

# CHIEF EXECUTIVE OFFICER'S REPORT



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Dear Shareholders,

On behalf of the Group, I report another set of remarkable results in 2006. It represented the Group's outstanding achievement in brand management, sales strategies, capital investments, optimisation in product mix and cost controls.

**OVERALL PERFORMANCE**

The Chinese economy maintained robust growth in 2006. According to the information published in the report of The People's Bank of China, Gross Domestic Product ("GDP") reached RMB20,940.7 billion, posting a year-on-year increase of approximately 10.7%. Consumer Price Index recorded a growth of approximately 1.5% over that of the previous year. The above figures demonstrated the favorable development momentum of China economy.

In the first three quarters of 2006, urban population disposable income per capita amounted to approximately RMB8,799 and rural population cash income per capita was approximately RMB2,762, representing a real growth rate of approximately 10% and 11.4% as compared with those of the previous year respectively. The market demand for personal hygiene products in China continued to grow with increasing consumption of both urban and rural population.

For the year ended 31 December 2006, the Group's turnover amounted to approximately HK\$4,114,943,000, representing a year-on-year growth of approximately 35.8%. The growth in turnover was mainly attributable to the rising market demand for high quality personal hygiene products in China, which boosted the demand for the Group's tissue paper, disposable diaper and sanitary napkins product. Despite market consolidation triggered by keen market competition and high raw material prices, the Group continued to implement different cost control measures. This, together with the benefit of economies of scale, optimisation of production process and the appreciation of Renminbi, contributed to an increase of approximately 54.7% in profit attributable to shareholders, reaching approximately HK\$696,624,000.

In addition, distribution costs and administrative expenses totally accounted for approximately 21.3% of total turnover, a year-on-year decrease of approximately 1.9%, as a result of economies of scale (2005: 23.2%).

**BUSINESS REVIEW****Tissue Papers**

The Group's tissue paper business developed rapidly, with "Hearttex" brand gaining popularity and became a household brand. Domestic demand for quality tissue paper products surged with increasing income of Chinese consumers, thereby contributed to an increase of 42.1% in sales revenue, reaching approximately HK\$1,789,440,000 and accounting for approximately 43.5% of overall sales revenue.

During the year, price of wood pulp, the major raw material of tissue paper, continued to surge while market competition had intensified, affecting the gross profit margin of tissue paper business. However, upon the commencement of production of Shandong Phase I production base and Fujian Phase I production base in August 2005 and July 2006 respectively, the Group's annual production capacity of raw papers was significantly increased to approximately 180,000 tons. As such, the proportion of outsourced production decreased. In addition, benefited from economies of scale, optimisation of production process and appreciation of Renminbi, the gross profit margin of tissue paper business was about 35.6% (2005: 38.6%), only a slight decrease of approximately 3.0% when compared with that of the previous year.

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To cope with rapid market development, the Group also devised appropriate marketing and promotion strategies based on different market landscape. For instance, the Group introduced “Green Tea” series tissue paper product to cater for market needs.

### Sanitary Napkins

With increasing income per capita and improving living standard, domestic consumers tend to purchase quality and renowned sanitary napkin products. Furthermore, high raw material prices imposed tremendous pressure on the operation of certain small to middle size sanitary napkin manufacturers, resulting in suspension in production or closure of these companies. As a leading large personal hygiene product manufacturer, the Group has formulated corresponding marketing strategy. By increasing effort to develop new products, improving product quality and launching new mid-to-high-end products at appropriate timing, the Group endeavors to minimise the impact of rising production cost and enhance profit. This successful sales strategy enabled the Group to

increase its market share and achieve a higher-than-market growth in sales.

In 2006, sales revenue of the Group's sanitary napkin business amounted to approximately HK\$1,249,468,000, posting a year-on-year growth of approximately 28.6% and accounting for approximately 30.4% of the Group's total sales revenue. Gross profit margin increased to approximately 55.3% (2005: 52.5%). The improvement in gross profit margin was mainly attributable to the increased proportion of mid-to-high-end products, in which “Anerle” branded (including “Space 7”) products accounted for approximately 80.3% (2005: 76.3%) of the Group's total sales revenue of sanitary napkin products.

### Disposable Diapers

Domestic market of disposable diapers maintained robust growth in 2006. The improvement in income per capita, together with relatively low penetration rate of disposable diapers, led to a faster growth in the demand for diaper products. The Group has a strong distribution network, contributing to an impressive growth in sales of disposable diapers in 2006. Disposable diapers business posted a sales revenue of approximately HK\$954,512,000 in 2006, an increase of approximately 45.9% when compared with that of the previous year and accounted for about 23.2% of the Group's overall sales revenue.

During the year under review, the Group continued to strengthen internal controls and was benefited from economies of scale as well as the slight decrease in price of petrochemical raw materials in the second half of the year. In 2006, the overall gross profit margin of disposable diapers increased to approximately 32.9% (2005: 31.2%).

