恒安國際集團有限公司

HENGAN INTERNATIONAL GROUP COMPANY LIMITED

Stock Code : 1044

INTERIM REPORT 2006

Corporate Mission

"Growing with you for a better life" has always been the mission of Hengan International. We will continue to adhere to our corporate spirit of "Integrity, Diligence, Innovation and Dedication". Our goal is "to build an effective corporate management and to develop a quality, ethical and enthusiastic staff team". By building an excellent corporate culture, reinforcing our brand image, and focusing on consumer and market need, Hengan International will become China's leading corporation in feminine hygiene products, diapers and family hygiene products.

恒安國際集團有限公司

HENGAN INTERNATIONAL GROUP COMPANY LIMITED

(Incorporated in the Cayman Islands with limited liability)

Unit 2101D, 21/F., Admiralty Centre, Tower 1, 18 Harcourt Road, Admiralty, Hong Kong.

Tel : (852) 2798 0770

Fax : (852) 2799 7372

e-mail : hengan@hengan.com.hk

websites : www.hengan.com

www.irasia.com/listco/hk/hengan

Hengan International Group Company Limited

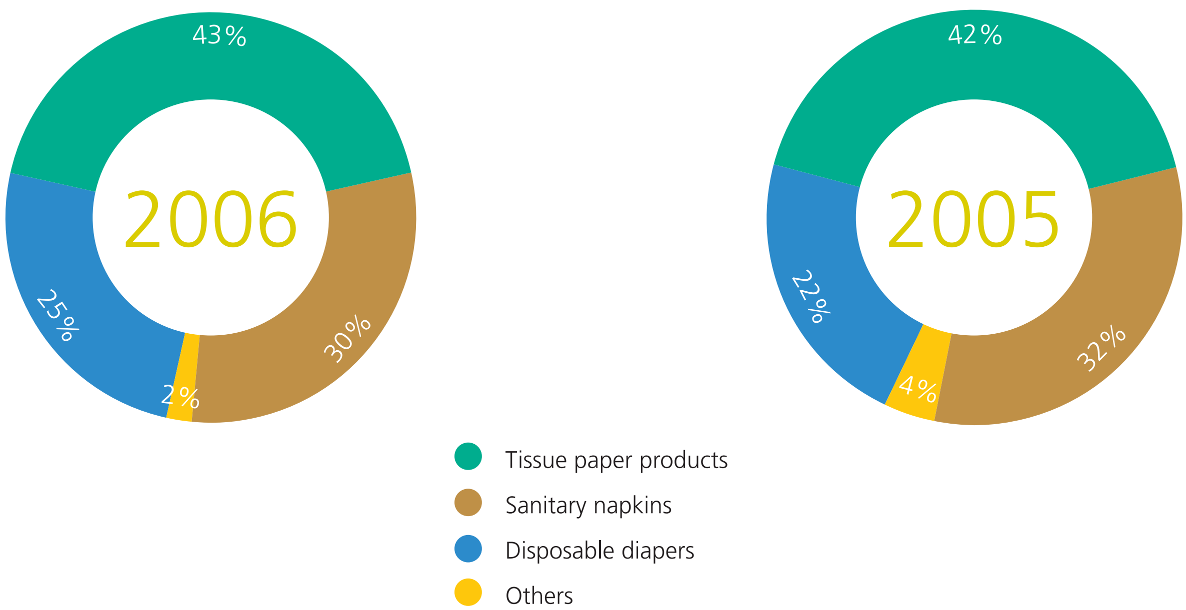
"Growing with You for a Better Life"

Financial Summary

	Unaudited Six months ended 30 June 2006 HK$'000	2005 HK$'000 Restated	% of Change
Turnover	**2,038,262**	1,443,719	41.2
Profit attributable to shareholders	**330,482**	204,073	61.9
Gross profit margin	**41.5%**	40.6%	
Net profit margin	**16.2%**	14.1%	
Earnings per share	**30.58 HK cents**	18.88 HK cents	
Finished goods turnover	**63 days**	66 days	
Accounts receivable turnover	**26 days**	31 days	

Turnover by Product

Six months ended 30 June



INTERIM RESULTS

The Board of Directors of Hengan International Group Company Limited ("Hengan International" or the "Company") (the "Board") is pleased to announce the unaudited condensed consolidated profit and loss account of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2006, and the unaudited condensed consolidated balance sheet of the Group as at 30 June 2006, together with the comparative figures and selected explanatory notes. The interim report has been reviewed by the Company's audit committee and the Company's auditors, PricewaterhouseCoopers, in accordance with Statement of Auditing Standard 700 "Engagements to review interim financial reports" issued by the Hong Kong Institute of Certified Public Accountants. The auditors, on the basis of their review, concluded that they were not aware of any material modifications that should be made to the interim financial information.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

