# Chief Executive Officer's Operation Review and Outlook

Dear Shareholders,

I am delighted to report that ND Paper achieved new heights this year with outstanding operational results, which have already started to reflect the benefits of economies of scale, capital investment, product optimisation and cost management.

## Review of operations

During the year, the Group recorded total revenue and gross profit of approximately RMB7,902,156,000 and RMB1,860,874,000 respectively, representing a year-on-year increase of 63.8% and 1.45 times. Profit attributable to equity holders of the Company was RMB1,374,782,000, an increase of 3.53 times that of the previous year and higher than the profit forecast stated in the Prospectus. Earnings per share were RMB0.41, increasing 3.02 times.

Meanwhile, the Group's designed production capacity and sales of containerboard reached historical high during the financial year. For the year ended 30 June 2006, the Group's designed production capacity increased 17.9% from the previous year to 3.3 million tonnes and the sales volume for the financial year 2006 also increased by 73.8% to approximately 2.83 million tonnes.

The board proposed the declaration of a final dividend of RMB2.30 cents per share in the board meeting held on 20 September 2006. No interim dividend was declared, and the final dividend is to be distributed out of the profit for the period from 3 March 2006 to 30 June 2006. The payout ratio is higher than the 20% benchmark stated in the Prospectus.

Our new paper machines PM9 and PM10 commenced operation on 23 and 25 December 2005, bringing us an additional annual production capacity of 500,000 tonnes of higher performance corrugating medium. These machines have achieved optimal operating efficiency in merely two months, providing us with a particularly joyful Christmas.

To date, we have invested in 10 paper machines, which are all in operation. ND Paper's diversified product mix enables us to serve as a one-stop shop for a broad range of high quality packaging paperboard products. The complementary nature of its products and operation also allows it to strengthen the value and competitiveness of the Group.

Abiding by the principle of long term growth, ND Paper has been persistently investing in raw material resources, infrastructure and production technology, so as to continuously perfect development, improve product quality, optimise cost structure and enhance production efficiency.

To meet our development needs in the long run, we have made various pre-investments, such as pier facilities and water supply facilities. With the support of the local governments, we have obtained additional land use rights, which are sufficient for expanding our total annual production capacity to nine million tonnes. Our newly installed coal-fired electricity power plant is capable of fulfilling the consumption of the Dongguan and Taicang production bases, each with a newly added production capacity of one million tonnes annually. The benefits of these pre-investments will gradually be demonstrated during the course of operation.

We are committed to enhancing the Group's human resources and emphasising our relationship with staff members. In addition to strengthening mutual communications and providing an ideal living environment, we also organise regular special training programmes for the staff in technology research and development, customer service and other aspects in order to enrich their industrial expertise and equip them with high-calibre management or technical skills. Aside from ensuring a sufficient pool of high quality talent to meet the needs of our operations, we always bear in mind our responsibility to contribute to society by assisting poor students with training in paper manufacturing. This programme serves the dual purposes of helping the needy and cultivating talent for the Group. In the future, we will increase our effort to recruit high-calibre professionals across the country to upgrade our overall management standard and improve the quality of our products and services. This will be an integral part of moving towards our goal of being one of the leading industry players of the world.

## Capital expenditure plans

In order to seize the anticipated business opportunities arising from the sustained growth in containerboard products demand, in April 2006 the Group decided to revise its original capital expenditure plans stated in the Prospectus to allow for greater expansion of production capacity in the financial year 2007. Under the revised plan, PM11, PM12, PM13, PM16 and PM17 will commence operation by the end of June 2007, and the Group's aggregate annual production capacity of containerboard is expected to increase by 62.1% to 5.35 million tonnes in the financial year 2007, representing an increase of 750,000 tonnes in aggregate as compared with the Group's original plan disclosed in the Prospectus. It is expected to help further strengthen the Group's leading position in the packaging paperboard market and improve our price competitiveness and profitability.

## Details of the revised capital expenditure plans

In the original plan as set out in the Prospectus, the Group intended to kick start in the financial year 2007 with the production of PM12 for linerboard and PM13 for high performance corrugating medium, and planned to adopt a production layout of one paper machine in each workshop. In order to speed up the expansion of its production capacity, the Group has undertaken a thorough technical feasibility study of the original layout plan together with the technical advisers of its machine suppliers. By adopting a layout of two machines installed side by side in a workshop ("the dual-machine layout"), the Group's production capacity and operating efficiency can be significantly increased. The dual-machine layout is expected to enable the Group to further optimise its product mix and reduce investment, operating and labour costs as a result of sharing equipment and man hours by two machines and more efficient utilisation of space.

