



粵海制革有限公司  
GUANGDONG TANNERY LIMITED

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二零零四年年報 ANNUAL REPORT 2004

ANNUAL REPORT 2004

二零零四年年報



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## Corporate Information

### Board of Directors

Wu Jiesi (*Honorary President*)  
Zhang Chunting (*Chairman*)  
Chen Hong (*Managing Director*)  
Hui Wai Man Lawrence (*Director & Chief Financial Officer*)  
Xiong Guangyang  
Cheng Hok Lai James\*  
Fung Lak\*  
Choi Kam Fai Thomas\*  
Ho Lam Lai Ping Theresa

\* Independent Non-Executive Director

### Company Secretary

Chan Miu Ting

### Auditors

Ernst & Young

### Share Registrar and Share Transfer Office

Tengis Limited  
Ground Floor, BEA Harbour View Centre  
56 Gloucester Road  
Wanchai  
Hong Kong

### Registered Office

29th Floor, Guangdong Investment Tower  
148 Connaught Road Central  
Hong Kong

Stock Code: 1058

Telephone: (852) 2308 1013

Facsimile: (852) 2394 7836



## Chairman's Statement

I am pleased to report that the Group's audited consolidated profit attributable to shareholders for the year ended 31 December 2004 was HK\$4,668,000. It was a reflection of our success in achieving profitability and ending the protracted loss since 1998.

We have adjusted our operations and management strategies in quick response to the freezing of bank accounts of Tongyuan Tannery in early 2004. In tandem with the strategic move to shift the operations from Nanhai to Xuzhou, we have put in place various measures to establish Xuzhou as a primary production base of the Group. These measures include expanding the production capacity, adding new product series with good competitiveness, and extending the supply and distribution network. With all these strategies and new measures, the Group is currently provided with a stronger platform for future growth.

Xuzhou Gangwei Colour Package Co., Ltd. has changed its name to Xuzhou Gangwei Leather Co. Ltd., and has commenced mass production in March 2005 after the production plant was restructured. Gangwei Tannery, primarily a downstream production line for imported cowhides, was established to fill the production vacuum of imported cowhides due to the suspended operations of Tongyuan Tannery. Following our moves to expand and restructure the two tanneries in Xuzhou, Xuzhou Nanhai Tannery is currently focusing on the processing of domestic cowhides, and the combined production capacity of the two tanneries will reach 36,000,000 sq.ft. per year.

To completely resolve the development bottleneck associated with environmental protection, we have outsourced the upstream processing to remote areas, and have increased the proportion of outsourcing and franchising. Currently part of our upstream processing is outsourced to a tannery in Shandong. We plan to seek one or two additional outsourcing partners, and are considering possible investments in upstream processing plants in the adjacent coastal areas where suitable conditions arise. These initiatives well illustrate our intact commitment to removing any environmental related barriers arising from the Group's expansion.

We have continued to follow up with the Guangzhou Customs to resolve the matter in relation to the freezing of Tongyuan Tannery's bank accounts and will, if necessary, take such measures as may be required to safeguard the rights and position of Tongyuan Tannery. Given that Tongyuan Tannery has suspended all of its operations in March 2004, we are taking steps to liquidate its assets such as production plant and equipment, and will utilize the fund for future development of the two tanneries in Xuzhou.



## Chairman's Statement

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The Group has more than ten years of experience in the leather industry. Leveraging on this extensive experience, coupled with our efforts to strengthen the market research, work with new suppliers with good reliability and integrity, and introduce competition into the sourcing process, we have been placed in a favourable position to acquire raw materials at reasonable prices. On the front of distribution, our active efforts initiated since last year to open up the direct sales market have delivered solid results. Looking ahead, direct sales to shoes manufacturers will be a major focus of the Group in distribution, and this approach will enable the Group to thrive on a leading position in China's highly competitive leather market.

I take this opportunity to thank our customers, suppliers and shareholders for their continued support, and our staff for their hard work and dedication.

