

# *Superior Technology*





## Chairman's Statement



Dear Shareholders,

It gives me great pleasure to present to you the annual report of ND Paper for the year ended 30 June 2007. We successfully achieved significant growth in both turnover and profit while simultaneously investing in infrastructure to further solidify our already sound foundation. The Group has entered into an accelerated phase of our development as we expands our geographic reach, product diversification, initial exploration of upstream resources and scale of operations in line with the paralleled growth of demand and supply. Our proactive approach and execution of our long-term strategy has further strengthened our number one position in Asia and paved the way for growth in the coming years.

During the year under review, the Group's success continued to validate our earlier expansion efforts to implement measured capacity growth to meet increasing demand for packaging paperboard. The result of our careful planning and diligent efforts translated to growth in both turnover and profit compared with the last financial year. For the year under review, we recorded total revenue and gross profit of approximately RMB9,837.7 million and RMB2,528.9 million respectively, representing an increase of 24.5% and 35.9% over the previous year. Net profit attributable to equity holders of the Company was RMB2,003.4 million, an increase of 45.7% that of a year ago. Our earnings per share were RMB0.48, representing an increase of 17.7% that of the previous year.

The Board proposed the declaration of a final dividend of RMB10.0 cents per share. Together with the interim dividend of RMB1.6 cents, the total dividend payout per share for the year was RMB11.6 cents, representing a payout ratio of 24.7%.

### **Fostering a Culture of Continuous Improvement and Quality**

The culture of ND Paper is firmly focused on continuous improvement. This philosophy is paramount to our success and runs from the foundation of our employee development program to our constant refinement in machinery, technology and infrastructure, as well as our dedication for expansion of product offerings and geographic reach. Meanwhile, economies of scale have brought pre-investment and production efficiency enhancements through strategic capacity expansion. The underlying theme of constant improvement is deeply ingrained in our corporate culture. Together with our ability to capture opportunities and leverage resources, it will guide us as a fundamental compass as we prosper as the world leader in the production of packaging paperboard.

### **Always Improving, Always Environmentally Conscious**

In keeping with our philosophy of “No environment, no paper” and our pursuit of continuous improvement, we stay abreast of technological advances within the sector and make sure that we are utilizing the best combination of imported machinery to ensure the most efficient and highest return on investment. This year, we have not only added three new paper machines, PM11, PM16 and PM17 which have brought our total annual production capacity to approximately 4.5 million tpa, but we have also upgraded and improved our existing machines whenever and wherever possible. In addition, we are leading the market with high-end new products and PM18 and PM21 are expected to produce a commercially viable scale production of light weight high performance corrugating medium. These machines will serve to meet the increasing demand for lighter weight corrugating medium.

Our tenacious pursuit of constant improvement is in the best interest of investors, the environment, our customers and our employees as it enables us to increase production while also improving efficiency, safety, and earnings. While we are committed to internal improvement, we also recognize and continue our pursuit of growth while maintaining high standards of transparency, corporate governance and social responsibility. We believe in this philosophy as a long-term approach to sustainable growth at every level as we continue to expand in a responsible manner. “No environment, no paper” is our mantra and our constant efforts to improve reaffirms strong commitment with consistent actions that reinforce this philosophy. Although growth has been robust, we will not compromise regarding the environment. We will continue to advocate the use of recovered paper as the primary raw material for manufacturing to ensure a harmonious coexistence with nature.

Regardless of the pace and locations of our development, we will be vigilant in maintaining the highest standards through the use of environmentally friendly equipment, technologies and processes combined with the appropriate management expertise to ensure that we are not only compliant with government standards, but that we consistently rise above those standards and serve as an example for the entire sector.



## Chairman's Statement

### **Investing in Our People, Investing in Our Future**

A fundamental strategy for success at ND Paper is the progress and development of our employees. As we reach greater heights of expansion, it is necessary to fill newly created staff and management roles that require a high level of expertise with the capability to efficiently execute. In addition to recruiting staff in China or overseas, we initiated a program of in-house employee development several years ago to ensure that we were ready for anticipated expansion efforts. We have a clear understanding of growth opportunities and want to ensure that employees are able to enjoy the benefits and participate in the growth of ND Paper. Therefore, as a result of our employee development program, we have targeted 80% of the management and staff to be sourced internally to fill the newly created positions at our additional bases. Also, we want to ensure that these new locations will not only be efficient from the commencement of operations, but we want to ensure that these facilities fully adopt the Nine Dragons culture and further inspire the spirit of the Company in every way possible.

### **Syndicated Loan and Share Placement**

In an effort to further cultivate healthy growth, we entered into two agreements in the amount of US\$350 million and HK\$2,300 million on 19 September 2006 and 18 June 2007 respectively and raised more than HK\$2 billion by share placement of new shares on 16 April 2007. The overwhelming response of both financing activities is very encouraging, as it demonstrates that the financial community has confidence in the packaging paper market and positively endorses our efforts to secure our leading position in the sector.

### **Broadening Our Reach into China**

#### **Chongqing Base**

China remains our primary area of operations and offers remarkable opportunities for further expansion. As the dominant manufacturer in China, we believe that there is significant room for additional growth and we fully intend to capitalize on this opportunity. In 2007 we have embarked on a strategy to diversify our domestic footprint that will help to meet increasing and divergent demand in a variety of regions. It is also a replication of our successful formula in the previous two production bases. This approach will not only expand our production lines, it will allow an avenue for expansion into a previously untapped area with strong demand. For example, our expansion into Chongqing City with its proximity to Hubei, Yunnan, Guizhou and Sichuan, will serve as a regional industrial hub to central and western China to serve numerous markets that previously had to source their needs from smaller manufacturers or have their needs met by manufacturers that were located at a greater distance. The proximity of this new base serves to tighten the supply chain for our new customers with a superior product while allowing ND Paper to fill a gap in demand. Operations are expected to commence by mid 2008 with an initial capacity of 800,000 tpa, including two sets of paper machines for each producing linerboard and high performance corrugating medium respectively.



