeung Wing Chun  
Mr. Hung Ching Shan  
Mr. Zhang Shi Pao  
Mr. Poon Fuk Chuen  
(resigned on 30th November 2004)  
Mr. Loo Hong Shing Vincent  
(appointed on 1st March 2005)  
Mr. Xu Da Zuo  
Mr. Xu Chun Man

### Independent Non-Executive Directors

Mr. Chan Henry  
Mr. Chu Cheng Chung  
Ms. Guan Tao  
Ms. Ada Ying Kay Wong

In accordance with Articles 99 and 116 of the Company's Articles of Association, Mr. Hui Lin Chit, Mr. Chan Henry, Mr. Loo Hong Shing Vincent, Ms. Guan Tao and Ms. Ada Ying Kay Wong retire, and being eligible, offer themselves for re-election. Ms. Guan has informed the Company that she is not going to be re-elected at the forthcoming annual general meeting.

## DIRECTORS' SERVICE CONTRACTS

Each of the Executive Directors has entered into a service contract with the Company for an initial term of three years and continuing thereafter on an annual basis until terminated by not less than three months' notice in writing served by either party.

## BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical details of Directors and senior management are set out on pages 18 to 20.

## DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed under the Continuing Connected Transactions below, no contracts of significance in relation to the Group's business to which the Company or any of its subsidiaries was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## REPORT OF THE DIRECTORS

### CONTINUING CONNECTED TRANSACTIONS

Before the acquisition of the entire equity interest in Gather Wise Investment Limited (“Gather Wise”) by the Group on 30th April 2004, Gather Wise was deemed a connected person under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) (the “Listing Rules”), so far as the transactions among certain subsidiaries of the Group are concerned, as it was a substantial shareholder of Hunan Hengan Paper Co., Ltd. (formerly known as Changde Hengan Paper Products Co., Ltd.) (“Hunan Hengan”) and all the subsidiaries of Hunan Hengan (“Paper Subsidiaries”). Following the acquisition of Gather Wise by the Group on 30th April 2004, Gather Wise is no longer a connected person. During the four months ended 30th April 2004, the following transactions were entered into among certain subsidiaries of the Group on normal commercial terms in the ordinary and usual course of business of all the companies concerned. The comparative figures were for the year ended 31st December 2003.

	<b>For the four months ended 30th April 2004 HK\$'000</b>	2003 HK\$'000
Purchase of raw materials from Hunan Hengan ( <i>note (a)</i> )	<b>3,489</b>	10,590
Commission income received from Hunan Hengan and Paper Subsidiaries ( <i>note (b)</i> )	—	6,032
Sales of products among Hunan Hengan and Paper Subsidiaries ( <i>note (c)</i> )	<b>189,598</b>	226,032
Sales of raw materials by Hunan Hengan to Paper Subsidiaries ( <i>note (d)</i> )	<b>111,331</b>	231,604

- (a) Pursuant to a supply agreement entered into by the Company and Hunan Hengan on 26th November 1998, the Group was granted a non-exclusive right to purchase tissue paper raw materials from Hunan Hengan at purchase price not less favourable than that offered by Hunan Hengan to other independent parties in the PRC.
- (b) Pursuant to an agency agreement entered into by the Company and United Wealth International (Holdings) Limited (“United Wealth”) on 26th November 1998, the Group was granted a non-exclusive right to distribute the packaged tissue paper products manufactured by United Wealth and its subsidiaries through the Group’s sales network and earns a commission income calculated at a rate of 7.5% (2003: 7.5%) on the total value of net sales.
- (c) Pursuant to an agreement entered into by Hunan Hengan and Paper Subsidiaries on 15th May 2003, Hunan Hengan and Paper Subsidiaries were granted a non-exclusive right to distribute among the parties packaged tissue paper products at predetermined unit prices based on average unit prices in the preceding year as well as relevant distribution costs.
- (d) Pursuant to a supply agreement entered into by Hunan Hengan and Paper Subsidiaries on 15th May 2003, Hunan Hengan was granted the exclusive right to sell raw materials to Paper Subsidiaries at prices not lower than the market prices of comparable products which are available from independent third parties.

