Investment

Business Review

In China, the packaging paperboard production industry (including the containerboard production sector) is relatively fragmented, and there are a large number of manufacturers. However, it is capital intensive, susceptible to environmental conditions and subject to limited supply of raw materials and that contribute to substantial entry barriers for large-scale investment in the paper manufacturing business.

According to the statistics from Resource Information Systems Inc. ("RISI"), as at 31 December 2004, the Group remained the biggest containerboard producer in China and one of the biggest in the world. The Group produces primarily linerboard, including kraftlinerboard, testlinerboard and white top linerboard, high performance corrugating medium and coated duplex board with grey back. The Group also participates in unbleached kraft pulp production.

The Group's operations enable it to serve as a one-stop shop for a broad range of high quality containerboard products. Due to the size, width, versatility and number of its paper machines, it is able to offer a diversified product portfolio with various types, grades, burst indices, stacking strengths, basis weights, printability and brands to meet a variety of customer requirements. The Group's multiple production lines allow for a flexible configuration offering of diversified product in an efficient manner. The broader width of its machines also allows the Group to produce products in a large variety of sizes, increasing its flexibility to meet customer demands. Its five principal products are available in 30 different basis weights and over 1,000 different sizes and type specifications.

The Group's ten technologically advanced paper machines imported from Europe, North America and Japan have an annual aggregate designed capacity of 3.3 million tonnes, comprising 1.5 million tonnes of linerboard, 1.35 million tonnes of high performance corrugating medium and 450,000 tonnes of coated duplex board with grey back. All of the Group's paper machines have advanced Distribution Control Systems ("DCSs") and quality control systems to monitor and control the equipment. These are located in the Group's two production bases in Dongguan, Guangdong Province, in the Pearl River Delta and in Taicang, Jiangsu Province, in the Yangtze River Delta Region.

Other than the 10 paper machines, there are additional supporting facilities that provide the Group with power, steam, water supplies and existing logistical support which together form an integral part of its operation. The integration of these facilities provides cost savings, increases the Group's flexibility and control over its business which enables it to reliably and efficiently serve its customers.

The Group's Dongguan and Taicang production bases obtained the ISO9001:2000 certification in November 2003 and December 2004 respectively. Meanwhile, the Group also obtained the ISO14001 certification for its environmental management standards in February 2005 and the OHSAS18001 certification for its occupational health and safety management system in March 2005.

Business Strategy

The Group aims to become the world's leading containerboard product manufacturer. The Group is able to increase its operational efficiency primarily through economies of scale, technologically advanced equipment, integrated production facilities and equipment know-how. During the year, the Group continued to seek sustainable business growth and increase shareholders' value. To achieve this, the Group focused on the implementation of the following strategies: Continuing to expand market leadership position in China, further enhancing operating efficiency, expanding geographical coverage and product offerings, as well as attracting high caliber employees and continuing to emphasize and reward performance excellence.

Management Discussion & Analysis

Continuing to expand market leadership position in China

The Group has achieved significant growth in production capacity, sales volumes, sales and profit attributable to equity holders at a compound annual growth rate of 48.9%, 50.3%, 52.1% and 131.6%, respectively, from financial years 2003 to 2006.

The Group will continue to expand its production capacity and market share so as to further strengthen its leading position in China. Its annual designed capacity increased by 17.9% to 3.3 million tonnes during the financial year 2006 and is expected to increase by 62.1% to 5.35 million tonnes in the financial year 2007. The Group well-prepared to capture any opportunity for future growth. The Group has made the following substantial investment to secure important resources:

Pre-investment in power resources for further development

As a large-scale containerboard manufacturer, the Group requires a significant amount of electricity and steam for its daily operations. The Group has set up central coal-fired cogeneration plants in both Dongguan and Taicang, providing both electric power and steam to all of its paper machines, thereby saving energy costs and valuable land resources. Because of their high thermal efficiency and low coal consumption, the Group can achieve savings as much as around one-third by using electric power from the Group's cogeneration plants compared to the cost of purchasing power from third parties. The Group's sourcing strategy for coal is to purchase from suppliers that can provide a stable and reliable supply at the lowest cost. To lower its coal costs, since September 2005, the Group has started to purchase all of its coal directly from coal distributors and arranged its own shipping. The Group receives the coal by ship at its pier in Taicang and at Xinsha Port.

With the power generators Unit 6 in Dongguan and Unit 2 in Taicang, with an installed capacity of 210 MW and 120 MW respectively, commencing production in mid 2005, the aggregate installed capacity of the Group has increased to 591 MW. In addition to electricity, the power plants also produce steam for use in the drying process in the production process. The Group's current installed generating capacity in Dongguan and Taicang can support annual production capacity expansion of up to an additional approximately two million tonnes at each of its two locations. This is sufficient to meet the electricity demand of the project to expand the Group's annual production capacity in financial year 2007.

All of the Group's power plants are connected with the regional power grid, which enables the Group to sell excess power generation. In addition, the connection to the grid provides the Group with a back-up power source in contingency.

Abundant land resources to meet the nine million-tonne productivity target

The Group has made substantial investments in acquiring land use rights in Dongguan and Taicang for its existing operations to allow for future development and expansion. The Group obtained the land use certificates for approximately 1.1 million sq.m. of land in Dongguan. To date, the Group has obtained approximately 2.6 million sq.m. of land in Taicang, which is a distance of approximately 50 km from Shanghai. The Group's land use rights are for 50 year terms.

In addition, in anticipation of future expansion plans, the Group has entered into compensation agreements with existing users of additional land of approximately 800,000 sq.m. in Dongguan. These land use rights are intended for use by additional manufacturing and infrastructural facilities as the Group further expands its capacity.