		Unaudited Six months ended 30 June	
	Note	**2006 HK$'000**	2005 HK$'000 *Restated (Note 17)*
Turnover	4	**2,038,262**	1,443,719
Cost of goods sold		**(1,192,072)**	(858,145)
Gross profit		**846,190**	585,574
Other gains — net		**40,720**	2,093
Distribution costs		**(338,785)**	(271,640)
Administrative expenses		**(89,742)**	(63,036)
Operating profit	5	**458,383**	252,991
Finance costs		**(25,372)**	(7,238)
Profit before income tax		**433,011**	245,753
Income tax expense	6	**(101,281)**	(41,385)
Profit for the period		**331,730**	204,368
Attributable to:			
Shareholders of the Company		**330,482**	204,073
Minority interest		**1,248**	295
		331,730	204,368
Earnings per share for profit attributable to shareholders of the Company — basic	7	**30.58 cents**	18.88 cents
Dividend	8	**194,538**	129,692

CONDENSED CONSOLIDATED BALANCE SHEET

	Note	Unaudited 30 June 2006 HK$'000	Audited 31 December 2005 HK$'000
ASSETS			
Non-current assets			
Property, plant and equipment	9	**1,371,988**	1,376,213
Construction-in-progress	9	**370,846**	246,659
Leasehold land and land use rights	9	**48,560**	47,554
Intangible assets	9	**454,994**	455,204
Deferred tax assets		**29,574**	32,457
Prepayment for non-current assets		**145,838**	63,886
		2,421,800	2,221,973
Current assets			
Inventories		**797,909**	732,629
Trade receivables	10	**346,493**	241,314
Other receivables, prepayments and deposits		**138,686**	159,691
Assets classified as held for sale		**—**	53,157
Bank balances and cash		**1,147,414**	499,937
		2,430,502	1,686,728
Total assets		**4,852,302**	3,908,701
EQUITY			
Capital and reserves attributable to the Company's shareholders			
Share capital	13	**108,077**	108,077
Other reserves		**1,796,359**	1,719,325
Retained earnings			
— Proposed dividend		**194,538**	172,923
— Unappropriated retained earnings		**431,621**	337,466
		2,530,595	2,337,791
Minority interest		**25,215**	24,497
Total equity		**2,555,810**	2,362,288

CONDENSED CONSOLIDATED BALANCE SHEET (Continued)

	Note	Unaudited 30 June 2006 HK$'000	Audited 31 December 2005 HK$'000
LIABILITIES			
Non-current liabilities			
Long-term bank loans — unsecured		**104,578**	188,571
Convertible bonds	12	**1,457,212**	—
Deferred tax liabilities		**11,756**	19,975
Deferred income on government grants		**11,343**	11,386
		1,584,889	219,932
Current liabilities			
Trade and bills payables	11	**387,600**	361,415
Other payables and accrued charges		**181,153**	153,556
Deferred income on government grants		**1,657**	1,567
Taxation payable		**67,394**	40,916
Trust receipt bank loans		**791**	35,598
Current portion of long-term bank loans — unsecured		**32,695**	251,429
Short-term bank loans — unsecured		**40,313**	482,000
		711,603	1,326,481
Total liabilities		**2,296,492**	1,546,413
Total equity and liabilities		**4,852,302**	3,908,701
Net current assets		**1,718,899**	360,247
Total assets less current liabilities		**4,140,699**	2,582,220

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Unaudited Six months ended 30 June 2005				
	Attributable to the Company's shareholders				
	Share capital HK$'000	Other reserves HK$'000	Retained earnings HK$'000	Minority interest HK$'000	Total HK$'000
Balance at 1 January 2005	108,077	1,632,211	344,681	24,558	2,109,527
2004 final dividends paid	—	—	(129,692)	(945)	(130,637)
Profit for the period	—	—	204,073	295	204,368
Appropriation to statutory reserves	—	26,740	(26,740)	—	—
Depreciation transfer on buildings	—	(898)	898	—	—
Reversal of deferred taxation associated with property revaluation in previous years	—	240	—	—	240
Translation of subsidiaries' accounts	—	3,929	—	(16)	3,913
Balance at 30 June 2005	108,077	1,662,222	393,220	23,892	2,187,411

	Unaudited Six months ended 30 June 2006				
	Attributable to the Company's shareholders				
	Share capital HK$'000	**Other reserves HK$'000**	**Retained earnings HK$'000**	**Minority interest HK$'000**	**Total HK$'000**
Balance at 1 January 2006	**108,077**	**1,719,325**	**510,389**	**24,497**	**2,362,288**
2005 final dividends paid	—	—	**(172,923)**	**(697)**	**(173,620)**
Profit for the period	—	—	**330,482**	**1,248**	**331,730**
Appropriation to statutory reserves	—	**42,687**	**(42,687)**	—	—
Depreciation transfer on buildings	—	**(898)**	**898**	—	—
Reversal of deferred taxation associated with property revaluation in previous years	—	**240**	—	—	**240**
Realisation of fair value gains on available-for-sale financial assets, net of tax	—	**(22,124)**	—	—	**(22,124)**
Convertible bonds — equity	—	**20,941**	—	—	**20,941**
Translation of subsidiaries' accounts	—	**36,188**	—	**167**	**36,355**
Balance at 30 June 2006	**108,077**	**1,796,359**	**626,159**	**25,215**	**2,555,810**