**Zhang Chunting**

*Chairman*

Hong Kong, 8 April 2005



## Management Discussion and Analysis

### Results

The Group's audited profit attributable to shareholders for the year ended 31 December 2004 was HK\$4,668,000, compared with a loss of HK\$101,294,000 for the same period last year.

The audited net asset value of the Group as at 31 December 2004 was HK\$171,072,000, an increase of HK\$912,000 and a drop of HK\$1,779,000 as compared to 31 December 2003 and 30 June 2004 respectively.

No final dividend is recommended by the Board of Directors for the year ended 31 December 2004.

### Operations Review

We achieved encouraging progress in production and operations based on our relentless efforts to strive for improvement over the past year. Manifestations include: (1) significant enhancement of operational efficiency and profitability at the production base in Xuzhou as we pursued the expansion initiatives and strengthened the management and operations in production, supply and distribution, as part of the measures to remedy the problems of shrinking business and climbing costs following the closure of Nanhai production base; (2) steady removal of supply related risks and barriers of distribution bottleneck by extending the supply channels and sales network, and (3) rapid growth in production volume, steady improvement in product quality, as well as higher competitiveness of the Group's products.

Consolidated turnover for the year was HK\$281,951,000, a drop of 26.11% as compared to HK\$381,601,000 for the same period last year. Turnover of Xuzhou Tannery for the year was HK\$162,741,000 (2003: HK\$158,485,000), an increase of 2.68% over the previous year. Turnover of cowhides decreased by 18.82% to HK\$254,917,000 (2003: HK\$314,003,000) whereas cow split, coated cow split and others dropped by 60% to HK\$27,034,000 (2003: HK\$67,598,000). The Group maintained a stable turnover in the face of the slowing market last year primarily because: (1) we have established a strong sales network following the marketing strategy of "focusing on targeted markets and customers"; (2) our pursuit of direct sales to leading manufacturers has delivered initial results; (3) we adopted an incentive mechanism under which remuneration was linked to sales results, and this helped arouse the initiative and creativity of sales personnel in market development and marketing.

On the front of product mix, we have developed and launched to the market dozens of new products in three leather series: bumpy, natural and embossed series, which were newly included in our product portfolio in addition to the existing series of the domestic nappa leather. All of the new products were well received by the market.



## Management Discussion and Analysis

Sourcing cost for raw materials was effectively controlled as we continued to introduce competition into the sourcing process through the tender system under the “Sunshine” program, and we were responsive to market changes in terms of supply and demand. Total sourcing costs for the year decreased by 58.8% to HK\$158,806,000 as we were focused on clearing the raw materials of Tongyuan Tannery in the first half of 2004.

The Group's total leather production for the year was 17,553,000 sq.ft., declined by 13,595,000 sq.ft. from 31,148,000 sq.ft. in 2003. Production of cowhides dropped by 26.49% to 16,344,000 sq.ft. (2003: 22,234,000 sq.ft.) whereas cow split, coated cow split and others down by 86.43% to 1,209,000 sq.ft. (2003: 8,914,000 sq.ft.). Xuzhou Tannery produced a total of 13,209,000 sq.ft. in cowhides for the year, an increase of 5,133,000 sq.ft. or 63.56% over the same period in the previous year.

As at 31 December 2004, the Group's consolidated inventories amounted to HK\$141,089,000, reduced by HK\$80,306,000 and HK\$64,368,000 as compared to 31 December 2003 and 30 June 2004 respectively. The decrease was primarily attributable to the reduced sourcing volume of the Group, and our moves to liquidate the assets and inventories of Tongyuan Tannery following its suspended operations.

Balance of trade receivables as at 31 December 2004 was HK\$29,382,000. After deducting the provisions for doubtful debts of HK\$3,473,000, trade receivables amounted to HK\$25,909,000, an increase of HK\$8,747,000 and a drop of HK\$8,614,000 as compared to 31 December 2003 and 30 June 2004 respectively. Trade receivables turnover was 13.1 times and average collection period was 27.88 days, an increase of 9.45 days as compared to 18.43 days in 2003. The trade receivables of Tongyuan Tannery upon its suspension of operations in March 2004 was RMB39,000,000. As at 31 December 2004, these trade receivables were reduced to RMB5,150,000 as we have made active attempts to recover the receivables.