The Group plans to enter into land use rights agreements with the government for additional land and apply for land use rights certificates for such land after execution of the land use rights agreement with the government. The land use rights obtained by the Group, together with the land for which the Group has entered into compensation agreements with existing users, are sufficient to accommodate expansion of its total annual production capacity to approximately nine million tonnes in the future.

Building Taicang Pier to reduce loading and unloading charges

In order to reduce port loading and unloading charges, avoid transportation bottlenecks and take advantage of ocean and inland waterway transportation, the Group has constructed a shipping pier at Taicang which can accommodate two berths in the near future. The Group completed construction of one berth in September 2005 and plans to construct another berth. The shipping pier is capable of accommodating oceangoing vessels of up to 50,000 tonnes. The Group has obtained all necessary permits to operate the shipping pier for its own use and to offer loading and unloading services to third parties.

The operating berth, with an annual loading and unloading capacity of 2.7 million tonnes, is dedicated to receiving coal deliveries. The Group plans to utilise approximately one million tonnes of the capacity per year of this berth for delivery of coal used for power generation at its Taicang facility. Given that the Group can take direct delivery by ocean freight from the major coal ports on China's coast, including Qinhuangdao, Tianjin and others, the Group is able to realise significant cost savings cost-savings by eliminating loading and unloading charges that the Group would otherwise have to pay for transshipment of coal. The Group plans to complete the second berth by the end of financial year 2007 with an expected annual loading and unloading capacity of approximately 3.3 million tonnes. The Group intends to use the second berth to receive direct deliveries of recovered paper and kraft pulp, and to ship its finished products to customers throughout the Yangtze River Delta area and upriver to other potential inland markets, such as Tianjin and Chongqing, and export markets. In addition, the Group plans to offer bulk loading and unloading services to third parties to take advantage of its excess loading capacity.

The expanded pier, with a total annual loading and unloading capacity of approximately six million tonnes after completion of the second berth, is expected to allow the Group to take advantage of inexpensive river transportation to satisfy its current and future transportation requirements for finished products, raw materials and coal. The expansion is in line with the Group's strategy to reduce costs and further expand its production capacity and coverage of inland markets.

Committed to environmentally responsible practices

The Group considers the implementation of environmentally responsible practices and the maintenance of high environmental standards a valuable asset and competitive strength of the Company. The Group obtained ISO14001 certification for its environmental management standards in February 2005. As part of this environmental commitment, the Group has adopted the following practices and invested in the following facilities, which significantly reduce the impact of its operations on the environment and the risk of exposure to liabilities under environmental protection laws and regulations:

- Approximately 80% to 90% of the fiber in the Group's products on average is derived from recovered paper. In addition, the Group recycles its scrap fiber by-product in linerboard production to supplement the raw materials used to produce high performance corrugating medium.

- To minimise impact on waste resources and the environment, the Group has wastewater treatment facilities in Dongguan and Taicang that incorporate state-of-the-art technologies. The Group's wastewater treatment facilities have automated programmable logic controller (PLC) systems and online monitoring equipment systems that allow the Group to monitor its wastewater discharge.

- To conserve and minimise the impact on water resources, the Group set up a water recycling and conservation system in Dongguan and Taicang to significantly reduce its water consumption at each of its production lines. To take advantage of the different water quality requirements for different production lines, water used in the manufacture of coated duplex board with grey back is treated and recycled and use in the high performance corrugating medium lines, before it is treated again and released. The paper production process consumes, depending on the product, approximately six to 15 tonnes of water, including treated and recycled water, for each tonne of product produced. This is less than half of that set forth in the standards governing water consumption in the manufacturing of paper products issued by the China National Standardization Administration Commission.

- To minimise waste products, the Group has a circulating fluidized bed waste-to-energy boiler at Dongguan capable of burning 87,500 tonnes of waste a year to produce 315,000 tonnes of steam. To optimise its use, in Dongguan, the Group collects solid waste from its wastewater for incineration. The circulating fluidised bed waste-to-energy boiler provides efficient combustion, low atmospheric emissions and has the ability to burn a wide range of low-grade fuels, including waste sludge, in an efficient and environmentally friendly manner. The Group believes that its waste-to-energy boiler is the only one of its kind used by paper manufacturers in China. In Taicang, the Group disposes of it solid waste by using it to produce recycled pallets.

- The Group's coal-fired cogeneration power plants in Dongguan and Taicang are equipped with particulate filtration and desulfuration equipment, with emission levels well below permitted emission levels under applicable PRC regulatory requirements.

- Since its establishment, the Group has been in compliance with the environmental laws and regulations promulgated by central and local environmental authorities. It has obtained all required permits for wastewater discharge, airborne emissions and solid waste disposal. It is believed that the Group's record of environmental compliance has been a positive factor in obtaining regulatory approvals for its expansion projects.

Continuing to enhance operating efficiency

The Group's multiple production lines provide economies of scale while its ability to manufacture a variety of products simultaneously allows it to minimise equipment shutdowns required for product and specification changes. The Group has technologically advanced paper machines with automated DCSs and quality control systems. Its fourdrinier kraftlinerboard paper machines are among the largest and fastest in China, and certain machines can shift the production from one type of product to another either without stopping the production run or with only a brief shutdown. The Group has designed its product mix both to meet market demand and to meet the target of recycling by redeploying water and scrap fiber by-product from the production of one product into the production of another product. Leveraging on its equipment know-how, the Group has been able to accommodate the use of an increased variety of recovered paper grades while maintaining product quality and performance characteristics. This feature provides the Group with increased flexibility in sourcing raw materials at competitive prices.

