
3. RISK FACTORS

Applicants for the IPO Shares should carefully consider, in addition to the other information contained herein, the following risk factors (which may not be exhaustive) before applying for the IPO Shares: -

a. Business Risks

Corrugated carton manufacturers are faced with certain risks that are inherent within the industry and Ornapaper is not insulated from these risks either. These risks include but are not limited to the entry of new players, the introduction of new technology and products, changes in law and tax affecting the industries, labour and raw material shortages, increases in the costs of labour and raw materials, changes in business and credit conditions and fluctuations in foreign exchange rates and interest rates. The specific impact of each of these business risks on the profitability of the Ornapaper Group in the past is difficult to be quantified. However, in the case of changes in interest rates, Ornapaper's profitability was affected by higher interest rates in financial year ended 31 December 1998. Higher interest rates coupled with higher borrowings contributed to higher Group interest expense of RM10.18 million as compared to RM4.63 million in 1997. Average interest rates charged for the Group increased from about 6.35% to 11.05% in financial year ended 1997 to about 10.3% to 16.55% in financial year ended 1998.

In addition, while it is commercially acceptable to pass on cost increases to Ornapaper's customers, it should be borne in mind that this may not always be possible.

Notwithstanding the fact that Ornapaper does not depend on any specific customers, Ornapaper Group is susceptible to certain business risk due to part of its business being derived from its strategic alliance partners throughout the Peninsular Malaysia. These strategic alliance partners purchase from Ornapaper and then process the products into finished carton boxes. The performance of these strategic alliance partners may to some extent affect the Ornapaper's performance.

Nevertheless, the tie-ups with these strategic partners also mean that Ornapaper will be able to increase its market coverage by servicing the customers located throughout the length of West Malaysia covering Northern region (Penang) to the Southern region (Johor). This enhances its ability to sustain and expand its market share and reach within the industry. As at 31 August 2002, turnover contribution from these strategic alliance partners accounted for 40% to Ornapaper's turnover.

Ornapaper seeks to limit its business risks through, inter-alia, delivering quality services and products to its clients, minimising delivery time establishing a large pool of reliable and reputable suppliers and clients with long term relationships, developing new products and increasing the use of automation to improve the efficiency of its operations.

b. No Prior Market for Ornapaper's Shares

Prior to this Public Issue and Offer for Sale, there has been no public market for Ornapaper's Shares. There can be no assurance that an active market for Ornapaper Shares will develop upon its listing on the Main Board of the KLSE or, if developed, that such a market will be sustained. The issue price of RM1.60 per Share for the Public Issue and Offer for Sale has been determined after taking into consideration a number of factors, including but not limited to, Ornapaper's financial and operating history and condition, its prospects and the prospects for the industry in which it operates, the management of Ornapaper, the market prices for shares of companies engaged in businesses similar to that of Ornapaper and the prevailing market conditions. There can be no assurance that the issue/offer price and Offer for Sale will correspond to the price at which the shares will trade on the Main Board of the KLSE upon or subsequent to its listing or that an active market for Ornapaper's Shares will develop and continue upon or subsequent to its listing. The price at which Ornapaper shares will trade on the Main Board of the KLSE after the Public Issue may be influenced by a number of factors, including the depth and liquidity of the market for Ornapaper's Shares and investors' perception of Ornapaper.

3. RISK FACTORS (Cont'd)

c. Political, Economic and Regulatory Considerations

Adverse developments in political and economic conditions in Malaysia or where Ornapaper operates could have unfavourable effects on the financial and business factors prospects of the Company. A discussion of the industry overview of Ornapaper's business is set out in Section 4.6 herein. Other political and economic uncertainties would include risks of war, expropriation, nationalisation, renegotiation or nullification of existing contracts, changes in interest rates and methods of taxation and currency exchange controls. Whilst Ornapaper will continue to take effective measures such as prudent financial management and increase the efficiency of its operating procedures, there is no assurance that adverse political, economic and regulatory conditions will not materially affect the Company. Save for financial year ended 31 December 1998, whereby the domestic lending rates were significantly higher during the Asian currency crisis, Ornapaper has not encountered any major adverse development in that political and economic conditions that has a material impact on its profitability.

d. Dependency on Key Management

As in other businesses, the Directors believe that Ornapaper's continued success will depend significantly on the abilities and continued efforts of its existing Directors and senior management. The loss of key members of the senior management may adversely affect Ornapaper's ability to compete in the industry. Nevertheless, Ornapaper's operations have not been affected significantly by any loss of key management in the past 5 years. In addition, the management believes that the IPO will enhance Ornapaper's ability to attract new talent and retain key staff.