### Financial Review

As at 31 December 2004, the Group's interest-bearing borrowings amounted to HK\$100,626,000 (as at 31 December 2003: HK\$133,648,000). Of the total interest-bearing borrowings, HK\$10,350,000 was denominated in Hong Kong dollars, HK\$35,676,000 in Renminbi and HK\$54,600,000 in US dollars. In addition, all interest-bearing borrowings are charged at fixed rate.

As at 31 December 2004, the Group's cash and bank balances amounted to HK\$98,040,000 (as at 31 December 2003: HK\$84,332,000), denominated in Hong Kong dollars (HK\$1,333,000), Renminbi (equivalent to HK\$74,677,000) and US dollars (equivalent to HK\$22,030,000) respectively.



## Management Discussion and Analysis

As at 31 December 2004, after deduction of cash and bank deposits, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 1.51% (as at 31 December 2003: 28.98%). Loan facilities bear interest at approximately 3% to 5% per annum. All borrowings are repayable on 30 June 2005. Subsequent to the balance sheet date, the repayment due date of the loans are extended to 30 June 2006. Interest expense incurred by the Group during the year was HK\$5,734,000, a drop of 3.59% as compared to the same period last year.

Net cash inflow from operating activities for the year was HK\$24,048,000 and net cash outflow from financing activities was HK\$16,931,000. Net increase in cash and cash equivalents for the year amounted to HK\$6,274,000.

Fixed assets as at 31 December 2004 were HK\$111,296,000, a reduction of HK\$7,110,000 as compared to 31 December 2003. The Group's capital expenditure during the year amounted to HK\$2,186,000 (2003: HK\$3,044,000). It was incurred mainly for the replacement of the leather manufacture machinery and equipment, a move to cope with the expansion of the Xuzhou Tannery.

As at 31 December 2004, certain of the Group's buildings, investment properties, bank deposits and plant and machinery with a total net book value of HK\$20,969,000 (31 December 2003: HK\$15,295,000) were pledged to secure general banking facilities granted to the Group.

### Freezing of Tongyuan Tannery's Bank Accounts

In February and March 2004, certain bank accounts of Foshan City Nanhai Tong Yuan Tanning Co., Ltd ("Tongyuan Tannery") were frozen by the Guangzhou Customs in the PRC. A written notification was later sent to Tongyuan Tannery by the Guangzhou Customs demanding payment of an amount of RMB36,989,441.92. As the freezing of bank accounts has severely affected its business, Tongyuan Tannery has suspended all of its operations in March 2004, and more than 600 employees were laid off as at the end of December 2004, which represented the entire pool of staff other than certain rear-service personnel. Tongyuan Tannery will continue to follow up with the Guangzhou Customs to resolve the matter and will, if necessary, take all such measures as may be required to safeguard its rights and position. As at 31 December 2004, the aggregate amount of Tongyuan Tannery's bank deposits being frozen was RMB9,247,000.

### Progress on winding up Qingdao Tannery

As regards the litigation between Qingdao Nanhai Tannery Co., Ltd. ("Qingdao Tannery") and its PRC joint venture partner, a ruling was made by the China International Economic and Trade Arbitration Commission in Shenzhen on 27 May 2004 confirming that: (i) the "Joint Venture Agreement in respect of Qingdao Nanhai Tannery Co., Ltd." ("Qingdao Joint Venture Agreement") was terminated on 23 August 2001; (ii) Qingdao Tannery is required to be wound up in compliance with all applicable laws





## Management Discussion and Analysis

and regulations of the People's Republic of China and the terms and conditions under the joint venture agreement; and (iii) proceeds from selling Qingdao Tannery's assets and the remaining assets not yet been realized must be included in the liquidation account. On 22 June 2004, the claims made by the PRC joint venture partner for loss of fixed return under the Qingdao Joint Venture Agreement and damages in an aggregate of RMB15,000,000 were also dismissed by the China International Economic and Trade Arbitration Commission in Beijing. The Company will proceed with the winding-up of Qingdao Tannery in compliance with the above rulings.