## REPORT OF THE DIRECTORS

The above transactions were conducted by the Group in accordance with the waiver granted by the Stock Exchange. In respect of these transactions:

- (a) The Independent Non-Executive Directors of the Company have reviewed and confirmed that:
  - (i) the transactions have been entered into in the ordinary and usual course of business of the Group;
  - (ii) the transactions have been entered into on normal commercial terms or terms that are no less favourable than terms available from independent third parties;
  - (iii) the transactions are on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole;
  - (iv) the transactions have been entered into either (1) in accordance with the terms of the agreements governing such transactions, or (2) where there is no such agreement, on terms no less favourable than terms available to third parties so far as the independent shareholders of the Company are concerned;
  - (v) in the year ended 31st December 2004, the aggregate amounts of tissue paper purchased by the Group from Hunan Hengan did not exceed 3% of the Group's audited consolidated net tangible assets as at 31st December 2004;
  - (vi) in the year ended 31st December 2004, the aggregate commission receivable by the Group from the distribution of packaged tissue paper products did not exceed 3% of the Group's audited consolidated net tangible assets as at 31st December 2004;
  - (vii) in the year ended 31st December 2004, the aggregate sales of tissue paper raw materials of Hunan Hengan to Paper Subsidiaries did not exceed 35% of the Group's audited consolidated cost of sales for the year ended 31st December 2004; and
  - (viii) in the year ended 31st December 2004, the aggregate sales of packaged tissue paper products of Hunan Hengan to Paper Subsidiaries and of Paper Subsidiaries to Hunan Hengan did not exceed 25% of the Group's audited consolidated turnover for the year ended 31st December 2004.
- (b) In the opinion of the Directors, the transactions have been entered into in the manner as stated in paragraph (a)(i) to (viii) above.

## REPORT OF THE DIRECTORS

### DIRECTORS' INTERESTS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ANY ASSOCIATED CORPORATION

At 31st December 2004, the interests of each director in the shares, short positions in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO"), as recorded in the register maintained by the Company under Section 352 of the SFO or as notified to the Company were as follows:

Name	Personal interests (held as beneficial owner)	Family interests (interests of spouse or child under 18)	Corporate interests (interests of controlled corporation)	Other interests	Total interests	Total interests as % of the relevant issued share capital
Mr. Sze Man Bok	220,335,505	—	—	—	220,335,505	20.39%
Mr. Hui Lin Chit	201,930,693	6,630,224*	—	—	208,560,917	19.30%
Mr. Yeung Wing Chun	40,794,257	45,619*	—	—	40,839,876	3.78%
Mr. Zhang Shi Pao	13,204,027*	—	—	—	13,204,027	1.22%
Mr. Hung Ching Shan	8,920,000	—	—	—	8,920,000	0.83%
Mr. Xu Da Zuo	20,270,135*	—	—	—	20,270,135	1.88%
Mr. Xu Chun Man	18,053,445*	—	—	—	18,053,445	1.67%

\* These interests were held by Hengan International Investments Limited, a nominee company holding shares of the Company on behalf of certain directors and senior management of the Group and their family members.

Apart from the above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the directors of the Company to hold any interests or short positions in the shares or underlying shares in, or debentures of, the Company or its associated corporations.

### SHARE OPTION SCHEME

(1) The terms of the share option scheme of the Company ("Scheme") are summarised as follows:

(i) Purpose of the Scheme

The purpose of the Scheme is to enable employees of the Group to acquire ownership interests in the Company and to encourage employees to work towards enhancing the value of the Company for the benefit of shareholders.

(ii) Eligible Persons

The Board shall have power at any time within the Scheme period to make an offer to any employee (including Directors), as the Board may at its absolute discretion determine and select subject to terms and conditions of the Scheme.

The basis of eligibility of any of the employees to the grant of options shall be determined by the Board from time to time on the basis of his contribution or potential contribution to the development and growth of the Group.

## REPORT OF THE DIRECTORS

### (iii) Subscription Price

The subscription price for the shares of the Company under the Scheme is to be determined by the Board provided always that it will not be lower than the highest of:

- (a) the closing price of the shares as stated in the daily quotation sheet issued by the Stock Exchange for the date of offer (which is deemed to be The date of grant if the offer for the grant of an option is accepted by the employee), which must be a business day;
- (b) the average closing price of the shares as stated in the daily quotation sheets issued by the Stock Exchange for the five business days immediately preceding the date of offer; and
- (c) the nominal value of a share.

### (iv) Maximum Number of Shares Available for Issue

The maximum number of shares available for issue is 99,531,200, representing approximately 9.21% of the issued share capital of the Company as at the date of this report.

### (v) Maximum Entitlement of Each Employee

The maximum number of shares issued and to be issued upon exercise of options granted under the Scheme of the Company to any employee (including both exercised and outstanding options) in any 12-month period from the date of grant shall not exceed 1% of the shares in issue. Any further grant of option in excess of such 1% limit in any 12 month period upto and including the date of such further grant shall be subject to the issue of a circular to the shareholders of the Company and the approval by shareholders with such employee and his associates abstaining from voting.