The Group seeks to continue enhancing its operating efficiencies mainly through the following means: Optimising and upgrading its production process and equipment to eliminate or minimise impediments to increase production volumes while enhancing production efficiency and product quality, and developing the use of new alternative chemicals with suppliers to improve machine performance and reduce costs.

Adding new production facilities to save time and increase utilisation

The Group has installed additional paper machines to allow the Group to further minimise equipment shutdown period required for product and basis weight changes. With the exception of periodic repair and scheduled maintenance, the Group seeks to maintain uninterrupted operation of its paper machines. PM9 and PM10, which have an annual production capacity of 500,000 tonnes of high performance corrugating medium, commenced production on 23 December and 25 December 2005 respectively. The machines achieved the optimal operating efficiency within merely two months, substantially shorter than the historical average optimising time of three to six months.

The following table sets forth information on the utilisation rates and actual hours of operation of the Group's paper machines during the year:

	For the year ended 30 June			
	2006		2005	
Paper machine	**Actual hours of operation**	**Equipment utilisation (%)**	Actual hours of operation	Equipment utilisation (%)
PM1	**8,127**	**95.4**	7,849	94.0
PM2	**8,097**	**95.0**	7,857	94.1
PM3	**8,108**	**95.2**	8,026	96.1
PM4	**7,980**	**95.7**	7,459	93.5
PM5	**8,111**	**96.0**	7,596	94.6
PM6	**7,777**	**94.0**	3,784	85.6
PM7	**7,833**	**94.5**	3,864	87.2
PM8	**7,982**	**94.5**	1,096	84.4
PM9	**3,782**	**95.3**	–	–
PM10	**3,491**	**87.8**	–	–

As of 30 June 2006, the management of the Group has accumulated extensive experience in successful installation of 10 paper machines. In the financial year 2006, the average utilisation rate of the Group's paper machines was 94.3%, and their actual hours of operation and utilitisation rates both improved across the board as compared with last year. Meanwhile, the optimising time of PM9 and PM10 was also substantially reduced and achieved the designed capacity and quality within merely two months. Therefore, we believe the commencement of new paper machines in the future will not materially and adversely affect the average gross profit margin of the Group.

Sources of high quality and price competitive raw materials

Recovered paper and kraft pulp are the Group's principal raw materials used in the manufacture of its products. Therefore, the ability to maintain a stable source of high quality raw materials at a reasonable price is one of the Group's keys to success.

Management Discussion & Analysis

Recycled Paper

Recovered paper is the Group's largest raw materials component. Like most large-scale containerboard manufacturers, the Group's ability to source large volumes of consistent high-quality recovered paper under stable, long-term arrangements is critical to its success. Because of the Group's policy of maximising the use of recovered paper to produce high-quality products to meet its customers' cost objectives and environmental policies, this ability is even more critical to the Group's strategy. As a result, the Group's sourcing strategy is to purchase from suppliers that can offer reliable and high volume supplies of recovered paper with consistent quality. To select additional suppliers, the Group's sourcing department compares the quality and price of recovered paper from major suppliers and considers each supplier's ability to satisfy its volume and delivery requirements. Currently, the majority of the Group's recovered paper comes from North America and Europe, as the Group has found the quality of such recovered paper to be relatively more consistent compared to other sources.

America Chung Nam, Inc. ("ACN") is a major exporter and supplier of recovered paper to China, and is indirectly wholly owned by Ms. Cheung Yan ("Ms. Cheung") and Mr. Liu Ming Chung ("Mr. Liu"). ACN sources its waste paper globally, including the United States and Europe, and has its own recycled paper packing plants. It is the largest exporter of recovered paper from the United States and Europe to China and is well-known in the international market. ACN was ranked from 2001 to 2004 by the Journal of Commerce as the top US exporter from the United States to China in terms of volume for exports of recovered paper with a volume of approximately 153,900 TEUs (twenty footer equivalent units) in 2001, which was later increased to approximately 201,000 TEUs in 2004. It procures recovered paper from major suppliers globally pursuant to long-term supply contracts to ensure a continuous and stable supply of recovered paper.

The Group sources the majority of its recovered paper from ACN and the remainder from several trading companies. For the financial years ended 30 June 2005 and 30 June 2006, the Group's purchases of recovered paper from ACN amounted to RMB1,888,101,000 and RMB2,591,692,000, respectively, representing 86.0% and 78.9% of Group's total purchases of recovered paper. During the same periods, the Group purchased approximately 1.55 million tonnes and 2.45 million tonnes of recovered paper from ACN and the remaining 196,000 tonnes and 526,000 tonnes of recovered paper from other suppliers.

Due to the Group's recurring purchases of recovered paper in large quantities, the Group has been able to secure supplies from ACN at a price lower than the market average. The Group also has a policy to diversify its sources of supply and to maintain at least a small proportion from suppliers other than ACN.

The Group's sourcing strategy is to source from suppliers that can offer a reliable supply of recovered paper with consistent quality. In selecting suppliers, the factors of consideration are quality, price and each individual supplier's ability to satisfy the relevant volume and delivery requirements. The Group's position as the leading containerboard manufacturer in China provides it with considerable bargaining power. Furthermore, the Group has sufficient manpower, resources and expertise to develop strong relationships with suppliers. To secure the stability of supply and improve transparency in the course of dealing, the Group will source not less than 20% of its recovered paper in terms of aggregate value of its purchases of recovered paper from suppliers other than ACN annually. In addition, ACN has agreed that prices and terms offered to the Group will be no less favourable than those offered to its other customers in respect of the same period and the same product type. In this regard, ACN will provide the Group access to its books and records for the purpose of examining ACN's supply terms with its other customers. The examination will be carried out by the general managers of members of the Group and/or the Group's external auditors on a quarterly basis.