### **Tianjin Base**

The fourth production base will be located in the Ninghe Economic Development Zone near the Tianjin port. It enjoys investment incentives that are the same as those available from the Binhai New Area. Construction will commence in 2008 and it is projected to ultimately reach a capacity of 4 million tpa. Operations are expected to commence by mid 2009 with an initial capacity of 800,000 tpa, including two sets of paper machines each for producing high performance linerboard and high performance corrugating medium respectively. The base will enable the Company to acquire comprehensive geographical coverage of all major markets in China, so as to address potential divergent demand among domestic regions. It will also serve to provide better services to capture valuable potential customers.

### **Growth Drivers**

#### **Diversification of scope with an eye on cost control and profit**

Over the next five years, additional focus will be dedicated to our manufacturing bases and cost control that will include management development, procurement of advanced equipment, increasing the quality of products, and the introduction of new product lines. Products will include light weight corrugating medium, light weight linerboard, high-end packaging board and others to further diversify our scope. The long-term plans for growth, ongoing development and constant margin improvement are essential to the success of ND Paper.

At the moment, our focus is on further development of scale and scope in China as there are still vast resources and opportunities that have not yet been tapped. When the timing is right and conditions are suitable, we will expand to international markets. If and when this decision is made, it will be executed in a well thought out, prudent manner that will be most beneficial to shareholders.

#### **Upstream Exploration**

Another important growth driver for us will be the strategic development of pulp production and a suitable kraft pulp resource production base. Although we produce packaging paperboard with an average of 85% recovered paper, we require a small percentage of kraft pulp for containerboard production. The ability to tap a direct source would further enable us to have stable raw material supply and reduce production costs. With our rapid capacity expansion and future product diversification, we require a consistently growing kraft pulp supply. Meanwhile, we can sell any excess pulp to the market with an attractive margin. While we currently have expansion plans for our joint venture in Inner Mongolia, we will also explore upstream wood pulp business opportunities overseas that offer strong potential. Any such consideration must provide



## Chairman's Statement

excellent forestry resources as well as cost and quality competitive edges. We currently have several prospects under consideration that will provide long-term, profitable returns. Each endeavor will be announced upon agreement at the appropriate time.

### **Closely Monitoring Market Conditions**

In an effort to obtain accurate and relevant data, we obtain market information from a variety of sources. This allows us to closely monitor changes and maintain an awareness of any alteration and quickly implement any appropriate adjustments.

The Company is able to leverage its extensive network of relationships with suppliers and customers to assemble a library of data that helps to determine current market conditions and forecast reasonable expectations for future demand. Information obtained from the front lines is often the most up-to-date, real-time, reliable intelligence available. We also closely monitor government and research institutes' studies to help determine the appropriate level of expansion. It is absolutely essential for the healthy maintenance of our production level to closely observe all data available to ensure a healthy balance between supply and demand.

### **Consolidation and the Positive Impact**

While ND Paper has been aggressively expanding to meet the growing demand, there has been consolidation in the market and a noteworthy impact from the closure of some small-scale paper manufacturers. In keeping with the government's efforts to promote "Green GDP" and the efficient use of energy and reducing emissions, within the year, a number of paper manufacturers will be retired from service. For example, the Jiangsu provincial government issued "Notice about Certain Policies and Measures Propelling Environmental Protection"《關於推進環境保護工作若干政策措施的通知》in 2006, forcing the closure of the production facilities using recycle paper with an annual capacity of less than 50,000 tonnes before the end of 2008. These manufacturers do not produce to the standard that is acceptable to be brought into the fold of ND Paper and are not suitable for acquisition. Therefore, such gaps in supply must be filled by organic growth and additional production. Meanwhile, the market environment produced by such a gap provides an opportunity for expansion not only in our current production bases, but outside of the regions where ND Paper already has a strong foothold.

Current market conditions have fostered a positive environment for expansion and paved the way for harmonious growth of both supply and demand. These market forces have enjoyed paralleled increases and nurtured the sector to reach healthy levels of production.

## Outlook

The outlook for long-term expansion is bright and we have dedicated a significant effort and meticulous planning to ensure that we are prepared to capitalize on the opportunities. Healthy market conditions are likely to continue as the GDP growth in the first half of 2007 was 11.5%, which was higher than market expectations. This situation will support further expansion in terms of both scale and scope as the Company implements the appropriate level of growth to develop in conjunction with the increasing level of demand. The Group has targeted to reach annual production capacity of 7.75 million tpa in 2008, 10.15 million tpa in 2009 and by 2008 we will become the world's number one manufacturer of packaging paperboard. According to our thorough research, this increase is likely to be commensurate with demand and the positive momentum is expected to continue.

## Appreciation

The fruits of our hard work are still in the early stages of their development as we begin to realize the advantages of building a solid infrastructure and diverse base of operations to service the growing demand. Our success is a direct result of visionary insight, meticulous planning and the willingness of management and staff to pursue innovative development within a culture that breeds responsible success. In addition to my gratitude to our management and staff, I would like to express my sincere appreciation to various governments for providing a business-friendly environment that has allowed us to prosper and positively influence the lives of our employees while contributing to the success of our industry. I would also like to thank our Shareholders, investors, bankers and business partners for their support and look forward to sharing our continued success.

**Cheung Yan**

*Chairman*

Hong Kong, 20 September 2007