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Unaudited Six months ended 30 June	
	2006	2005
	HK$'000	HK$'000
Net cash generated from operating activities	**331,077**	333,001
Net cash used in investing activities	**(240,833)**	(340,639)
Net cash generated from/(used in) financing activities	**538,792**	(144,429)
Net increase/(decrease) in bank balances and cash	**629,036**	(152,067)
Bank balances and cash at 1 January	**499,937**	543,807
Effect of foreign exchange rate changes	**18,441**	5,178
Bank balances and cash at 30 June	**1,147,414**	396,918

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL INFORMATION

1. General information

Hengan International Group Company Limited (the "Company") and its subsidiaries (together the "Group") manufactures, distributes and sells personal hygiene products through a network of retailers. The Group has manufacturing plants in various parts of the People's Republic of China (the "PRC") and sells mainly in the PRC.

The Company is a limited liability company incorporated in the Cayman Islands. The address of its registered office is Ugland House, South Church Street, P.O. Box 309, George Town, Grand Cayman, Cayman Islands, British West Indies. The Company has its primary listing on The Stock Exchange of Hong Kong Limited.

These condensed consolidated interim financial information was approved for issue on 12 September 2006.

2. Basis of preparation

This condensed consolidated interim financial information for the six months ended 30 June 2006 has been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34, 'Interim financial reporting.' The condensed consolidated interim financial information should be read in conjunction with the annual accounts of the Company for the year ended 31 December 2005.

3. Accounting policies

The accounting policies adopted are consistent with those of the annual accounts for the year ended 31 December 2005, except that the Group has changed certain of its accounting policies following the adoption of new/revised Hong Kong Financial Reporting Standards ("HKFRS") and HKAS (collectively referred to as the "new HKFRSs"), which became effective for the accounting periods beginning on or after 1 January 2006. The applicable new HKFRSs adopted by the Group in this interim financial report are set out below:

HKAS 21 (Amendment)	Net investment in a foreign operation
HKAS 39 (Amendment)	The fair value option
HK(IFRIC)-Int 4	Determining whether an arrangement contains a lease

The adoption of the above HKFRSs did not result in substantial changes to the Group's balance sheet and profit and loss account. The changes in the Group's accounting policies are summarized as follows:

- HKAS 21 (Amendment) changes the net investment definition to include loans between fellow subsidiaries. It permits inter-company loans denominated in any currency to be part of a net investment in a foreign operation and to recognise foreign exchange volatility on such loans funding foreign operations in exchange reserve in the consolidated accounts;

- HKAS 39 (Amendment) changes the definition of financial instruments classified at fair value through profit and loss account and restricts the ability to designate financial instruments as part of this category; and

- HK(IFRIC)-Int 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use such assets.

3. Accounting policies (Continued)

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2006 and have not been early adopted:

- HKAS 1 (Amendment) — Presentation of Financial Statements: Capital Disclosures
- HKFRS 7 — Financial Instruments: Disclosures
- HK(IFRIC)-Int 7 — Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
- HK(IFRIC)-Int 8 — Scope of HKFRS 2
- HK(IFRIC)-Int 9 — Reassessment of Embedded Derivatives

It is expected that the adoption of such standards, amendments to standards and interpretations will not result in substantial changes to the Group's accounting policies.

4. Segment information

(a) *Business segment analysis*

	Unaudited Six months ended 30 June									
	2006					Restated *(Note 17)* 2005				
	Sanitary napkins 2006 HK$'000	Disposable diapers 2006 HK$'000	Tissue paper products 2006 HK$'000	Skincare and cleansing products, hygiene materials and others 2006 HK$'000	Group 2006 HK$'000	Sanitary napkins 2005 HK$'000	Disposable diapers 2005 HK$'000	Tissue paper products 2005 HK$'000	Skincare and cleansing products, hygiene materials and others 2005 HK$'000	Group 2005 HK$'000
Segment turnover	637,699	501,149	890,736	80,543	2,110,127	477,048	323,995	612,839	85,131	1,499,013
Inter-segment sales	(23,160)	(633)	(3,133)	(44,939)	(71,865)	(18,686)	(622)	(4,251)	(31,735)	(55,294)
Turnover of the Group	614,539	500,516	887,603	35,604	2,038,262	458,362	323,373	608,588	53,396	1,443,719
Segment results	222,418	65,792	128,204	8,577	424,991	118,336	33,849	100,907	968	254,060
Unallocated costs					(7,328)					(3,515)
Interest income					6,101					2,446
Other gains					34,619					—
Operating profit					458,383					252,991
Finance costs					(25,372)					(7,238)
Profit before income tax					433,011					245,753
Income tax expense					(101,281)					(41,385)
Profit for the period					331,730					204,368
Minority interest					(1,248)					(295)
Profit attributable to shareholders of the Company					330,482					204,073

(b) No geographical analysis is provided as less than 10% of the Group's turnover and less than 10% of the consolidated trading results of the Group are attributable to markets outside the PRC.