### Major Customers and Suppliers

For the year ended 31 December 2004, the amount of purchases attributable to the Group's largest supplier represented 21.18% of the Group's total purchases; and the aggregate amount of purchases (not including the purchases of items which are of a capital nature) attributable to the Group's five largest suppliers represented 69.97% of the Group's total purchases. In addition, the amount of turnover attributable to the Group's largest customer represented 24.28% of the Group's total turnover; and the aggregate amount of the turnover attributable to the Group's five largest customers represented 69.16% of the Group's total turnover. None of the Directors of the Company or their associates holds or any shareholders (which, to the best knowledge of the Directors, owns more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest suppliers or customers.

### Employees

As at 31 December 2004, a total of 448 employees (2003: 1,018 employees) were employed by the Group. The pay levels of employees are made with reference to the Group's operating results and the employee's performance. The Group offered social and medical insurance and provident fund to all employees in different areas. The Company has adopted a share option scheme ("Share Option Scheme") in May 2002, and the purpose of which is to provide incentives to participants to contribute to the Group, and to enable the Group to recruit and retain quality employees to serve the Group on a long-term basis. Details of the Share Option Scheme are set out in the Report of the Directors.

### Auditors – Services provided other than audit

Messrs. Ernst & Young, the auditors of the Group, have provided services to the Group other than the statutory audit work including the review of interim results and charges of such services were HK\$186,000.



## Biographical Details of Directors and Senior Management

### (A) EXECUTIVE DIRECTORS

#### **Mr. Zhang Chunting (Age: 40) *Chairman***

Mr. Zhang was appointed Chairman of the Company in February 2004. He joined the Group and was appointed deputy general manager of the Company in March 2002. He is an economist and holder of doctorate degree in economics at the Fudan University in the People's Republic of China (the "PRC"). Prior to joining the Company, Mr. Zhang worked as the governor of a bank's sub-branch and subsequently worked for a securities firm in Mainland China and was responsible for senior management and research duties.

#### **Mr. Chen Hong (Age: 49) *Managing Director***

Mr. Chen was appointed Managing Director of the Company in February 2004. He joined the Group in July 2003 and is an economist in the PRC. Mr. Chen has over 20 years of working experience in business management. Prior to joining the Company, Mr. Chen act as vice-principal of an industrial school, and deputy secretary, officer of economic commission and general manager of various enterprises.

#### **Mr. Hui Wai Man Lawrence (Age: 48) *Director & Chief Financial Officer***

Mr. Hui was appointed Director and Chief Financial Officer of the Company in June 2002. Mr. Hui is a Fellow of the Hong Kong Institute of Certified Public Accountants and an Associate of The Association of Chartered Certified Accountants. He was a director and the chief financial officer of Guangnan (Holdings) Limited and Guangdong Alliance Limited. Prior to joining the GDH group, Mr Hui was the finance manager of Beijing Oriental Plaza Company Limited, the general manager (Corporate Finance) of Sinoland Company Limited, and the group financial controller of Lai Fung Company Limited. Prior to that, Mr. Hui worked for Deloitte Touche Tohmatsu in Hong Kong and Britain and was the manager in its Audit and Technical & Training Department before he left the firm.



## Biographical Details of Directors and Senior Management

### (B) NON-EXECUTIVE DIRECTORS

#### **Dr. Wu Jiesi (Age: 53) *Honorary President***

Dr. Wu was appointed Honorary President of the Company in February 2004. He is Chairman of 廣東粵港投資控股有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) and GDH Limited (“GDH”), and is also Honorary President of Guangdong Investment Limited (“GDI”) and Independent Non-Executive Director of Beijing Enterprises Holdings Limited and China Insurance International Holdings Company Limited. Dr. Wu holds a Doctorate degree in Economics. He conducted post-doctorate research work in theoretical economics at the Nankai University in the PRC and was conferred the professorship qualification by the University in 2001. He was with the Industrial and Commercial Bank of China (the “Bank”) from 1984 to 1995 and was the President of Shenzhen Branch of the Bank prior to his appointment as Deputy Mayor of the Shenzhen Municipal Government. As the Deputy Mayor between 1995 and 1998, he was responsible for finance, taxation, public revenue, securities, banking and education. He was appointed Assistant to the Governor of Guangdong Province from 1998 to February 2000 and assisted the governor in the handling of GITIC bankruptcy, the restructuring of the Guangdong Enterprises (Holdings) Limited and other financial incidents.