### (vi) Time on Exercise of Options

An option may be exercised in accordance with the terms of the Scheme at any time during a period commencing on the date on which the employee complies in full with the requirements of the Board for the acceptance of the offer and expiring at the close of business on the last date of the 10-year period or the end of the Scheme period, whichever is the earlier subject to the provisions of early termination thereof.

### (vii) Acceptance of Offer

An offer for the grant of options must be accepted not less than 30 days after the offer date and must be accompanied by payment of the option price.

### (viii) Remaining Life of the Scheme

The Scheme will remain in force before 2nd May 2013.

- (2) No option has been granted under the Scheme as at 31st December 2004.
- (3) No valuation of share options was made as no option has been granted under the Scheme.

## REPORT OF THE DIRECTORS

### SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES OF THE COMPANY

The register of substantial shareholders maintained under section 336 of the SFO shows that as at 31st December 2004, the Company had been notified of the following substantial shareholders' interests and short positions, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the directors.

Substantial Shareholders	Long position	Capacity	Percentage of issued share capital
J.P Morgan Chase & Co	45,612,000	Investment manager	4.22%
	9,190,000	Custodian/Approved lending agent	0.85%
	<hr/> 54,802,000		<hr/> 5.07%
FMR Corp.	54,176,000	Investment manager	5.01%

### MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

### MAJOR CUSTOMERS AND SUPPLIERS

During the year, the Group purchased less than 30% of its goods and services from its five largest suppliers and sold less than 30% of its goods and services to its five largest customers.

### CORPORATE GOVERNANCE

The Company is committed to high standards of corporate governance and transparency which the Board believes provides a positive framework for the overall performance of the Group as well as enhances shareholders' value.

The Directors are of the opinion that the Company has been in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules throughout the year, except that non-executive directors of the Company were not appointed for a specific term as they are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Company's Articles of Association.

During the year, the Company has adopted the Model Code as set out in Appendix 10 to the Listing Rules. The Company has made specific enquiry of all directors regarding any non-compliance with the Model Code during the year ended 31st December 2004, and they all confirmed that they have fully complied with the required standard set out in the Model Code.

The Company has received from each of its independent non-executive directors an annual confirmation of his independence pursuant to rule 3.13 of the Listing Rules and considers the independent non-executive directors to be independent.

### AUDIT COMMITTEE

The written terms of reference which describe the authority and duties of the Audit Committee were prepared and adopted with reference to "A Guide for the Formation of an Audit Committee" published by the Hong Kong Institute of Certified Public Accountants.



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The Audit Committee provides an important link between the Board and the Company's auditors in matters coming within the scope of the group audit. It also reviews the effectiveness of both the external and internal audit and of internal controls and risk evaluation. The committee comprises four independent non-executive directors, namely Mr. Chan Henry, Ms. Guan Tao, Ms. Ada Ying Kay Wong and Mr. Chu Cheng Chung. Two meetings were held during the current financial year.

### ACQUISITIONS

- (a) The Group acquired on 1st March 2004 70% equity interests in Hengan Pharmacare Company Limited at a cash consideration of HK\$14,000,000. The goodwill arising from this acquisition amounted to HK\$13,195,000 which will be amortised over a period of 20 years.
- (b) Further to the acquisition on 16th May 2003 of 68.9% equity interest in Hunan Hengan, which holds a group of companies engaged in the manufacturing and sale of tissue paper products, the Group completed on 30th April 2004 an additional acquisition of approximately 20.6% equity interest in Hunan Hengan and 25% equity interest in each of the Paper Subsidiaries (as defined in the circular of the Company dated 6th April 2004) of Hunan Hengan through the acquisition of the entire equity interest in Gather Wise. The aggregate purchase consideration of approximately HK\$275,482,000 was satisfied as to approximately 50% by cash and the remaining approximately 50% by issuance of 30,160,000 consideration shares of the Company at an issue price of HK\$4.60 per share.
- (c) On 30th July 2004, the Group completed acquisition of the remaining 10.5% equity interest in Hunan Hengan through the acquisition of the entire equity interests in Promise Management Limited and Asset One Holdings Limited at an aggregated consideration of approximately HK\$100,242,000 which was satisfied as to approximately 50% by cash and the remaining approximately 50% by way of issuance of a total of 10,739,900 consideration shares of the Company at an issue price of HK\$4.775 per share.

The total goodwill arising from the acquisition mentioned in (b) and (c) above amounted to approximately HK\$260,764,000 which will be amortised over a period of 20 years.

### PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association and there is no restriction against such rights under the laws of the Cayman Islands.

### AUDITORS

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

**Sze Man Bok**

Chairman

Hong Kong, 22nd March 2005