5. Operating profit

Operating profit is stated after crediting and charging the following:

	Unaudited Six months ended 30 June	
	2006 **HK$'000**	2005 HK$'000
Crediting		
Gains on disposals of assets classified as held-for-sale	**29,654**	—
Charging		
Depreciation of property, plant and equipment	**82,438**	67,845
Amortisation of leasehold land and land use rights	**2,027**	1,606
Amortisation of patent and trademarks	**243**	236
Losses on disposals of property, plant and equipment	**1,170**	1,066
Operating lease expenses in respect of factory premises and sales liaison offices	**7,034**	5,549
Staff costs	**123,836**	100,797
Provision for obsolete stock	**9,779**	1,669

6. Income tax expense

	Unaudited Six months ended 30 June	
	2006 **HK$'000**	2005 HK$'000
Hong Kong profits tax *(Note (a))*	**505**	302
PRC income tax *(Note (b))*	**97,578**	46,424
Deferred taxation *(Note (c))*	**3,198**	(5,341)
Taxation charges	**101,281**	41,385

(a) Hong Kong profits tax has been provided for at the rate of 17.5% (2005: 17.5%) on the estimated assessable profits for the period.

(b) PRC income tax represents tax charges on the assessable profits of the PRC subsidiaries of the Group at the prevailing tax rates applicable to the PRC subsidiaries. Included in the balance is the PRC income tax of approximately HK$ 8,006,000 which is related to the gains on disposal of assets classified as held-for-sale.

(c) Deferred income tax is calculated in full on temporary differences under the liability method using the prevailing tax rates applicable to the PRC subsidiaries of the Group.

7. Earnings per share

The calculation of basic earnings per share is based on the profit attributable to shareholders of HK$330,482,000 (2005: HK$ 204,073,000) and on the weighted average number of 1,080,766,355 ordinary shares (2005: 1,080,766,355) in issue during the period.

Diluted earnings per share is not presented as the convertible bonds issued during the period do not have any dilutive effect on the earnings per share.

8. Dividend

	Unaudited Six months ended 30 June	
	2006 HK$'000	2005 HK$'000
Proposed interim dividend of 18 HK cents per share (2005: 12 HK cents)	194,538	129,692

The interim dividend proposed by the board in a meeting held on 12 September 2006 is not reflected as a dividend payable in the condensed consolidated interim financial information but will be reflected as an appropriation of retained earnings for the year ending 31 December 2006.

9. Capital expenditure — net book value

				Intangible assets		
	Property, plant and equipment HK$'000	Construction-in-progress HK$'000	Leasehold land and land use rights HK$'000	Goodwill HK$'000	Patents and trademarks HK$'000	Total HK$'000
At 1 January 2005	1,041,767	100,522	43,243	452,030	3,575	455,605
Unaudited:						
Exchange differences	(1,108)	(113)	(46)	—	(3)	(3)
Additions, at cost	21,250	291,238	125	—	—	—
Transfer from construction-in-progress	37,467	(37,467)	—	—	—	—
Disposals/write-off	(14,087)	—	—	—	—	—
Depreciation/amortisation for the period	(67,845)	—	(1,606)	—	(236)	(236)
At 30 June 2005	1,017,444	354,180	41,716	452,030	3,336	455,366
At 1 January 2006	**1,376,213**	**246,659**	**47,554**	**452,030**	**3,174**	**455,204**
Unaudited:						
Exchange differences	**14,462**	**2,983**	**438**	—	**33**	**33**
Additions, at cost	**9,530**	**177,645**	**2,595**	—	—	—
Transfer from construction-in-progress	**56,186**	**(56,186)**	—	—	—	—
Disposals/write-off	**(1,965)**	**(255)**	—	—	—	—
Depreciation/amortisation for the period	**(82,438)**	—	**(2,027)**	—	**(243)**	**(243)**
At 30 June 2006	**1,371,988**	**370,846**	**48,560**	**452,030**	**2,964**	**454,994**

10. Trade receivables

The majority of the Group's sales is on open accounts with credit terms ranging from 30 days to 75 days. At 30 June 2006, the ageing analysis of the trade receivables was as follows:

	Unaudited 30 June 2006 HK$'000	Audited 31 December 2005 HK$'000
1–30 days	152,672	88,461
31–180 days	183,654	136,467
181–365 days	7,801	16,003
Over 365 days	2,366	383
	346,493	241,314

There was no concentration of credit risk with respect to trade receivables as the Group has a large number of customers. The carrying value of the trade receivables approximates their fair value due to the short-term maturity.