Datuk Ting Chung Cheng, the managing director cum promoter has considerable experience in the corrugated box industry with over twenty (20) years of industry exposure and he is supported by a team of experienced senior management with each of them having more than five (5) years of experience within the packaging industry. *Please refer to Competitive Strengths of Ornapaper in Section 4 of this Prospectus for a detailed summary of its management team's industry experience.*

However, with a secure working environment, Ornapaper's professional management team has expanded and strengthened over the years. Thus, the Board of Directors of Ornapaper is confident that with the capabilities of its employees, it would not expect any difficulties in the newer members of the management team having to eventually take over from their seniors in the future.

Also, it is a continuous policy for Ornapaper to groom the newer members in the senior management to gradually take-over from the senior members to ensure smooth transition in the management team. Hence, Ornapaper's future success will also depend upon its ability to attract new and retain existing skilled personnel.

e. Competitive Risk

Ornapaper operates in a competitive industry and is expected to face increasing competition from its existing competitors and new market entrants in the future, especially in the event that its competitors aggressively engage in lowering prices in order to gain more market share. Competition may also be caused by an excess supply of corrugated products in the market arising from low demand and excess production capacity. Nevertheless, Ornapaper has been in business for many years and believes that it can compete as it has successfully built up strong relationship with its customers and diversified and expanded its customer base by entering into strategic tie-ups with other local corrugators/converters throughout Peninsular Malaysia. In addition, the Group constantly strives to improve the quality, delivery time and design of its products which will enable it to be better positioned to compete.

3. RISK FACTORS (Cont'd)

Ornapaper faces competition from various competitors, which include private and public listed companies such as Corrugated Offset Packaging Sdn Bhd, HPI Resources Berhad, Box-Pak (Malaysia) Berhad, Public Packages Holdings Berhad, Magni-Tech Industries Berhad, United Kotak Berhad and Golden Frontier Berhad. Notwithstanding this, Ornapaper tries to differentiate itself from the majority of its competitors through expanding its market reach through its, inter-alia, strategic alliances, delivering quality services and products to its clients, minimising delivery time by establishing a large pool of reliable and reputable suppliers and clients with long term relationships, developing new products and increasing the use of automation to improve the efficiency of its operations.

No assurance is given that Ornapaper will be able to maintain its existing market share in the future. However, the Directors believe that Ornapaper will be able to maintain its position due to their extensive knowledge and expertise in the field. *Please refer to Competitive Strengths of Ornapaper in Section 4 of this Prospectus for a detailed discussion of its competitive strengths.*

f. Profit Estimate and Forecast

This Prospectus contains the profit estimate and forecast of Ornapaper for the financial years ending 31 December 2002 and 31 December 2003 respectively that is based on certain assumptions made by the Directors of Ornapaper, but which nevertheless are subject to uncertainties and contingencies. Due to subjective judgments and inherent uncertainties of the profit estimate and forecast, and because events and circumstances may not occur as expected and projected, there can be no assurance that the estimate and forecast contained herein will be realised and actual results may be materially different from those shown. Investors will be deemed to have read and understood the descriptions of the assumptions and uncertainties underlying the forecasts that are contained herein.

g. Dependency of Packaging Industry to Manufacturing Sector

The packaging industry is an indispensable part of the modern manufacturing economy. To a large extent, the prospects of the packaging industry are highly correlated to the growth of the manufacturing sector, which in turn is dependent on the state of the economy.

The Malaysian economy expanded at a stronger pace in the second quarter of 2002. Sustained strength in domestic demand and a recovery in exports raised real GDP growth to 3.8% on an annual basis, from 1.1% in the first quarter. The important development in this quarter has been the significant income effect from improved export volume and prices. For the first time since the first quarter of 2001, exports recorded a positive annual growth of 5.3% due to the stronger growth in electronic exports and positive terms of trade from higher prices for palm oil, rubber, cocoa and saw logs.

Activity in the manufacturing sector rebounded in the second quarter of 2002 to take the lead, with value added increasing by 5.6% (1Q2002: -2.3%), the first positive growth since the first quarter of 2001. The improved performance was attributed to a stronger expansion in output of the domestic-oriented industries, as well as a turnaround in production of export-oriented industries, due primarily to an upturn in the electronics industry. With the improved performance, the overall capacity utilization rate in the manufacturing sector increased to 8.2% in the second quarter of 2002 (79% in the first quarter). Growth in output of the domestic-oriented industries was higher at 8.4% in the second quarter of 2002 (1Q2002: 3.5%), with positive growth in all industries except petroleum products and the tobacco product industries.