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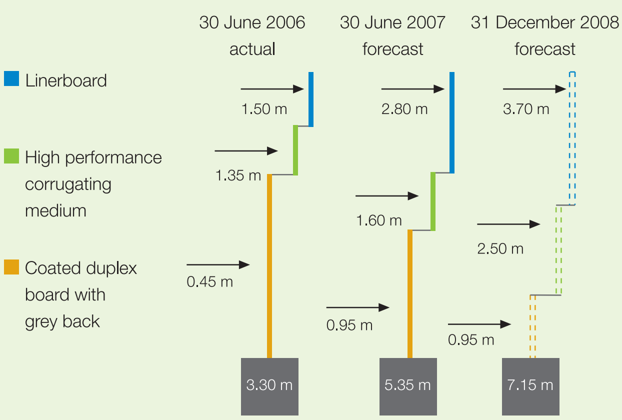
Under the revised plan, the Group will adopt the dual-machine layout and put online two paper machines for each workshop, that is, PM12 plus PM13 (instead of only PM12 under the original plan) for one workshop, and PM16 plus PM17 (instead of PM13 under the original plan) for the other. The aggregate annual production capacity will be 700,000 tonnes more than the original plan. The Group will upgrade the annual production capacity of PM8 by 50,000 tonnes of high performance corrugating medium with two-ply sheet from 450,000 tonnes to 500,000 tonnes of linerboard with three-ply sheet in the financial year 2007.

The following table sets forth the information relating to the growth of the Group's annual production capacity in the financial year 2007:

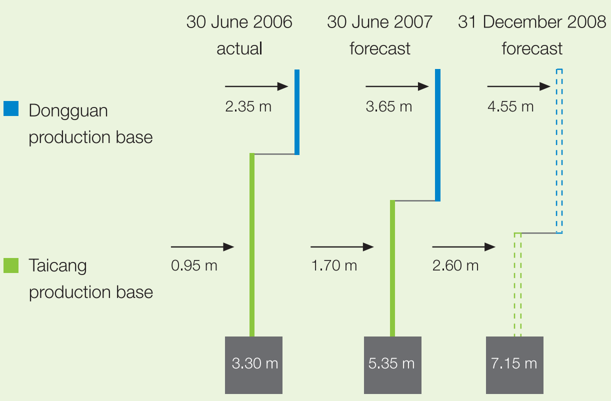
| Paper machine | Location | Product | Annual production capacity | Expected date of commencement of operation |
|---|---|---|---|---|
| PM11 | Dongguan | Coated duplex board with grey back | 500,000 tonnes | Before the end of March 2007 |
| PM12 plus PM13 (originally only PM12) | Dongguan | Linerboard | Totally 800,000 tonnes | Before the end of June 2007 |
| PM16 plus PM17 (originally only PM13) | Taicang | High performance corrugating medium | Totally 700,000 tonnes | Before the end of June 2007 |
| PM8 | Taicang | Linerboard | Increasing by 50,000 tonnes to 500,000 tonnes | Before the end of June 2007 |

The following charts set forth the information relating to the Group's annual production capacity as at 30 June 2006 and 2007 (upon completion of the revised plan) and 31 December 2008:

**Production capacity – by product (tonnes)**




**Production capacity – by production base (tonnes)**



The increase in the capital expenditure will dramatically improve the utilisation efficiency of the Group's investment cost, allowing it to capture anticipated business opportunities in the containerboard market and deliver a higher return to our shareholders. The Group looks forward to maximising the benefits from such capital expenditure with the accumulated experience and technical know-how derived from the successful installation and operation of 10 paper machines so far and the cost savings from adopting the dual-machine layout.

Despite all these changes in the future capital expenditure, the use of the net proceeds raised from the issue of the new shares of the Group is consistent with what was set out in the Prospectus.

## Reasons for implementing the revised capital expenditure plan

We consider that the implementation of the revised capital expenditure plan is in the best interest of the shareholders and the Group as a whole and will not have any adverse material effect on its liquidity or gearing position. The revised capital expenditure plan will enable the Group to capture the anticipated market opportunities while the additional capital expenditure is relatively small as compared with the incremental production capacity and the expected cost savings.

## Financial performance

The Group's results for the financial year 2006 reflect the benefits of its pre-investment, the vision of its management team and the advanced standard of its technology in the packaging paperboard industry. Revenue of the Group's products increased across the board with total revenue growing by 63.8% to RMB7,902,156,000.