11. Trade and bills payables

	Unaudited 30 June 2006 HK$'000	Audited 31 December 2005 HK$'000
Trade payables	358,888	301,290
Bills payables	28,712	60,125
	387,600	361,415

The carrying amount of trade and bills payable approximates their fair value due to short-term maturity.

(a) At 30 June 2006, the ageing analysis of the trade payables was as follows:

	Unaudited 30 June 2006 HK$'000	Audited 31 December 2005 HK$'000
1–30 days	208,548	237,058
31–180 days	145,463	59,358
181–365 days	1,075	3,303
Over 365 days	3,802	1,571
	358,888	301,290

(b) Bills payable of approximately HK$28,712,000 (2005: HK$60,125,000) are normally with maturity periods within 180 days.

12. Convertible bonds

On 16 May 2006, the Company issued zero-coupon convertible bonds due on 16 May 2011 (the "maturity date") in the aggregate principle amount of HK$ 1.5 billion with an initial conversion price of HK$ 19.12 per ordinary share of the Company (subject to adjustment). Unless previously redeemed, converted, purchased or cancelled (subject to redemption conditions), these bonds will be redeemed at 126.15 per cent of their principal amount on the maturity date.

The fair values of the liability component and the equity conversion component were determined upon the issuance of the convertible bonds.

The fair value of the liability component, included in long-term borrowings, was calculated using a market interest rate for an equivalent non-convertible bond. The residual amount, representing the value of equity conversion component, is included in shareholders' equity in other reserves.

The convertible bonds recognised in the balance sheet are calculated as follows:

	Unaudited 30 June 2006 HK$'000	Audited 31 December 2005 HK$'000
Face value of convertible bonds issued on 16 May 2006	**1,500,000**	—
Issuing expenses	**(31,989)**	—
Equity component	**(20,941)**	—
Liability component on initial recognised on 16 May 2006	**1,447,070**	—
Imputed finance costs	**10,142**	—
Liability component	**1,457,212**	—

The carrying value of the liability component of the convertible bonds at 30 June 2006, which approximately its fair value, is calculated using cash flows discounted at an effective borrowing rate of 5.05% per annum.

From 16 May 2006 to the date of this interim report, no bond holders have converted their bonds into ordinary shares of the Company.

13. Share capital

	Authorised share capital Ordinary shares of HK$ 0.10 each Number of shares	HK$'000
At 1 January 2006 and 30 June 2006	3,000,000,000	300,000

	Issued and fully paid Ordinary shares of HK$ 0.10 each Number of shares	HK$'000
At 1 January 2006 and 30 June 2006	1,080,766,355	108,077

14. Capital commitments

	Unaudited 30 June 2006 HK$'000	Audited 31 December 2005 HK$'000
Contracted but not provided for in respect of		
Plant, machinery and equipment	**161,618**	159,827
Land and buildings	**40,095**	46,616
Authorised but not contracted for in respect of		
Plant, machinery and equipment	**21,633**	150,601
	223,346	357,044

15. Contingent liabilities

There were no material contingent liabilities for the Group as at 30 June 2006 and 31 December 2005.

16. Related party transactions

(a) During the period, the Group entered into the following related party transaction with a company which is 95% beneficially owned by the relatives of Mr. Sze Man Bok and Mr. Hui Lin Chit, the directors and substantial shareholders of the Company:

	Unaudited Six months ended 30 June	
	2006 HK$'000	2005 HK$'000
Purchase of heat energy	**3,091**	—

The Directors are of the opinion that the above transaction was conducted in the ordinary course of business under normal commercial terms.

(b) For the six months ended 30 June 2006, the key management compensation amounted to approximately HK$ 1,814,000 (2005: HK$ 1,705,000).

17. Comparative figures

Turnover, cost of sales, distribution costs and other gains for the six months ended 30 June 2005 have been reclassified in order to conform to the presentation of the 2006 interim financial information and the annual accounts for the year ended 31 December 2005. The business segment analysis for the six months ended 30 June 2005 has also been amended accordingly. There is no impact on the Group's balance sheet as at 30 June 2005 and its operating result for the six months ended 30 June 2005.

BUSINESS OVERVIEW

With the advent of 2006, the PRC economy sustained steady growth. The Central Government has launched a series of austerity measures to rein in the overheated domestic property market and, on the other hand, also resorted to different policies to control development of the domestic industrial production and raw material industries, in order to prevent any adverse effect on the overall economy caused by robust growth in various industries. These austerity measures have an indirect effect on certain domestic industries. However, enterprises with a competitive edge and substantial strength are still able to continue to grow steadily.