ACN's board of directors and management team are independent of the Company. Ms. Cheung and Mr. Liu are not directors of ACN and are not involved in the day-to-day management of ACN. Day-to-day management of ACN is carried out by a team of 10 independent senior management members. Such team includes, among others, all the directors of ACN. As directors of the Company, Ms. Cheung and Mr. Liu, together with the Group's senior management teams, are responsible for the operation and management of the Group. However, the Company has delegated the management of the transactions between the Group and ACN to certain members of the Group's senior management other than Ms. Cheung and Mr. Liu. In addition, Ms. Cheung and Mr. Liu will, together with their associates, Mr. Zhang Cheng Fei ("Mr. Zhang") and Mr. Lau Chun Shun, who are the Directors, abstain from voting at the board meetings of the Company in respect of the supply arrangement between ACN and the Group.

The Group has also adopted an independent system with the following features to govern and monitor its recovered paper purchase process:

(a) the Group will obtain bids from a number of independent suppliers and select the successful bid based on objective standards such as price and quality of recovered paper, and delivery schedule and services;

(b) one of the independent non-executive Directors with solid industry expertise will review the Group's selection of successful bid each time before placement of orders by the Group;

(c) the independent non-executive Directors, if required, will decide on whether the Group should proceed with a particular purchase transaction; and

(d) regular reports regarding the Group's purchase and other relevant information will be provided to the independent non-executive Directors who will conduct a quarterly review of the purchase terms and the fairness of the Group's basis for selecting its recovered paper suppliers.

We believe that the above system will ensure that the terms of the Group's purchases with its suppliers, including ACN, are in the best interests of the Company and its independent shareholders as a whole.

The Group has entered into a contract with ACN at arm's length commencing on 3 March 2006 and expiring on 30 June 2008 for the supply of recovered paper. The contract is renewable for a further period of three years at the Group's option, as well as for successive periods of three years with terms to be negotiated between the parties on a fair and reasonable basis and in compliance with the Listing Rules. Under the supply contract with ACN, the Group has priority in supply over ACN's other customers. Prices of recovered paper under the contract will be determined with reference to the prevailing prices in the recovered paper market in China comparable to those offered by independent suppliers. As the Group's purchases from ACN currently account for only approximately half of ACN's total sales volumes to China its priority to purchase from ACN under the long-term supply contract as well as the Group's other sources of recovered paper supply, the Group will have sufficient raw material supply to support its capacity expansion.

Management Discussion & Analysis

Kraft Pulp

Kraft pulp is the Group's second largest raw materials component. The Group uses both bleached and unbleached kraft pulp in the production of some of its products to increase the consistency of appearance and strength of the products. Due to the short supply of kraft pulp in China, a stable supply of substantial volumes of consistent high quality kraft pulp is critical to the Group's success. The Group's sourcing strategy is to seek to maintain a diversified source of kraft pulp, to ensure stable supply and cost competitiveness while meeting its quality requirement. The Group currently imports most of its kraft pulp and sources only a small proportion from China. To take advantage of ACN's volume of shipments to China and favourable ocean freight rates, the Group has entered into a long-term service agreement with ACN at arm's length commencing on 3 March 2006 (the listing date) and expires on 30 June 2008 for import services in connection with the import of kraft pulp.

To secure a future supply of unbleached kraft pulp, on 16 February 2004, the Group established an equity joint venture, Nine Dragons Xing An Paper Industries (Inner Mongolia) Company Limited ("ND Xing An"), with China Inner Mongolia Forestry Industry Co., Ltd. (中國內蒙古森林工業集團有限責任公司) ("Forestry Industry Group"). The Group holds a 55% interest in ND Xing An while Forestry Industry Group holds the remaining 45%. As at 30 June 2006, ND Xing An had the capacity to produce 100,000 tonnes of long-fibred unbleached kraft pulp annually. The Group plans to increase ND Xing An's annual production capacity to 300,000 tonnes in the future. ND Xing An obtains its raw materials, which are wood logs and wood chips, from the extensive softwood forests in Inner Mongolia owned and managed by Forestry Industry Group under an agreement commencing on 3 March 2006 and expiring on 30 June 2008. Under the terms of the joint venture, the Group has the right to purchase, in priority to other customers of ND Xing An at the same price, up to its entire output, providing the Group with a secure supply of unbleached kraft pulp. During financial years 2005 and 2006, the Group purchased approximately 7.8% of its kraft pulp and 10.1% of its unbleached kraft pulp from ND Xing An, with the balance of unbleached kraft pulp sold to third parties. The ND Xing An joint venture enables the Group to secure a future supply of unbleached kraft pulp. However, the Group continues to import most of its supply of unbleached kraft pulp as the costs of transporting unbleached kraft pulp from Inner Mongolia to its production facilities in Dongguan and Taicang currently exceed that of importing it from abroad.

Retaining in-house maintenance teams to enhance the life span and efficiency of production equipment

The Group has over 700 maintenance personnel who have undergone training provided by the original equipment vendors and are responsible for periodic repair and maintenance of its paper machines. The paper machines are regularly inspected and maintained by the Group's maintenance teams to ensure that they are in proper working order. The paper machines are also subject to scheduled inspections and maintenance twice a month and are shut down for approximately 20 hours during this monthly maintenance. The Group also schedules an annual maintenance program for each paper machine during which the paper machine is shut down for approximately three to five days, and a major maintenance program for each paper machine once every three years, during which the paper machine is shut down for approximately 10 to 15 days. The Group upgrades its production equipment concurrently with its repair and maintenance from time to time to increase the life span and efficiency of its production equipment.