3. RISK FACTORS (Cont'd)

In the second half-year, growth is expected to be supported by continued expansion in domestic and external demand. On the domestic front, the composite index of leading indicators registered the eleventh consecutive positive growth in May, suggesting that the Malaysian economy is in its expansionary phase. The Coincident Index, an indicator of the current state of the overall economic activities, showed a positive growth for the second straight month in May 2002.

(Source: Press Release by Bank Negara Malaysia on 21 August 2002)

As an illustration of Ornapaper's strengths, Ornapaper weathered the recent economic recession in 1998 relatively well. Although most facets of the economy have experienced slower growth, Ornapaper still remained profitable as it had established a wide customer base with companies operating in diverse industries. During that period, Ornapaper took the opportunity to consolidate its customer base and expand its market share as some of the weaker players decided to exit the industry.

It should be borne in mind that by operating in an ancillary industry, Ornapaper's future performance is still very much dependent on the future outlook of the manufacturing sector. When there is a downturn in the manufacturing industry, there will likelihood there will be a correlated downturn in the packaging industry or vice versa. Nevertheless, the manufacturing sector has been resilient for the past ten (10) years between the period 1990 and 2000 by registering an average annual growth rate of 9.8%. According to the Eighth Malaysia Plan, the manufacturing sector is envisaged to grow at an average rate of 8.9% per annum from 2001 to 2005. Ornapaper believes that with the right strategy and a stronger financial position from its listing, Ornapaper will be able to sustain its business.

h. Fluctuation of Raw Material Prices

Ornapaper is susceptible to changes in prices of raw materials. As Ornapaper's principal activities are in the manufacturing of corrugated cartons and boards, the main raw material in the manufacturing of corrugated carton boxes is paper. Paper cost contributes about 97% of the Group's cost of raw material for financial period ended 31 August 2002. Due to the nature of the global market place for the raw materials of the industry, the prices of papers are subjected to cyclical fluctuations. Thus the use of paper and board which are subject to cyclical fluctuations in their raw material prices, may have an impact on Ornapaper's bottom line and also the sustainability of the business in the long run. For illustrative purposes, the increase in the paper roll prices during the financial year 2000 caused the raw material cost to increase by 20% based on a total volume of 59,456MT. However, the trend reversed in the financial year 2001 when the raw material cost decrease by 22% based on a total volume of 53,605MT.

In order to mitigate the increasing costs and potential erosion of profits, Ornapaper has taken steps and will continue to take steps to improve efficiency and control wastage as well as to monitor prices of its raw materials.

i. Exchange Rate Risk

Ornapaper is also exposed to foreign exchange fluctuation risks. All transactions with overseas suppliers are currently transacted in US dollars which is currently being pegged to the Ringgit at 1US Dollar = RM3.80. As a result, Ornapaper is not affected by the fluctuation in exchange rates. However, no assurance can be given that the currency peg will not be lifted or revised in the future.

3. RISK FACTORS (Cont'd)

j. Product Substitutes

At the moment, there are no effective substitutes for corrugated cartons notwithstanding that wooden crate and plastic containers may serve the same purpose. However, both wooden crates and plastic containers are not collapsible and as such, would require more area for storage resulting in poor utilisation of factory space and increased production costs. In addition, they are not flexible and are difficult to be shaped. Needless to say, manufacturers are in favour of corrugated cartons and do not view neither wooden crates nor plastic containers as effective substitutes.

Another factor to be considered is the current emphasis on environmental consciousness. Corrugated carton products are made from either virgin wood pulp or recycled paper and are thus recyclable. Plastic cartons, on the other hand, are not biodegradable and some companies are switching to corrugated carton boxes in line with the call to preserve the environment. These carton products can be recycled for further use either as corrugated cartons or as other paper products. It is evident then, that the Company is in good position to ward off competition from non-environmentally friendly products such as plastic cartons.