According to the data of the National Bureau of Statistics, preliminary figures for the gross domestic product ("GDP") for the first and second quarters of 2006 amounted to approximately RMB9,144.3 billion, an 10.9% increase over the corresponding period last year. Total retail sales of consumer products during January to June 2006 amounted to approximately RMB3,644.82 billion, a period-on-period increase of approximately 13.3%. Overall income level of the Chinese population increased. Apart from the first tier cities where per capita income continued to increase, per capita income of the population in the second and third tier cities, town and villages in the PRC also continued to grow rapidly. The increase in per capita income has led to a rise in the living standards in the PRC, which together with the enhancement of education level, have led to the popularity of quality personal hygiene products amongst all Chinese population, including the town and rural population, causing a significant increase in consumption in this respect.

The PRC market of personal hygiene products maintained a robust growth in the first half of 2006. Although market competition remained ferocious, market demand for high quality personal hygiene products continued to grow. During the period under review, the price of some of the major raw materials continued to rise, leading to a rise in production costs. In line with the consolidation of the personal hygiene products industry, small manufacturers dropped out of the market due to operational difficulties, while certain large-scale production enterprises with economies of scale have benefited during this consolidation process and experienced a rapid growth accordingly.

In the first half of 2006, the Group continued to actively explore sales channels, improve its product quality and realign its product portfolio. In response to the increasing production costs, the Group sought to control its production costs by enhancing production efficiency, including shortening workflow and reducing raw material wastage rate, and through economies of scale. With effect from the middle of last year, the Group also benefited from the appreciation of Renminbi by the People's Bank of China, as it sourced some of its raw materials from overseas.

For the six months ended 30 June 2006, the Group's turnover amounted to approximately HK$2,038,262,000, representing a period-on-period increase of approximately 41.2%. Profit attributable to shareholders was approximately HK$330,482,000, an increase of approximately 61.9% compared to the same period of last year. The impressive performance in 2006 was mainly attributable to the continuous growth in sales of the three major businesses of tissue paper, disposable diaper and sanitary napkin products. Although prices of some of the major raw materials increased during the period, through launching quality products with high gross profit margin, implementing effective cost control measures, benefiting from economies of scale and appreciation of Renminbi, the Group's overall gross profit margin for the first half of 2006 improved to approximately 41.5% (2005: 40.6%).

In addition, the total of distribution costs and administration expenses for the period decreased to approximately 21.0% of the turnover (2005: 23.2%), mainly resulted from effective cost controls and economies of scale.

BUSINESS REVIEW

Tissue Papers

During the first half of 2006, as the domestic per capita income and living standards continued to rise, there was a surge in market demand for quality tissue products, leading to a strong growth in the sales of the tissue products of the Group. During the period under review, sales of tissue products rose by approximately 45.8% to approximately HK$887,603,000, accounting for approximately 43.5% of the total sales of the Group.

In order to meet the continuously rising market demand, the Group has continued to expand its production capacity. Production efficiency of the first phase of the Shandong production base which commenced production in last year has gradually improved. The new production base in Fujian province, which commenced production in July this year and remained at a preliminary stage, has therefore not yet reached its optimum production efficiency and achieved economies of scale. It is expected to contribute profit to the Group in the second half of this year. During the period, gross profit margin for the Group's tissue paper is approximately 37.2% (2005: 38.4%), the main reason for the drop being an increase in the cost of raw materials and a rise in the proportion of sales of toilet rolls with lower gross profit margin.

Disposable Diapers

The disposable diapers market continued to grow rapidly during the first half of 2006. Demands for diapers in the third and fourth tier cities, towns and villages continued to grow. With the strong distribution networks established in these areas in the past, the Group capitalises on market opportunities, causing the sales of disposable diapers to continue its significant growth in the first half of 2006.

In the first half of 2006, sales of disposable diapers of the Group rose by approximately 54.8% to approximately HK$500,516,000, accounting for approximately 24.6% of the total sales of the Group. The Group strengthened its internal controls and benefited from the economies of scale, partially offsetting the adverse impact of a rise in the cost of some of the key raw materials. Accordingly, gross profit margin of disposable diapers for the period suffered a mild drop to 31.3% (2005: 32.6%). In the future, the Group will continue to actively enhance the quality of its products, and diversify its disposable diaper products to improve its profitability.