Despite a general increase in business activities during 2006, our operating expenses were well contained due to the gains in our productivity. Operating expenses net of depreciation increased from RMB4,123,963,000 to RMB6,116,606,000. However, by virtue of the benefits from economies of scale, product optimisation and cost management, operating margin for the year improved significantly to 22.9% from 11.6% in 2005. Depreciation charges increased by 97.9% to RMB331,329,000 from RMB167,392,000 in 2005, mainly due to the full-year contribution of PM4 and PM5, which were acquired in January 2005, and PM6, PM7 and PM8, which commenced operation in the financial year 2005. Together with the commencement of operation of PM9 and PM10 during the period, our production capacity increased significantly. Finance costs increased 63.9% to RMB294,793,000 mainly as a result of the increased amount of borrowings. Net of the income tax expenses of RMB116,286,000, the Group's profit attributable to equity holders for the year was RMB1,374,782,000, a significant increase of 3.53 times over 2005.

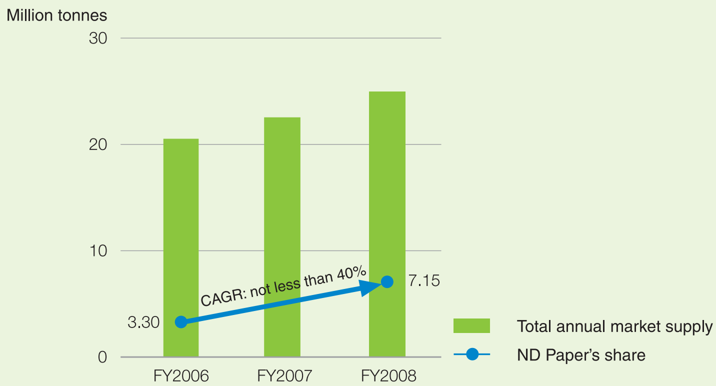
On 19 September 2006, the Group successfully raised US$350 million by a loan syndication, enabling us to obtain cost-effective long-term funds. The attractive terms of our new financing also enable us to reduce our average borrowing cost in the coming financial year and enjoy the benefits from revaluation of RMB in the future.

## Prospects

The rate of sustained growth of demand for containerboard products has exceeded the management's expectation. Given the promising market landscape on the horizon, the management is fully confident of the Group's future development. We will maintain our strategy of active expansion to increase our market share and strengthen our leadership globally and in China. Indeed, our management's wisdom in making the right decisions in respect of business development and capital expenditure is evident in the Group's brilliant track record. The Group aims to become the world's leading manufacturer of packaging paperboard products. Hence, our management will closely monitor market developments and prudently analyse the demand for our products in order to seize every business opportunity. In this connection, we will fully capitalise on our substantial pre-investments, the expertise of our management and the successful and rich experience in operating our ten paper machines. We will also refine our existing product mix as appropriate and seek new investment projects, while applying the principle of low costs and high productivity to create a better value for our shareholders.

The Group expects the packaging paperboard business to continue its high pace of growth for the next five years, mainly driven by the increase in domestic consumption in China and export packaging demand. We foresee that total imports of containerboard in the coming five years will stand at around four million tonnes per year.

The following chart sets forth the Group's plans for expanding its annual production capacity in the next three years:




It is expected that the Group's packaging paperboard manufacturing business will experience a compound annual growth rate of not less than 40% until 2008. Hence, the Group aims to substantially expand its annual production capacity by 62.1% from the current 3.3 million tonnes to 5.35 million tonnes in the coming year. We are also planning to invest in four additional paper machines in the financial year 2008 so as to further expand our annual production capacity by 1.8 million tonnes from 5.35 million tonnes to 7.15 million tonnes. Such 1.8 million tonnes additional annual production capacity consists of one million tonnes of linerboard and 800,000 tonnes of high performance corrugating medium. We intend to finance future capital expenditure by internally generated funds and bank loans. The Group will continuously assess the risks involved and maintain its net gearing ratio within the range between 45% and 55%. The Group does not rule out the possibility of entering into strategic joint ventures or acquisition projects which can create value for shareholders and the Group, in order to enhance its return on assets and capital employed.

## Appreciation

On behalf of the management, I would like to express my sincere gratitude to the government authorities, clients, suppliers and business associates for their support, and to our management team and staff for their loyalty, which form a sound foundation for our steady growth and outstanding results. I would also like to express my immense appreciation to our shareholders and friends from the financial sector for their unreserved support, which allowed us to become a new star in the investment market and attract much attention when ND Paper was listed. The management hereby commit ourselves to maintaining our efforts to live up to the high expectations of our shareholders and business associates for even better results and returns.

**Liu Ming Chung**
*Deputy Chairman and Chief Executive Officer*

Hong Kong, the PRC, 20 September 2006