There is no assurance that the reversal of the trends will not have unfavourable effects on Ornapaper's business and financial conditions. However the Company foresees that there should not be any drastic change in market conditions or the emergence of a perfect substitute product to corrugated cartons in the near future.

k. Market Price War

Market price war is more likely to occur during recession whereby players in the industry will try to squeeze one another out of the industry to maintain or increase their market share. It is important for companies to maintain sufficient reserves in order to be sustainable during this period. Market price war is also more likely to occur if the industry is facing an over-production of corrugated boards. The over-production will cause producers to reduce their prices, thus resulting in a price war in the industry. However, any market price war within the industry would be seen as temporary given that the market forces of supply and demand would ultimately bring the imbalances back to an equilibrium level.

Notwithstanding this, Ornapaper Group will continue to strive to maintain its product quality and design excellence as well as timely delivery to reduce the need to compete on pricing which will help to ensure minimal business impact to the Group. As a testimony to this, Ornapaper has weathered the 1998 recession well by maintaining its net profit despite lower demand and high interest rates. Being aware of the risk of market price war, Ornapaper has strived to differentiate itself and to find a niche within the corrugated carton industry through product innovation as well as the expansion of its geographical market reach through its strategic alliances. This will help mitigate the risk of competing with other competitors as price for both the generic paper cartons boxes and corrugated boards.

l. Capital Market Risks

As an investor of Ornapaper, it is to be noted that Ornapaper will be listed on the Main Board of the KLSE. The performance of our local bourse is very much dependent on external factors such as the performance of the regional and world bourses and the inflow or outflow of foreign funds. Sentiments are also largely driven by internal factors such as the economic and political conditions of the country as well as the growth potential of the various sectors of the economy. These factors will invariably contribute to the volatility of trading volumes witnessed on KLSE, thus adding risk to the market price of the listed shares of Ornapaper. Nevertheless, it shall be noted the profitability of Ornapaper is not dependent on the performance of the KLSE.

3. RISK FACTORS (Cont'd)

m. Borrowings

Ornapaper's total short-term and long-term borrowings as at 31 August 2002 amounted to RM38.5 million and RM5.7 million respectively. This translates to a gearing of 0.79 times. After the listing of Ornapaper, Ornapaper's total short-term and long-term borrowings will be reduced to RM36.5 million and RM0.8 million respectively. Its gearing ratio will be reduced from 0.79 times to approximately 0.55 times. All the loans of Ornapaper are interest bearing. As such, any increase in interest rates will increase the burden of Ornapaper with respect to interest payments of the loans depending on the total outstanding loans as at the point in time. There can be no assurance that the performance of Ornapaper would remain favourable in the event of adverse changes in the interest rates. Ornapaper is taking effective steps to gradually reduce its gearing levels and the listing exercise is a step towards this direction.

n. Failure / Delay in Listing Exercise

The listing exercise is also exposed to the risk that it may be aborted or be delayed should the following events occur:-

- (a) The Company or the Underwriters fail to honour their obligations under the underwriting agreement; and
- (b) The Company is unable to meet the public spread requirements i.e. at least 25% of the issued and paid-up capital of the Company must be held by a minimum number of 1,000 public shareholders holding not less than 1,000 shares each, of which at least 750 shareholders are members of the public who are not employees of the Company, upon completion of the Public Issue and Offer for Sale and at the point of listing.

o. Adequacy of insurance coverage on the Group's assets

As at 31 August 2002, the net book value of plant and machinery was RM41.3 million and the value of stocks was RM15.1 million which have insurance coverage amounting to RM44.1 million and RM10.5 million respectively. Furthermore, Ornapaper has a total insurance coverage of RM38.1 million for fire consequential loss for the year 2002. Although the Group has taken the necessary measures to ensure that all its assets are adequately covered by insurance, there can be no assurance that the insurance coverage would be adequate to compensate for the replacement cost of the assets or any consequential loss arising there from.

p. System Disruption

The Group did not experience any disruption in business arising from system disruption as its plant which having significant effect on its operations for twelve (12) months prior to the date of this Prospectus. Notwithstanding this, no assurance is given that a system disruption will not materially affect Ornapaper's business. However, the directors do not foresee a disruption of its operation which could affect materially Ornapaper's manufacturing output. To this end, Ornapaper has a regular maintenance schedule for its machineries and equipment.

q. Control of Major shareholders

Following the Public Issue, the major shareholders of Ornapaper, namely Datuk Ting Chung Cheng, Intisari Delima Sdn Bhd and Lembaga Tabung Haji, collectively hold 66.57% of the Company's enlarged issued and paid-up capital. The aforesaid shareholders, if they act together, may be able to influence the outcome of certain matters requiring the vote of the Company's shareholders unless they are required to abstain from voting by law and/or by the relevant authorities.