

## CHIEF EXECUTIVE OFFICER'S REPORT



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### OVERALL PERFORMANCE

In 2005, the mainland China economy experienced a robust growth, and the average income and consumption capacity of Chinese people continued to improve. According to the statistics published by the China Government, Gross Domestic Product ("GDP") reached RMB10,627.5 billion while total retail sales of consumer products amounted to RMB5,683.6 billion for the periods up to the end of third quarter and November of 2005, representing an increase of 9.4% and 12.9% respectively when compared with the same periods of last year. Meanwhile, income of urban and rural population also continued to surge. Increase in income per capita and improvement in living standard, together with the enhancement of education level and awareness of the quality of personal hygiene products roused among rural population, contributed to the substantial increase in spending on personal hygiene products.

The mainland China market of personal hygiene products maintained rapid growth in 2005. Market demand for high quality personal hygiene products continued to increase but the market remained highly competitive. During the year under review, major raw material costs, such as wood pulp and petrochemical raw materials, continued to rise. Production costs increased correspondingly while expediting industrial consolidation. As a result, large scale enterprises with remarkable economies of scale experienced faster growth pace.

During the year, the Group proactively developed modern distribution and marketing channels, enhanced product quality and adjusted product mix, provided quality personal hygiene products with different pricing levels and successfully maintained its leading market position in mainland China. In response to the increasing production costs, the Group controlled its average production cost by enhancing internal efficiency, including shortening workflow and reducing raw material wastage rate, and through economies of scale effect. In addition, as a portion of raw materials were purchased from overseas and settled in US dollars, the Group was also benefited from the appreciation of Renminbi exchange rate by approximately 2% since July 2005 accordingly.

For the year ended 31 December 2005, the Group's turnover amounted to approximately HK\$3,030,122,000, representing a year-on-year increase of approximately 32.1%. Profit attributable to shareholders was approximately HK\$450,291,000, an increase of approximately 51.1% over that of the previous year. The impressive performance in 2005 was mainly attributable to the growth in sales of the tissue paper and diaper businesses. Despite the increase in raw material costs, with the implementation of effective cost control measures, benefits from economies of scale and the appreciation of Renminbi during the year, the Group's overall gross profit margin in 2005 improved slightly to approximately 41.6% (2004: 40.3%).

In addition, as the Group continued to benefit from economies of scale, distribution costs and administration expenses for the year under review totally accounted for approximately 23.2% of turnover, representing a decrease of approximately 0.6% (2004: 23.8%).



## CHIEF EXECUTIVE OFFICER'S REPORT

### BUSINESS REVIEW

#### Tissue Papers

During the year, the Group's "Hearttex" brand was accredited the "China Top Brand". As the income and living standard of domestic consumers continued to improve, the demand for high-end tissue paper products recorded an impressive growth. In 2005, the Group's tissue paper business achieved strong sales performance with sales revenue increased by approximately 31.4% to approximately HK\$1,259,700,000, accounting for approximately 41.6% of total sales.



During the year, the demand for the Group's tissue paper products exceeded supply such that part of the production activities had to be outsourced resulting in a higher production cost. Besides, raw materials costs of tissue papers sustained its growth trend. In order to control costs effectively, the Group endeavored to increase production efficiency. In addition, it also increased its promoting efforts on product series with higher gross profit margins so as to minimize the impact brought forth by the increase in costs. As such, the gross profit margin of the Group's tissue paper business reached approximately 38.6% (2004: 39.9%), representing a mild year-on-year decrease of approximately 1.3%.

In order to satisfy the ever-growing market demand, the Group's new phase one plant of Shandong production base commenced production in late August 2005.

#### Sanitary Napkins

Improvement in living standard of domestic consumers stimulated the demand for quality feminine hygiene products. In 2005, the Group focused on producing and promoting mid-to-high-end brand "Anerle", of which the "Space 7" series was especially well received by the market. In addition, due to the adverse impact of increasing raw material costs, a number of small and medium-sized sanitary napkin manufacturers experienced

## CHIEF EXECUTIVE OFFICER'S REPORT

business difficulties and some of them ceased production or closed down their businesses. Thus, the Group captured part of the market share of these small and medium-sized manufacturers. Overall speaking, sales revenue of sanitary napkins business increased by approximately 21.6% to approximately HK\$971,315,000. "Anerle" products accounted for approximately 76.3% of total sales revenue for sanitary napkins business (2004: 70.9%). Sanitary napkin sales accounted for approximately 32.0% of the Group's sales. During the year, the Group's mid-to-high-end sanitary napkin products achieved encouraging growth, together with an impressive increase in sales of pantliners which have a higher profit margin, the overall gross profit margin of the business increased from approximately 46.4% in 2004 to approximately 52.5% in 2005.



### Disposable Diapers

Domestic market for disposable diapers experienced robust growth in 2005. With increasing disposable income per capita, people living in 3rd and 4th tier cities, towns and villages are capable of buying disposable diapers. In addition, the original disposable diapers usage rate in these regions was relatively lower, hence, the demand for diapers grew faster. The Group possesses a strong distribution network in these regions, contributing to a significant growth in sales of disposable diapers in 2005.

The Group continued to introduce a number of quality improvement projects and launched various product series, including "slim & comfort" and "dry and breathable" series, with the view of satisfying market demand. In 2005, sales revenue of disposable diapers business amounted to approximately HK\$654,216,000, accounting for approximately 21.6% of overall sales revenue. The adoption of cost control measures during the year, together with the economies of scale, outweighed the impact of the increase in raw material costs such that the overall gross profit margin increased slightly to approximately 31.2% (2004: 30.9%).