Sanitary Napkins

Persistent high cost of raw materials created operational difficulties for domestic mid-to-small-scale sanitary napkins manufacturers, causing some of them to cease production or go into liquidation. As a leading domestic large-scale personal hygiene products manufacturer, the Group has been able to capture some of the market share from such mid-to-small-scale manufacturers. During the period under review, the Group's sanitary napkin business continued to grow, and the mid-to-high-end "Anerle" and "Space 7" brands continued to be popular in the market. During the period, sales of sanitary napkins amounted to approximately HK$614,539,000, a growth of approximately 34.1%. Sales of sanitary napkins accounted for approximately 30.2% of the Group's total sales. Mid-to-high-end sanitary napkin products contributed 79.8% of the total sales of the Group's sanitary napkins (2005: 75.7%). Owing to the satisfactory growth of the mid-to-high-end sanitary napkin products during the period, overall gross profit margin of the sanitary napkin business had a period-on-period increase from approximately 50.4% to approximately 54.7%.

It is anticipated that demands for mid-to-high-end sanitary napkin products will continue to increase. Accordingly, the Group will focus its attention on any market changes, and realign its product portfolio and marketing strategy appropriately in order to capitalise on market opportunities.

Skin Cleansing and Care Products

Market competition of China's skin cleansing and care products has remained ferocious. Sales of "MissMay" products during the period amounted to approximately HK$15,049,000, and a loss before minority interests of approximately HK$2,889,000 was recorded. This business only accounted for approximately 0.7% of the Group's total turnover such that the result of this business does not have any significant impact on the Group's result.

First-aid Products

During the first half of 2006, the Group's first-aid products under the brand names of "Banitore", "Bandi" and "Comfitore" performed well. The Group recorded a profit before minority interests of approximately HK$2,358,000, representing a period-on-period increase of approximately 64.4%.

DISTRIBUTION AND MARKETING STRATEGIES

The Group has a nationwide distribution network for selling its diversified personal hygiene products. In view of the ever increasing demand for personal hygiene products in mainland China, the Group will further explore new markets.

Apart from strengthening collaboration with various chain supermarkets, the Group has also employed numerous sales and marketing professionals to promote its products in small shops and small convenience stores in order to enhance the coverage of the Group's products. During the period, distribution costs accounted for approximately 16.6% of the total turnover (2005: 18.8%).

FUTURE PROSPECTS

As the demand for quality consumer products continues to grow in the PRC market, the Group is optimistic about the prospects of the PRC's personal hygiene and care products market. During the first half of the year, the Group performed well in the businesses of tissue paper, disposable diapers and feminine products, and it is expected that satisfactory growth in these three major businesses will continue during the second half of the year.

As for the tissue paper business, the growth in demand for mid-to-high-end tissue paper products in the PRC is higher than the mid-to-low-end ones in recent years. In order to satisfy overwhelming market demand, the Group has continued to expand its production capacity. Since the first phase of the

Shandong production base commenced production in August last year, the Group's production capacity and economies of scale had gradually improved. The new production base in Fujian commenced production in July 2006, and is expected to contribute profit to the Group in the second half of this year. In order to further expand the Group's production capacity to meet the rapid growing market demand, the construction of the second phase of the Shandong production base has been started in July of the year, and is expected to commence operations in June 2007, while the second phase of the Fujian production base is expected to commence operation in early February 2008. It is expected that the Group will further benefit from the economies of scale, reduce the proportion of production by out-sourcing, and increase the profit of the tissue paper business. In the future, the Group will continue to develop more new products in order to meet the diversified market demand.

Demands for disposable diapers has continued to grow, especially in the third and fourth tier cities, towns and villages. It is expected that the uprising trend will be sustained in the following years. To capture this market opportunity, the Group will continue to enhance the production capacity of disposable 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.

Taking the opportunity arising from the consolidation of the sanitary napkins market, the Group will produce more mid-to-high-end products with better gross profit margin, enhance its product portfolio and improve profitability of this business. At the same time, the Group will also enhance its marketing strength, enhance quality and increase popularity of its products.

Looking ahead, the Group expects the growth trend of its three major businesses to remain strong in the second half of the year. The Group will continue to expand its product capacity and improve its production efficiency in order to satisfy market demand. The management firmly believes that, through its distinguished product quality, extensive sales network, renowned brand awareness and reasonable pricing policy, the Group is able to maintain its leading position in the personal hygiene and care products market in the PRC, bringing satisfactory returns to the shareholders.

LIQUIDITY, FINANCIAL RESOURCES AND BANK LOANS

The Group's financial position remained healthy. As at 30 June 2006, the Group had bank balances and cash of approximately HK$1,147,414,000 (31 December 2005: HK$499,937,000), convertible bonds liability portion of HK$1,457,212,000 (31 December 2005: nil) and short-term and long-term bank loans totally amounted to approximately HK$178,377,000 (31 December 2005: HK$957,598,000). There was a significant drop in bank loans as part of the proceed from the issuance of convertible bonds was used to repay part of the bank loans. During the first half of 2006, the Group's total capital expenditure amounted to approximately HK$189,770,000 and the prepayments made thereon amounted to approximately HK$145,838,000.