Use of information technology to optimise resource allocation

The Group is in the process of implementing an enterprise resource planning (ERP) system for its Dongguan and Taicang operations. It will manage, control and track all aspects of operations, including inventory control, operation and maintenance of the paper machines, quality control of its products, sales and marketing and delivery of its products through its internal transportation and delivery network. The system is scheduled to be fully implemented in the financial year 2007. All paper machines have DCSs that monitor and control all aspects of production and automated quality control systems. Manufactured by Honeywell and ABB, the automated control systems are designed to be linked, and provide data input, to the enterprise resource system. The enterprise resource planning system is expected to provide the Group with up-to-date information to determine optimal resource allocation in terms of financial planning and operations management. In order to enhance work place safety, the Group installed an additional protection device in the DCSs of the paper machines for the operating staff to confirm activation of the paper machines. Its fleet of trucks at Dongguan is also equipped with GPS.

Seeking to expand geographical coverage and product offerings

The Group actively seeks opportunities to expand its geographical coverage beyond the Yangtze River Delta and the Pearl River Delta regions. So far, the Group has already established warehouses in Tianjin and Chongqing. In the future, it will extend its presence in inland regions such as the central-western and the northeastern region of China as the manufacturing industries in these areas become more active. The Group also seeks to increase its exports to tap selected international markets.

The Group is actively exploring opportunities to expand its product lines to allow the Group to offer a broader range of complementary products to customers, and to leverage its existing production expertise and distribution network.

Attracting high caliber employees and continuing to emphasize and reward performance excellence

The Group is led by an experienced and dedicated management team, particularly its founding shareholders Ms. Cheung, Mr. Liu and Mr. Zhang. The founders, who have led the Group through its rapid growth and expansion since its establishment in 1995, have an average of approximately 16 years of experience in the recovered paper recycling and paper manufacturing businesses. Other senior management have an average of approximately eight years' experience in the field. The Group also retains international talents from overseas with professional qualifications to join its senior management team. Through management's leadership, vision and drive, and their consistent effort to implement international best practices, the Group has become the market leader in China within a short period of time. Most of the senior management have been with the Group or its subsidiaries since their establishment.

We believe that the quality of the Group's human resources, particularly its management and professional engineers, are critical to its ability to compete effectively. The Group aims to achieve and exceed international standards of performance excellence by following international best practices for management processes and corporate governance.

As at 30 June 2006, the Group had approximately 7,460 full time management, administration and production staff in Hong Kong and the PRC. The related employee's costs for the period (including directors' emoluments) amounted to approximately RMB337,155,000. The Group ensures that the pay levels of its employees are competitive and employees are rewarded on a performance related basis within the general framework of the Group's remuneration system. The Group adopted a share option scheme for employees. It also seeks to continue to attract and retain domestic and international management and engineering talent by continued implementation and refinement of its incentive bonus program and through staff development programs such as periodic in-house and overseas training. Last but not least, the Group obtained the OHSAS18001 certification for its occupational health and safety system in February 2005.

Financial Review

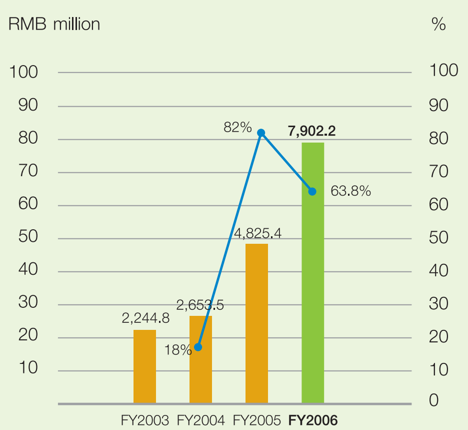
Revenue

For the year ended 30 June 2006, the Group achieved record revenue of RMB7,902,156,000, an increase of 63.8% over the previous financial year. This brilliant result was primarily due to the full year contribution in the financial year 2006 by PM4 and PM5, which were acquired in January 2005, and by PM6, PM7 and PM8, which commenced operation in the financial year 2005. The commencement of operation by PM9 and PM10 during the current financial year also provided a boost in productivity.

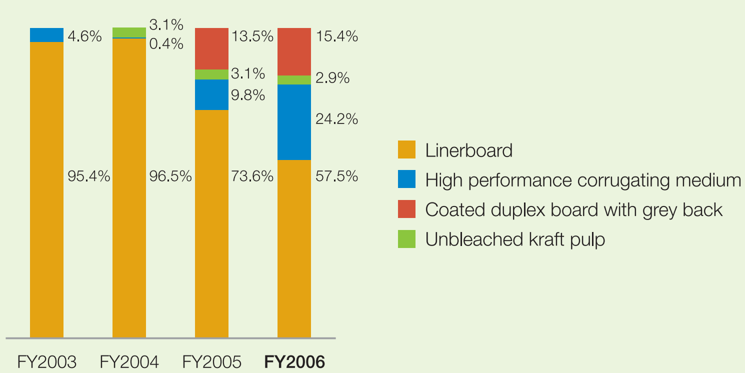
The Group's customers are primarily corrugators who use the Group's containerboard products to manufacture corrugated containers for their end user customers, as well as coated duplex board packaging and printing companies that manufacture printed packaging boxes according to the specifications of their end user customers. The Group sells substantially all of its products to customers in China. A significant portion of such domestic sales is made to foreign invested processing enterprises for further export sales and is denominated in foreign currency, while other domestic sales are denominated in RMB. The raw materials used in products manufactured for export sales by these foreign invested processing enterprises in China are exempt from customs duties and value-added taxes. As a result, the products that the Group sells as raw materials to these foreign invested processing enterprise customers for their further processing and export are also exempt from customs duties and value-added taxes. For the two financial years ended 30 June 2005 and 2006, sales denominated in foreign currencies, which primarily represented sales made to foreign invested processing enterprises, constituted 51.0% and 40.1% of the Group's total sales respectively.