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**Skincare and Cleansing Products**

The skin cleansing and care products market in China continued to experience vigorous competition. Sales revenue of “MissMay” products amounted to approximately HK\$32,742,000 (2005: HK\$38,381,000). This business segment only accounted for approximately 0.8% of the Group’s turnover. Therefore, it does not bring any material impact to the Group’s overall results.

**First-aid Products**

Sales of the Group’s first-aid products under the brand names of “Banitore”, “Bandi” and “Comfitore” recorded satisfactory performance in 2006. Sales revenue reached approximately HK\$24,922,000 (2005: HK\$19,753,000), representing a growth of approximately 26.2%. This business only accounted for approximately 0.6% of the Group’s turnover.

**DISTRIBUTION AND MARKETING STRATEGIES**

The Group has a nationwide distribution network for selling its diversified personal hygiene products. In view of the escalating demand for personal hygiene products, the Group will further explore to new markets, so as to maintain sustainable business growth.

The Group has established different sales channels targeting at different market segments. In addition to expanding traditional sales channels, including local convenient stores and small shops, the Group also strengthened its communication and cooperation with supermarkets. During the year, the Group carried out business cooperation negotiations with certain large-scale supermarkets and successfully secured more satisfactory terms. Furthermore, the Group also employed a number of sales and marketing professionals to promote its products in supermarkets and hypermarkets. During the year, distribution costs accounted for approximately 16.8% of total turnover (2005: 19.2%), a decrease of approximately 2.4% when compared with that of the previous year due to economies of scale.

**HUMAN RESOURCES MANAGEMENT**

As at 31 December 2006, the Group employed approximately 17,500 full-time and temporary employees. The Group’s remuneration package is determined with reference to the experience and qualifications of 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. In addition, the Group has been assessed by China Central Television as one of the top 40 best employers in China in 2006.



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**LIQUIDITY, FINANCIAL RESOURCES AND BANK LOANS**

The Group's financial position remained healthy. As at 31 December 2006, the Group's bank balances and cash amounted to approximately HK\$1,020,669,000 (2005: HK\$499,937,000), convertible bonds liability portion was approximately HK\$1,497,313,000 (2005: Nil) and short-term and long-term bank loans totally amounted to approximately HK\$273,802,000 (2005: HK\$957,598,000). During the year, the Group's capital expenditure on the acquisition and installation of production facilities was approximately HK\$558,244,000, and the related prepayments made thereon amounted to approximately HK\$175,153,000.

The annual interest rates of bank loans ranged from approximately 4.46% to 5.32%. All bank loans were unsecured and there were no charges on the Group's assets. As at 31 December 2006, the Group's gross gearing ratio was approximately 63.4% (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 26.9% (2005: 19.6%). The increase in gross and net gearing ratios was mainly due to the increase in borrowings for the construction of new production bases.

As at 31 December 2006, the Group had no material contingent liabilities.

**FOREIGN CURRENCY RISKS**

Most of the Group's income was in Renminbi while a portion of raw materials were purchased and settled in US dollar. The Group had never any difficulties in getting sufficient foreign currencies for settlement of the purchases or repatriation of profits declared by the subsidiaries in mainland China to their overseas holding company. As at 31 December 2006, the Group had not issued any financial instruments or entered into any contracts for foreign currency hedging purposes.

**FUTURE PROSPECTS**

Alongside with the rapid economic growth in China, the Group is optimistic towards the prospects of personal hygiene product market and has devised appropriate development strategy.

As for tissue paper business front, although the Group's production capacity increased significantly upon completing the construction of Shandong Phase I production base and Fujian Phase I production base, it is still inadequate to meet the overwhelming market demand. Therefore, the Group commenced the construction of Shandong Phase 2 production base last year, which is expected to be completed and put into operation by the end of June 2007. The Group's annual production capacity will be enhanced from approximately 180,000 tons to approximately 240,000 tons. Apart from expanding production capacity, the Group also endeavors to optimise production process to control costs and continue to diversify product portfolio, such as kitchen tissue papers, to develop new market demand.

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The Group expects that the sanitary napkin market will continue to consolidate in 2007. Hence, the Group will capture the opportunity to manufacture more mid-to-high-end products with higher gross profit margin, enhance product portfolio and provide diverse range of products to increase market share.

It is expected that the surging demand for disposable diapers in China will persist in the coming years. To increase market share and profit margin, the Group plans to launch "Free to Grow" series in the second half of 2007 and develop more mid-to-high-end products. In addition, the Group will carry out technical revamp on its existing production lines, establish new production bases and add new production lines to strengthen production capacity and enable the distribution of production facilities to be more reasonable.

Furthermore, the Group also intends to sell its first-aid products in mainland China under the brand names of "Banitore", "Bandi" and "Comfitore" through its nationwide distribution network, with a view of enhancing its product series.



Looking ahead, the Group expects the growth momentum for its major businesses to remain strong. With more comprehensive internal controls, improvement in the Group's execution capability, appropriate marketing strategy, together with its quality products, extensive sales network, renowned brand names and reasonable pricing, the Group is well-poised to consolidate its leadership in the personal hygiene product market in China, generating lucrative returns to shareholders.

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

Hong Kong, 21 March 2007