Management Discussion and Analysis

"The Group continued with its policy of prudent and strategic investment. We are confident that our planned investment will yield business benefits in future years."

Mr. Yum Chak Ming, Matthew
Managing Director

During the year under review, the Group achieved an overall increase in turnover of 15%. This increase was driven in part by the continued improvement in the global economy, which resulted in increased sales in China as well as overseas markets for the Group. In addition, the acquisition of a majority stake in the two paper manufacturing associates in Zhongshan and the consequent consolidation of their revenues contributed to the increase in the Group's turnover.

The Group capitalized on the advantageous exchange rates as well as an overall trend to outsource to China to achieve turnover growth in Europe and Australia, while business in Hong Kong and the United States remained stable. The continued growth in the China domestic economy helped the Group achieve an increase in turnover of 55% from mainland China.

The Group continues to expand its facilities to plan effectively for future growth. The Wuxi facility is now fully operational and a new printing facility is planned in Heshan, a city in the Guangdong province, phase I of which is expected to be completed by the end of 2005.

In addition, the Group added a significant number of staff in 2004/05 via expansion to full capacity of our Shenzhen printing plant as well as the absorption of employees from the two Zhongshan associates following the acquisition of a majority stake in them.

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Certain macro-economic factors that impacted the Group in 2004/05 are likely temporary. These include the power and water shortages affecting businesses across Shenzhen during 2004. The Group has nonetheless taken prudent measures to diversify its cost base by investing in the facility at Heshan, which not only increases our printing capacity, but also takes advantage of the lower wage levels and is away from the high-demand zone of Shenzhen.

An analysis by business division is as follows:

	Turnover			Contribution to operating profit		
	2005 HK'000	%	% change from 2004	2005 HK'000	%	% change from 2004
Paper and carton box printing and manufacturing	1,433,719	62	+10	242,842	77	-11
Paper trading	228,155	10	-9	24,506	8	-45
Corrugated carton	509,769	22	+8	31,330	10	+14
Paper manufacturing	155,750	6	N/A	11,342	4	N/A
Eliminations	—	—	—	1,560	—	N/A
	2,327,393	100	+15	311,580	99	-10
Interest, dividend income and other gains				22,522	7	+99
Corporate and unallocated expenses				(19,507)	-6	+1
				314,595	100	-7

PAPER AND CARTON BOX PRINTING AND MANUFACTURING

Our biggest division reported a steady increase in turnover of 10%, which was achieved largely on volume growth from new customers in both the overseas and China markets. Many of these new customers were book publishers and OEMs (Original Equipment Manufacturers).

The Group's Wuxi plant has been operational for more than a year, contributing to business growth from within the mainland China market. The strength of the Euro as well as the continuing global trend of outsourcing to manufacturers in China continued to drive European business, which the Group capitalized on with marketing efforts and the appointment of a sales agent in Germany. The performance of this division contributed to the Group's sales increases from the UK and Germany of 23% and 93% respectively. Business from the US and Hong Kong remained stable.

Exterior and internal facilities of the new plant in Zhongshan

In addition to children's books and paper products, this division increased the quantity of other types of books it printed this year, in order to be well placed to benefit from any future trends to outsource commercial printing to printers in mainland China.

Our plant at Wuxi has already achieved ISO 9002 and 14000 certification within just a year of operations.

The Group continues to expand into new markets. In South America, for the first time, we have appointed a new agent to increase the Group's presence and drive revenues.

PAPER TRADING

This division was affected by continued competition from local paper manufacturers as well as prevalent paper and oil price adjustments during the year under review, and experienced a drop in external sales of 9%. The delay in approval of a business license for the Shenzhen distribution and logistic facility also affected operations.

The Shenzhen distribution and logistic warehouse initially maintained a credit policy of cash on delivery, which had resulted in some loss of business. However the policy has now been made more flexible with respect to very well-established customers, which is expected to contribute to an increase in business.

This division aims to bypass intensive price-based competition with local manufacturers by focusing as far as possible on higher-margin business, as well as maintaining a stock of foreign and higher-value paper.

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The new corrugator (left) and other equipment in the new plant in Zhongshan

CORRUGATED CARTON MANUFACTURING

The corrugated carton manufacturing division achieved steady growth of 9%, with growth in external sales of 8%. This growth was driven by an increase in China-based customers. The division successfully diversified its customer base by entering segments such as electronics, computer accessories and food and beverage.