For the financial years ended 30 June 2005 and 2006, the Group's five largest customers in aggregate accounted for approximately 10.6% and 7.9% of the Group's sales respectively. Sales to the single largest customer for the same periods accounted for approximately 2.8% and 2.4% of the Group's sales respectively.

Revenue and revenue growth



Revenue by products



The growth in revenue was primarily due to the increase of the Group's total sales volume of packaging paperboard products to approximately 2,760,000 tonnes in the year ended 30 June 2006 from approximately 1,578,000 tonnes in last year, representing an increase of approximately 74.9%. The Group's total sales volume of unbleached kraft pulp products also increased to approximately 66,000 tonnes from approximately 47,000 tonnes in last year, representing an increase of approximately 40.4%. The significant increase in the total sales volume reflected the Group's commencement of production of PM6, PM7, PM8, PM9 and PM10, as well as the contribution from PM4 and PM5 acquired as part of the acquisition of certain subsidiaries, including Nine Dragons Paper Industries Co, Ltd, Millennium Scope Limited, Emperor Dragon Paper Industries Co, Ltd, River Dragon Paper Industries Co, Ltd and their respective subsidiaries ("Acquired Subsidiaries") on 1 January 2005. During the year ended 30 June 2006, the Acquired Subsidiaries contributed sales of RMB3,446,178,000, representing 43.6% of the Group total sales for the current financial year.

Gross profit

The gross profit for the financial year 2006 was RMB1,860,874,000, an increase of RMB1,100,370,000 compared to the RMB760,504,000 recorded in the previous financial year. Gross margin for the year also improved from 15.8% to 23.5%. The increase in gross margin was due to economies of scale from production capacity expansion, further optimisation of the Group's paper machines, realisation of synergies from the Acquired Subsidiaries and management's effort to control overheads.

Other gains – net

Other gains, net, of the Group increased significantly to RMB356,982,000 in the financial year ended 30 June 2006 from RMB24,122,000 in the previous financial year. The increase was primarily due to the commencement of operations of power generator Unit 6 of the Group's coal-fired cogeneration power plant in Dongguan and Power Plant Unit 2 in Taicang in mid 2005, which resulted in a significant increase in the sales of excess electricity to RMB150,118,000 in the financial year ended 30 June 2006 from RMB3,650,000 in the previous financial year. The increase in other gains, net was also attributable to the interest income of RMB117,695,000 derived from the lock up of subscription monies of approximately HK$178.9 billion from over-subscription during the listing of the Company's shares in March 2006.

Management Discussion & Analysis

Operating profit

The operating profit for the year ended 30 June 2006 was RMB1,811,203,000, an increase of RMB1,253,063,000 or 2.25 times over the previous financial year. The improvement mainly came from a significant increase in gross profit and gross margin which resulted from overall growth in revenue, a change in the sales mix and improvement in operational efficiency.

Selling and marketing costs increased by 88.9% from RMB91,466,000 in the previous financial year to RMB172,756,000 in the financial year 2006. The increase was mainly attributable to the increased overheads arising from transportation costs and the acquisition of the Acquired Subsidiaries. The total amount of selling and distribution costs as a percentage of the Group's revenue increased from 1.9% in the previous financial year to 2.2% in the financial year 2006.

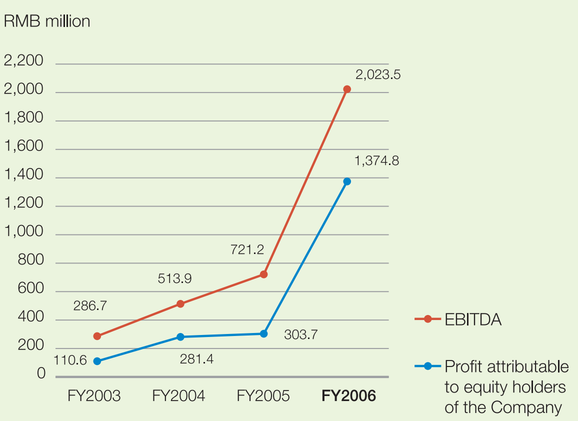
Administrative expenses increased from RMB135,020,000 in the previous financial year to RMB233,897,000 in the financial year 2006. The increase was mainly a result of the acquisition of the Acquired Subsidiaries, which included the Taicang production base and the launch of a new product, coated duplex board with grey back. In addition, the Group also made provision of RMB16,797,000 for the share option scheme adopted for its employees according to the new accounting system of Hong Kong. Additional management and administrative staff were hired to support the commencement of new paper machines and the new addition power plant units in Dongguan and Taicang. The amount of administrative expenses as a percentage of Group revenue increased from 2.8% in the previous financial year to 3.0% in the financial year 2006. The Group's administrative expenses amounted to RMB217,100,000 after deducting the provision for the share option scheme, representing 2.7% of its revenue.