#### **Mr. Xiong Guangyang (Age: 51)**

Mr. Xiong was appointed a Director of the Company in June 2002. Mr. Xiong is a Senior Economist in the PRC. He graduated from Jilin University and obtained a master degree in finance from the Graduate School of The People’s Bank of China. Mr. Xiong joined GDH in October 2000 and was appointed a director of GDH in May 2001. He is the chief strategic planning officer of GDH. Prior to joining GDH, Mr. Xiong was mainly engaged in management and operations works in banks. From 1986 to 1996, he was the assistant governor of The People’s Bank of China, Guangdong Branch and the governor of The People’s Bank of China, Shantou Branch. From 1996 to September 2000, Mr Xiong was with China Everbright Bank in a number of positions including deputy-managing governor of its Guangzhou Branch.

#### **Mrs. Ho Lam Lai Ping Theresa (Age: 49)**

Mrs. Ho was appointed a Director of the Company in July 2000. She is also a director of Kingway Brewery Holdings Limited. Mrs. Ho has been Company Secretary of GDI since December 1992. She graduated from the Hong Kong Polytechnic and is an associate of both The Institute of Chartered Secretaries and Administrators in the United Kingdom and The Hong Kong Institute of Company Secretaries.



## Biographical Details of Directors and Senior Management

### (C) INDEPENDENT NON-EXECUTIVE DIRECTORS

#### **Mr. Cheng Hok Lai James (Age: 57)**

Mr. Cheng was appointed an independent non-executive director of the Company in November 1996. He has over 20 years of experience in the commercial and industrial sectors of Hong Kong.

#### **Mr. Fung Lak (Age: 57)**

Mr. Fung was appointed an independent non-executive director of the Company in November 2002. Mr. Fung holds a bachelor degree in Science (Economics) major in Accounting and Finance from the London School of Economics and Political Science of University of London. He is also the holder of a number of professional qualifications including the fellow memberships of the Association of Chartered Certified Accountants, the Hong Kong Institute of Certified Public Accountants and the Taxation Institute of Hong Kong. Mr. Fung was the former president of the Society of Chinese Accountants and Auditors. Mr. Fung has over 20 years' experience in accounting and finance and is a partner of Fan, Mitchell & Co., Certified Public Accountants.

#### **Mr. Choi Kam Fai Thomas (Age: 60)**

Mr. Choi was appointed an independent non-executive director of the Company in October 2004. Mr. Choi is a Certified Management Accountant with the Society of Management Accountant of Canada. He holds a bachelor degree in Commerce and Business Administration from the University of Alberta, Canada and completed the Executive Development Program organized by J.L. Kellogg Graduate School of Management of the Northwestern University, U.S.A. Mr. Choi is the General Manager of the Internal Audit Department of Henderson Land Development Company Limited. He has worked for the audit departments of various private, public and governmental bodies in Hong Kong and Canada for 30 years.

### (D) SENIOR MANAGEMENT

The senior management of the Group comprises the executive Directors above, namely Messrs. Zhang Chunting, Chen Hong and Hui Wai Man Lawrence.



## Report of the Directors

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The Directors herein present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2004.

### **PRINCIPAL ACTIVITIES**

The Company acts as an investment holding company and provides corporate management services to its subsidiaries. The Group is principally engaged in the processing and sale of semi-finished and finished leather. The activities of the subsidiaries and associates are set out in notes 13 and 14 to the financial statements, respectively. There were no significant changes in the nature of the Group's principal activities during the year.

### **SEGMENT INFORMATION**

An analysis of the Group's turnover and contribution to results by principal activity and geographical area of operations for the year ended 31 December 2004 is set out in note 4 to the financial statements.