The annual interest rates of bank loans ranged from approximately 4.8% to 5.3%. All bank loans are unsecured and there were no charges on the Group's assets. As at 30 June 2006, the Group's gross gearing ratio was approximately 64.6% (31 December 2005: 41.0%) which was calculated on the basis of the amount of borrowings as a percentage of the total shareholders' equity. The net gearing ratio, which was calculated on the basis of the amount of borrowings less bank balances and cash as a percentage of the total shareholders' equity, was approximately 19.3% (31 December 2005: 19.6%). The increase in the gearing ratio was mainly due to the increase in borrowings for construction of new production bases.

FOREIGN CURRENCY RISKS

Over 97% 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 overseas holding company. During the first half of 2006, the Group had not issued any financial instruments or entered into any contracts for foreign currency hedging purposes.

HUMAN RESOURCES MANAGEMENT

As at 30 June 2006, the Group employed approximately 17,000 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.

INTERIM DIVIDEND AND CLOSURE OF REGISTER OF MEMBERS

The Board of Directors has declared an interim dividend of 18 HK cents (2005: 12 HK cents) per share for the six months ended 30 June 2006 to be paid to shareholders whose names appear on the Register of Members of the Company at the close of business on 3 October 2006. Dividend warrants will be despatched to shareholders on or about 18 October 2006.

The Register of Members of the Company will be closed from 3 October 2006 to 6 October 2006 (both days inclusive), during which no transfer of shares will be effected. In order to be qualified for the interim dividend, all transfers accompanied by the relevant share certificates shall be lodged with the Company's share registrar, Abacus Share Registrars Limited, at 26th Floor, Tesbury Centre, 28 Queen's Road East, Hong Kong by 4:00 p.m. on 29 September 2006.

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

At 30 June 2006, the interests of each director in the shares, short position 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 and disclosed in accordance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules") were as follows:

Name	Personal interests (held as beneficial owners)	Family interests (interests of spouse or child under 18)	Corporate interests controlled (interests of 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	206,068,693	6,630,224*	—	—	212,698,917	19.68%
Mr. Yeung Wing Chun	40,794,257	45,619*	—	—	40,839,876	3.78%
Mr. Zhang Shi Pao	12,404,027*	—	—	—	12,404,027	1.15%
Mr. Hung Ching Shan	7,680,000	—	—	—	7,680,000	0.71%
Mr. Xu Da Zuo	20,270,135*	—	—	—	20,270,135	1.88%
Mr. Xu Chun Man	16,493,445*	—	—	—	16,493,445	1.53%
Mr. Loo Hong Shing Vincent	100,000	30,000	—	—	130,000	0.01%

* 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 period 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.

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 30 June 2006, the Company had not been notified of any substantial shareholder's interests and short positions, being 5% or more of the Company's issued share capital, other than those of Mr. Sze Man Bok and Mr. Hui Lin Chit as disclosed above.

SHARE OPTION SCHEME

No option has been granted under the Share Option Scheme approved by the shareholders of the Company on 10 November 1998 nor has there been any option granted since the adoption of the Share Option Scheme by the shareholders of the Company on 2 May 2003 ("New Scheme"). In accordance with the New Scheme, the Company may grant upto 99,531,200 share options within 10 years from its adoption date.

PURCHASE, SALE OR REDEMPTION OF SHARES

The Company did not redeem any of the Company's shares during the period. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's listed securities during the period.

AUDIT COMMITTEE

The Audit Committee is chaired by an independent non-executive director and comprises three independent non-executive directors. It meets at least two times a year.

The Audit Committee provides an important link between the Board and the Company's external and internal 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, including the interim report for the six months ended 30 June 2006.

COMPLIANCE WITH THE MODEL CODE OF THE LISTING RULES

For the six months ended 30 June 2006, 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 six months ended 30 June 2006, and they all confirmed that they had fully complied with the required standard set out in the Model Code.

COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES OF THE LISTING RULES

None of the Directors of the Company is aware of any information that would reasonably indicate that the Company is not, or was not in compliance with the Code on Corporate Governance Practices contained in Appendix 14 of the Listing Rules during the six months ended 30 June 2006.

ACKNOWLEDGEMENT

On behalf of the Board of Directors, I extend my gratitude to all our staff for their hard work and dedication.

By Order of the Board
Hengan International Group Company Limited
Sze Man Bok
Chairman

As at the date of this report, the Board comprises Mr. Sze Man Bok, Mr. Hui Lin Chit, Mr. Yeung Wing Chun, Mr. Hung Ching Shan, Mr. Xu Da Zuo, Mr. Xu Chun Man and Mr. Loo Hong Shing Vincent as executive directors, Mr. Zhang Shi Pao as a non-executive director and Mr. Chan Henry, Mr. Chu Cheng Chung and Ms. Ada Ying Kay Wong as independent non-executive directors.

Hong Kong, 12 September 2006