Net profit and dividends

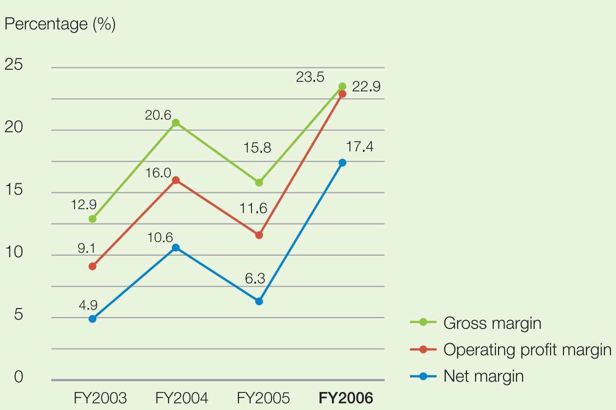
The profit attributable to equity holders for the year ended 30 June 2006 was RMB1,374,782,000, an increase of RMB1,071,023,000 as compared to the previous financial year. The ratios of EBIT and EBITDA to revenue were 21.1% and 25.6% respectively.

The Group's finance costs increased by 63.9% to RMB294,793,000 in the financial year ended 30 June 2006 from RMB179,814,000 in the last year, as a result of an increase in the Group's borrowings in order to meet its production capacity expansion plan.

Results performance



Profitability ratios



Basic earnings per share for the year ended 30 June 2006 and the previous financial year were RMB0.41 and RMB0.10 respectively. The directors have proposed a final dividend of RMB2.30 cents per share, which will aggregate to RMB95,450,000.

Liquidity and financial resources

The shareholders' funds as at 30 June 2006 were RMB7,541,404,000, an increase of RMB5,219,450,000 from RMB2,321,954,000 reported for the financial year 2005. The net assets per share increased by 136.4% from RMB0.77 to RMB1.82.

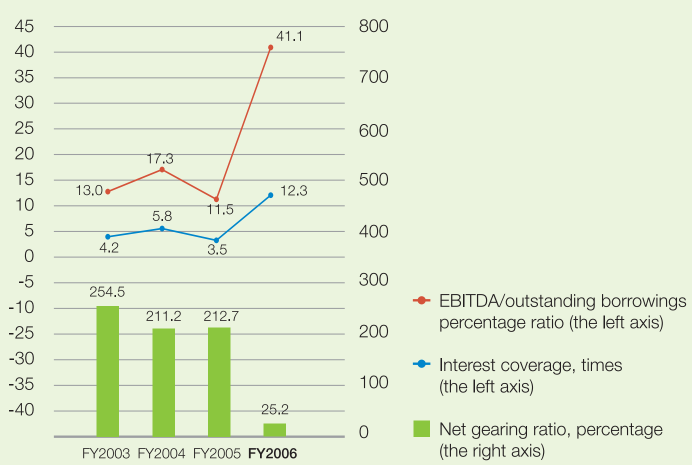
In terms of available financial resources as at 30 June 2006, the Group had total available bank loan and facilities of RMB5,443,395,000 and cash and bank deposits (including restricted cash) of RMB3,017,250,000. In addition, the strong recurrent cashflow generated from the Group's paper business provides the Group with a strong financial position and enables the Group to reap the benefits of investment opportunities as and when they arise. The ample financial resources available to the Group together with the net proceeds of approximately RMB3,829,291,000 from the listing of the Company's shares on the Stock Exchange will provide adequate funding for the Group's operational requirements and also put the Group in a favourable position for further expansion.

Out of the Group's total borrowings of RMB4,920,776,000 as at 30 June 2006, RMB2,176,875,000 (approximately 44.2%) was repayable within one year, RMB1,537,000,000 (approximately 31.2%) was repayable within two years, RMB1,016,901,000 (approximately 20.7%) was repayable within three to five years and RMB190,000,000 (approximately 3.9%) was repayable after five years. As at 30 June 2006, the Group pledged assets with aggregate carrying value of RMB2,308,754,000 (2005: RMB2,963,691,000) to secure bank loans facilities of the Group. The Group continued to maintain most of its borrowings on an unsecured basis, with unsecured debt accounting for approximately 78.7% of total borrowing as at 30 June 2006. The Group will continue to obtain financing on an unsecured basis.

As at 30 June 2006, the net gearing ratio for the Group was 25.2%, based on net debt of RMB1,903,526,000 and shareholders' equity of RMB7,541,404,000.

Debt and equity

Solvency



Management Discussion & Analysis

On 19 September 2006, the Group entered into a syndicated loan agreement with 15 reputable international and domestic banks and financial institutions for an unsecured loan facility of US$350 million. The loan facility bears an interest rate of LIBOR (London Interbank Offered Rate) plus 55 basis points. The loan facility will be used by the Group to meet future capital expenditure and working capital requirement.

The Group services its debts primarily with strong recurrent cash flow generated from a stable base of operation. The Board is confident that the Group has adequate financial resources to sustain its working capital requirement, future expansion and meet its foreseeable debt repayment requirements.

Net current liabilities

With an enhanced capital structure and operating cash flow, the Group's net current liabilities of RMB1,984,365,000 for the financial year 2005 had been significantly reduced and had turned into new current asset of RMB1,270,530,000 as at 30 June 2006.

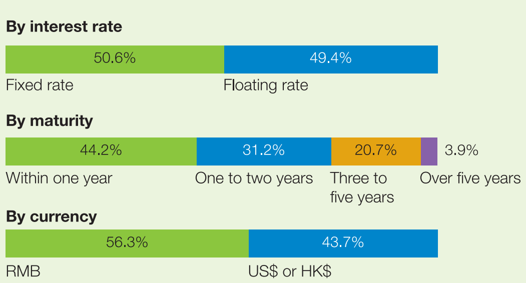
Treasury policies

The Group has centalised funding for all its operations at the Group level where foreign exchange exposure is also reviewed and monitored. This policy also achieves better control of treasury operations and lower average cost of funds.