### **RESULTS AND DIVIDENDS**

The results of the Group for the year ended 31 December 2004 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 27 to 83.

No interim dividend was paid during the year and the Directors do not recommend the payment of a final dividend in respect of the year ended 31 December 2004.



## Report of the Directors

### FINANCIAL SUMMARY

The following is a summary of the published results and assets and liabilities of the Group for the last five financial years, as extracted from the audited financial statements and reclassified as appropriate. The summary does not form part of the audited financial statements.

#### Results

	Year ended 31 December				
	2004 HK\$'000	2003 HK\$'000	2002 HK\$'000	2001 HK\$'000	2000 HK\$'000
Turnover					
Continuing operations	281,951	381,601	503,088	711,572	644,111
Discontinued operations	–	–	25,967	53,357	77,030
	<u>281,951</u>	<u>381,601</u>	<u>529,055</u>	<u>764,929</u>	<u>721,141</u>
Profit/(Loss) from operating activities	11,605	(95,632)	(198,991)	(62,571)	(92,196)
Finance costs	(5,734)	(5,948)	(6,387)	(15,221)	(21,555)
Share of results of associates	–	–	–	(154)	(965)
Profit/(Loss) before tax					
Continuing operations	5,871	(101,580)	(205,002)	(19,837)	(23,565)
Discontinued operations	–	–	(376)	(58,109)	(91,151)
	<u>5,871</u>	<u>(101,580)</u>	<u>(205,378)</u>	<u>(77,946)</u>	<u>(114,716)</u>
Tax					
Continuing operations	(1,203)	286	–	88	971
Discontinued operations	–	–	–	–	–
	<u>(1,203)</u>	<u>286</u>	<u>–</u>	<u>88</u>	<u>971</u>
Profit/(Loss) before minority interests	4,668	(101,294)	(205,378)	(77,858)	(113,745)
Minority interests	–	–	177	5,575	29,195
Net Profit /(loss) from ordinary activities attributable to shareholders	<u>4,668</u>	<u>(101,294)</u>	<u>(205,201)</u>	<u>(72,283)</u>	<u>(84,550)</u>



## Report of the Directors

### Assets and liabilities

	As at 31 December				
	2004 HK\$'000	2003 HK\$'000	2002 HK\$'000	2001 HK\$'000	2000 HK\$'000
Assets					
Fixed assets	111,296	118,406	180,994	204,436	257,801
Trademarks	–	–	–	1,500	7,000
Interest in associates	–	–	–	–	8,305
Other long term assets	–	–	1,268	–	–
Current assets	301,790	361,411	301,387	368,195	452,866
Total assets	413,086	479,817	483,649	574,131	725,972
Liabilities					
Current liabilities	233,002	300,824	181,546	149,567	191,988
Long term liabilities	9,012	8,833	26,460	73,566	123,827
Total liabilities	242,014	309,657	208,006	223,133	315,815
Minority interests	–	–	–	4,171	9,716
Net assets	171,072	170,160	275,643	346,827	400,441

### FIXED ASSETS AND INVESTMENT PROPERTIES

Details of movements in the fixed assets and investment properties of the Company and the Group during the year are set out in note 12 to the financial statements.

### SHARE CAPITAL AND SHARE OPTIONS

There were no movements in either the Company's authorized or issued share capital during the year. Details of the Company's movements in the share options during the year, together with the reasons therefore, are set out in note 27 to the financial statements.



## Report of the Directors

### PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

### RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in note 28 to the financial statements and in the consolidated statement of changes in equity, respectively.

### DISTRIBUTABLE RESERVES

At 31 December 2004, no reserves, calculated in accordance with the provisions of Section 79B of the Companies Ordinance, is available for cash distribution.

### CHARITABLE CONTRIBUTIONS

The Group did not make any charitable contributions during the year (2003: HK\$47,000).