This division was impacted by adjustments in paper prices, but the Group's prudent inventory practices, tight cost controls and the implementation of several measures to enhance operational efficiency helped to increase profit from operating activities by 14%.

The installation of a new corrugator in our new plant in Zhongshan has been completed and production is underway. The additional capacity rendered available by the new corrugator will further enhance the competitiveness and efficiency of this division.

PAPER MANUFACTURING

The Group acquired a majority stake in its associates — Zhongshan Rengo Hung Hing Paper Manufacturing Company Ltd. and Zhongshan Ren Hing Paper Manufacturing Company Ltd. — to bring them under the effective ownership of the Group. The Group experienced a 57% decrease in share of profits and losses of our former associates due to a one-time write-off of bad debt as part of the cost of acquiring the companies.

Following the acquisition, it is the strategy of the Group to enhance management practices at these two facilities and increase inter-company business. Part of this strategy is to improve the quality of our product by using 100% overseas waste paper for paper manufacturing, as well as to purchase more paper from the paper mill within the Group.

FINANCIAL AND CAPITAL RESOURCES

The Group continued with its policy of prudent and strategic investment for future business growth.

The Group incurred HK$268 million in capital expenditure during the financial year 2004/05, as follows:

	HK$ million
Investment in the new corrugating and printing facility at the Zhongshan plant	122
Machinery for the Shenzhen plant	92
Machinery for the Wuxi plant	12
Construction of and equipment for the Shenzhen distribution and logistic warehouse	13
Land for the Heshan facility	23
Construction of and equipment for other facilities	6
Total:	268

Another major investment the Group made was the acquisition of the majority stake of the two Zhongshan paper manufacturing companies at a total cost of HK$119 million.

These investments were partly financed by a net drawdown of bank loan facilities of HK$176 million.

The increased stake in the two Zhongshan paper manufacturing companies and consolidation of their bank borrowings led to an increase in the Group's total bank borrowings. As at 31 March 2005, the Group had total bank borrowings of HK$654 million, of which HK$329 million was short term borrowings repayable within one year and HK$325 million was long term borrowings repayable within two to five years.

To capitalize on the low interest rate prevailing in Hong Kong, the Group arranged its bank borrowings primarily in Hong Kong dollars, except for the bank loans of the two Zhongshan paper manufacturing companies, which were arranged in Renminbi. Of the Group's total bank borrowings of HK$654 million, 77% was in Hong Kong dollars, 21% was in Renminbi and 2% was in U.S. dollars.

During the year under review, interest expenses went up to HK$12.2 million, largely due to the higher level of borrowings, increases in interest rates towards the fourth quarter of the year, and the inclusion of loan interest of HK$3 million upon consolidation of the two Zhongshan paper manufacturing companies.

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As at 31 March 2005, the Group had cash on hand of HK$334 million, down 24% from last year, mainly due to the need to use part of the Group's cash to pay for its capital investments. Of our total cash of HK$334 million, 71% was in Renminbi, 19% in U.S. dollars, 9% in Hong Kong dollars and 1% in Sterling Pounds.

The Group's bank borrowings as a ratio to shareholder equity went up from 20% to 35% as a result of higher level of borrowings and consolidation of borrowings of the two Zhongshan paper manufacturing companies. However the Group's bank borrowings net of cash as a ratio to shareholder equity was maintained at 17%, a comfortable level in terms of net debt gearing ratio.

The Group's planned capital investment program to drive sustained business growth resulted in a higher level of borrowings. The Group is confident that its planned investment will yield business benefits in future years.

EMPLOYEES

As of 31 March 2005, the Group employed a total of 17,030 staff in Hong Kong and China. Of the total, 292 were employed in Hong Kong and 16,738 in China. There is an increase over the previous year — particularly in China, where our operations have grown by approximately 6,000 employees. This number includes staff absorbed with our effective ownership of the two paper manufacturing companies in Zhongshan.

Hung Hing Printing Group is dedicated to providing the best possible work environment and training for our staff, to ensure both operational efficiency for the Group and career opportunities for employees.

We provide this out of gratitude to our staff, who continue to give their best in an increasingly competitive and challenging market place. I would like to thank all of you for your unwavering support.

Matthew C.M. Yum
Managing Director

Hong Kong, 5 July 2005