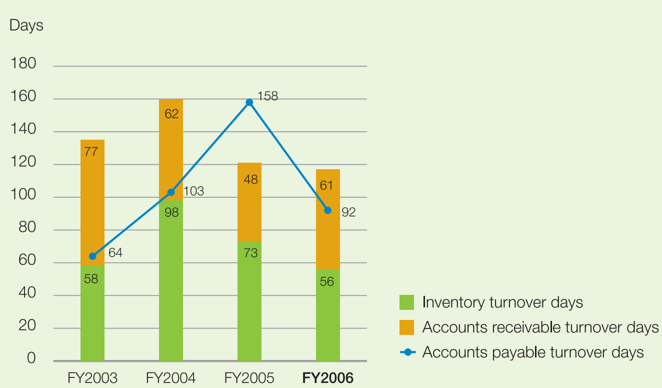
At 30 June 2006, total foreign currency borrowings (non-RMB loans) amounted to the equivalent of RMB2,149,458,000 and RMB loans amounted to RMB2,771,318,000. Therefore, the total amount of non-RMB loans that constitute foreign currency borrowings represented approximately 43.7% of the Group's borrowings, a sharp increase compared to 16.9% in last year.

The Group entered into a syndicated unsecured loan agreement of US$350 million on 19 September 2006, which enables the Group to increase the portion of total non-RMB foreign currency loans in the Group's total loans. In addition, the Group can also better utilise its RMB income and accelerate the repayment of RMB loans in order to minimize exposure to exchange fluctuation and maximize the benefit from the appreciation of RMB brought to the Group.

Financing means and currency



Liquidity ratios



As the Group's major raw materials (including recovered paper and kraft pulp), which in aggregate accounted for approximately 65.4% of the operating cost of the Group, were denominated in US dollar, and approximately 59.9% of revenue was denominated in RMB, while the remaining was mainly denominated in HK dollar, and the Group's machines and equipment were denominated in US dollars, any revaluation of the RMB will have a positive effect on the Group.

As at 30 June 2006, 50.6% of the Group's borrowings are based on fixed interest rates, and the interest cost of the remaining borrowings bear interest costs which are based on floating interest rates.

The objective of the Group's treasury policies is to manage its exposure to fluctuations in foreign currency exchange rates and interest rates on specific transactions and will use appropriate financial instruments to hedge any material exposure. It is the policy of the Group not to engage in speculative activities.

Working capital

The stock balance as at 30 June 2006 decreased by 6.6% over the balance at 30 June 2005 to RMB932,031,000. The turnover days decreased from 73 days to 56 days. The trade debtors balance as at 30 June 2006 was RMB1,312,378,000, an increase of 71.9% over the balance as at 30 June 2005. The turnover days increased from 48 to 61 days. The decrease in stock balance and the increase in trade debtors were primarily due to larger sales volume in the fourth quarter of the financial year 2006 than the Group's average sales volume for the whole year. Total turnover days of stock balance and trade debtors decreased from 121 days to 117 days.

Trade payables and bills payable as at 30 June 2006 were RMB1,516,837,000, representing a decrease of 30.0% over the balance as at 30 June 2005. Turnover days decreased from 158 days to 92 days. As its capital structure and operating cash flows enhanced, the Group further reduced its cost of raw materials in the financial year 2006 and actively reduced the payment cycle for suppliers, which contributed to the corresponding decrease in the turnover days of trade payables and bills payable.

Capital expenditure

For the year ended 30 June 2006, the Group invested RMB1,413,832,000 for the construction of factory buildings, purchase of plant and machinery, equipment and other tangible assets. These capital expenditures were fully financed by internal resources, net proceeds from the issue of new shares and bank borrowings.

Use of net proceeds from the issue of new shares

The net proceeds from the issue of new shares amounted to approximately RMB3,829,291,000. Part of the net proceeds has been applied as follows:

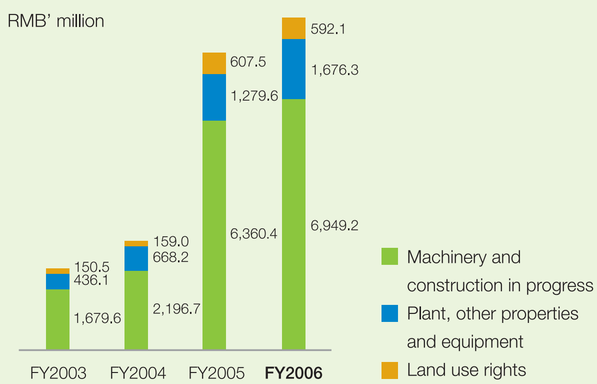
	Planned amount *RMB'000*	**Amount utilised up to 30 June 2006** *RMB'000*	**Balance as at 30 June 2006** *RMB'000*
– as funding for capital expenditure	1,828,903	434,322	1,394,581
– repayment of bank loans	1,627,660	1,627,660	–
– as additional working capital and for other general corporate purposes	372,728	372,728	–
– total	3,829,291	2,434,710	1,394,581

The balance of the net proceeds has been placed as bank deposits.

Capital expenditure

(1) Including the capital expenditure of RMB3,339.8 million incurred upon the acquisition of the Acquired Subsidiaries

Tangible assets



Capital commitments and contingencies

Up to 30 June 2006, the future capital expenditure for which the Group had contracted but unprovided for and authorised but not yet contracted amounted to approximately RMB3,976,505,000.

As at 30 June 2005, corporate guarantee granted by the Group to secure bank borrowings and credit facilities granted to related parties amounted to RMB62,000,000. The guarantee was released upon the Company's shares listed on the main board of the Stock Exchange on 3 March 2006.