### DIRECTORS

The Directors of the Company during the year and up to the date of this report were:

Wu Jiesi ( <i>Honorary President</i> )	(appointed on 19 February 2004)
Zhang Chunting ( <i>Chairman</i> )	(appointed on 19 February 2004)
Chen Hong ( <i>Managing Director</i> )	(appointed on 19 February 2004)
Hui Wai Man Lawrence ( <i>Director &amp; Chief Financial Officer</i> )	
Xiong Guangyang	
Cheng Hok Lai James *	
Fung Lak *	
Choi Kam Fai Thomas *	(appointed on 15 October 2004)
Ho Lam Lai Ping Theresa	
Li Wai Keung	(resigned on 19 February 2004)
Luo Fanyu	(resigned on 19 February 2004)
Chan Hee Kwan	(resigned on 11 September 2004)

\* Independent Non-Executive Director





## Report of the Directors

The Company has received independence confirmation from the Independent Non-Executive Directors, namely: Messrs. Cheng Hok Lai James, Fung Lak and Choi Kam Fai Thomas, and considers them to be independent.

### RE-ELECTION OF DIRECTORS AT ANNUAL GENERAL MEETING

Mr. Choi Kam Fai Thomas who was appointed a Director of the Company after the last Annual General Meeting of the Company is due to retire pursuant to Article 77 of the Company's Article of Association at the forthcoming Annual General Meeting. Being eligible, he offers himself for re-election.

After his re-election at the forthcoming annual general meeting, Mr. Choi Kam Fai Thomas will continue to serve on the board of Directors for a period of approximately three years until he becomes due to retire by rotation in accordance with the Articles of Association of the Company. Mr. Choi is not related to any director, senior management or substantial or controlling shareholder of the Company. As at the date of this report, Mr. Choi was not interested or deemed to be interested in any ordinary shares and derivative interest of the Company and other associated companies with the meaning of Part XV of the Securities and Futures Ordinance (the "SFO"). There is no service contract between the Company and Mr. Choi. In accordance with the Articles of Association of the Company, Mr. Choi as a Non-executive Director, is entitled to such director's fee as may be approved by the Board of Directors of the Company. The total current emoluments of Mr. Choi as an Independent Non-Executive Director amounts to HK\$100,000 annually.

Mr. Fung Lak and Mrs. Ho Lam Lai Ping Theresa are due to retire by rotation from the Board in accordance with Article 82 of the Company's Article of Association at the forthcoming Annual General Meeting. Being eligible, they offer themselves for re-election.

After his re-election at the forthcoming annual general meeting, Mr. Fung Lak will continue to serve on the board of Directors for a period of approximately three years until he becomes due to retire by rotation again in accordance with the Articles of Association of the Company. Mr. Fung is not related to any director, senior management or substantial or controlling shareholder of the Company. As at the date of this report, Mr. Fung had a derivative interest in respect of 600,000 Ordinary Shares in the Company within the meaning of Part XV of the SFO, which represents Mr. Fung's entitlement to subscribe for 600,000 Ordinary Shares in the Company. There is no service contract between the Company and Mr. Fung. In accordance with the Articles of Association of the Company, Mr. Fung as a Non-executive Director, is entitled to such director's fee as may be approved by the Board of Directors of the Company. The total current emoluments of Mr. Fung as an Independent Non-Executive Director amounts to HK\$100,000 annually.



## Report of the Directors

After her re-election at the forthcoming annual general meeting, Mrs. Ho Lam Lai Ping Theresa will continue to serve on the board of Directors for a period of approximately three years until she becomes due to retire by rotation again in accordance with the Articles of Association of the Company. Other than those particulars as stated in the section titled "Biographical Details of Directors and Senior Management" in this report, Mrs. Ho is not related to any director, senior management or substantial or controlling shareholder of the Company. As at the date of this report, Mrs. Ho was interested in 700,000 Ordinary Shares in Guangdong Investment Limited ("GDI") and 80,000 Ordinary Shares in Kingway Brewery Holdings Limited. Mrs. Ho also had a derivative interest in respect of 4,900,000 Ordinary Shares in GDI within the meaning of Part XV of the SFO, which represents Mrs. Ho's entitlement to subscribe for 4,900,000 Ordinary Shares in GDI. There is no service contract between the Company and Mrs. Ho. In accordance with the Articles of Association of the Company, Mrs. Ho, as a Non-executive Director, is entitled to such director's fee as may be approved by the Board of Directors of the Company. Mrs. Ho is not currently receiving any remuneration from the Company.