## CHIEF EXECUTIVE OFFICER'S REPORT

### Skincare and Cleansing Products

The skin cleansing and care products market in mainland China experienced intense market competition. Sales revenue of "MissMay" products amounted to approximately HK\$38,381,000 during the year (2004: HK\$40,230,000). This business only accounted for approximately 1.3% of the Group's turnover such that the result of this business does not have any significant impact to the Group's result.

### First-aid Products

Sales of the Group's first-aid products under the brand names of "Banitore", "Bandi" and "Comfitore" performed well in 2005 and sales revenue reached approximately HK\$19,753,000 (2004: HK\$17,411,000). This business only accounted for approximately 0.7% of the Group's turnover such that the result of this business does not have any significant impact to the Group's result.

## DISTRIBUTION AND MARKETING STRATEGIES

The Group has a nationwide distribution network for selling its diversified personal hygiene products. During the year, the living standard of people in 3rd and 4th tier cities, towns and villages gradually elevated with a growing demand for quality personal hygiene products. The Group will further develop and explore more sales channels targeting these markets.

Apart from strengthening the collaboration with various supermarkets, the Group also employed numerous sales and marketing professionals to promote its products in different supermarkets and hypermarkets. During the year, distribution costs accounted for approximately 19.2% of total turnover, an increase of approximately 0.7% when compared with that of the previous year (2004: 18.5%).



## HUMAN RESOURCES MANAGEMENT

As at 31 December 2005, the Group employed approximately 15,960 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.

## CHIEF EXECUTIVE OFFICER'S REPORT

### LIQUIDITY, FINANCIAL RESOURCES AND BANK LOANS

The Group financial position remained healthy. As at 31 December 2005, the Group's bank balances and cash amounted to approximately HK\$499,937,000 (2004: HK\$543,807,000), with short-term and long-term bank loans totalling approximately HK\$957,598,000 (2004: HK\$776,743,000). During the year, the Group's capital expenditure for acquisition and installation of production facilities was approximately HK\$609,805,000.



The annual interest rates of bank loans ranged from approximately 0.87% to approximately 5.13%. All bank loans are unsecured and there were no charges on the Group's assets. As at 31 December 2005, the Group's gross gearing ratio was approximately 41.0% (2004: 37.3%) which was calculated on the basis of the amount of bank loans as a percentage of the total shareholders' equity. The net gearing ratio, which was calculated on the basis of the amount of bank loans less bank balances and cash as a percentage of the total shareholders' equity, was approximately 19.6% (2004: 11.2%). The increase in gross and net gearing ratios was mainly due to the increase in loans for construction of new production bases.

As at 31 December 2005, the Group had no material contingent liabilities.

### FOREIGN CURRENCY RISKS

Most of the Group's income was in Renminbi while a portion of raw materials were purchased and settled in US dollar. The Group had 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 31 December 2005, the Group had not issued any financial instruments or entered into any contracts for foreign currency hedging purposes.

### FUTURE PROSPECTS

As the demand for quality consumer products continues to grow in the mainland China market, the Group is optimistic towards the prospects of mainland China personal hygiene and care products market. The Group expects the major growth momentum in next year will be from the tissues paper and disposable diaper businesses. In addition, as the sanitary napkins market has entered into a consolidation stage, the Group expects that sanitary napkins business will also continue to grow in the future.

## CHIEF EXECUTIVE OFFICER'S REPORT

As for the tissue paper business front, demand for quality tissue paper products in mainland China has been rising significantly in recent years. In order to satisfy the overwhelming market demand, the Group has launched a series of plan to expand production capacity. The new production base in Fujian Province is expected to put into production in July 2006, while the Group also plans to build the phase two plant of the Shandong tissue production base, which is expected to commence construction and production in July 2006 and second half of 2007 respectively. As the production capacity expands, it is expected the overall profit of tissue paper business will improve as the Group will be benefited from economies of scale and decrease in proportion of outsourcing production activities. Besides, the Group will develop more diversified product series to meet the growing market demand.

The demand for diapers in the mainland China market increases continuously, especially in these 3rd and 4th tier cities, towns and villages. It is expected that the uprising trend will sustain in the following years. To capture this market opportunity, the Group will proactively enhance the production capacity and product quality of diapers. Apart from carrying out technical upgrading on existing production lines to expand production capacity, the Group will also increase production lines for manufacturing baby and adult diapers to meet market demand.

The Group expects the sanitary napkins market will further consolidate in 2006. As such, the Group is dedicated to fully utilize this opportunity to enhance product portfolio and produce more mid-to-high-end products with higher profit margin. Capitalizing on its sales and marketing strategies, the Group will also strengthen its market presence together with the effort of marketing staff members.

Looking ahead, the growth trend of tissue paper and disposable diaper businesses remain strong in the following year. The Group will continue to increase and upgrade existing production facilities and expand production capacity to satisfy enormous domestic market demand. By leveraging on its distinguished product quality, extensive sales network, renowned brand awareness and reasonable pricing policy, the Group is confident of consolidating its leading position in the competitive personal hygiene and care products market in mainland China, bringing fruitful returns to shareholders.



**Hui Lin Chit**  
*Chief Executive Officer*

Hong Kong, 21 March 2006