### **DIRECTORS' SERVICE CONTRACTS**

No Directors proposed for re-election at the forthcoming Annual General Meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the employer within one year without payment of compensation, other than statutory compensation.

### **DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE**

No contracts of significance to which the Company or the Company's subsidiaries or holding company or a subsidiary of the Company's holding company was a party and in which a Director of the Company had a material interests, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

### **DIRECTORS' INTERESTS IN SECURITIES**

#### *Directors' interest and short position in the securities*

As at 31 December 2004, the interests and short positions of the Directors and chief executives of the Company in the shares, underlying shares or debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) (a) which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which the Directors or the chief executives were taken or deemed to have under such provisions of the SFO); or (b) which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) which are required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed



## Report of the Directors

Companies contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") were as follows:

### (1) Interests and short positions in the Company

#### (a) Interest in ordinary shares

Name of director	Nature of interests	Number of shares	% of issued share capital	Long/short positions
Cheng Hok Lai James	Personal	400,000	0.076	Long position

Note: The number of ordinary shares of the Company in issue as at 31 December 2004 was 524,154,000.

#### (b) Interest in options relating to ordinary shares

Name of director	No. of options held on 01/01/2004	Options granted during the year Date	Number	Period during which option is exercisable (dd/mm/yyyy)	Total consideration paid for options (HK\$)	Price per Ordinary Share payable on exercise of option (HK\$)	Number of options exercised during the year	No. of options held on 31/12/2004
Zhang Chunting	2,500,000	-	-	10/09/2003 – 09/09/2008	1	0.22	-	2,500,000
	-	11/02/2004	2,000,000	12/05/2004 – 11/05/2009	1	0.246	-	2,000,000
Chen Hong	-	11/02/2004	1,800,000	12/05/2004 – 11/05/2009	1	0.246	-	1,800,000
Xiong Guangyang	3,000,000	-	-	10/09/2003 – 09/09/2008	1	0.22	-	3,000,000
	-	11/02/2004	2,200,000	12/05/2004 – 11/05/2009	1	0.246	-	2,200,000
Cheng Hok Lai James	300,000	-	-	10/09/2003 – 09/09/2008	1	0.22	-	300,000
	-	11/02/2004	300,000	12/05/2004 – 11/05/2009	1	0.246	-	300,000
Fung Lak	300,000	-	-	10/09/2003 – 09/09/2008	1	0.22	-	300,000
	-	11/02/2004	300,000	12/05/2004 – 11/05/2009	1	0.246	-	300,000

Note: If the last day of any of the option period is not a business day in Hong Kong, the option period shall end at the close of business on the business day preceding that day.



## Report of the Directors

### (2) Interests and short positions in Guangdong Investment Limited (“GDI”)

#### (a) Interest in ordinary shares of GDI

Name of director	Nature of interests	Number of shares	% of issued share capital of GDI	Long/short positions
Wu Jiesi	Personal	16,000,000	0.2877	Long position
Ho Lam Lai Ping Theresa	Personal	900,000	0.0162	Long position

Note: The number of ordinary shares of GDI in issue as at 31 December 2004 was 5,561,612,672.

#### (b) Interest in options relating to ordinary shares of GDI

Name of director	No. of options held on 01/01/2004	Options granted during the year Date	Number	Period during which option is exercisable (dd/mm/yyyy)	Total consideration paid for options (HK\$)	Price per Ordinary Share payable on exercise of option (HK\$)	Number of options exercised during the year	No. of options held on 31/12/2004
Wu Jiesi	7,000,000	-	-	02/05/2002 – 01/05/2007	-	0.74	7,000,000	-
	9,000,000	-	-	08/11/2002 – 07/11/2007	-	0.814	9,000,000	-
	6,000,000	-	-	05/03/2003 – 04/03/2008	1	0.96	-	6,000,000
	3,000,000	-	-	08/08/2003 – 07/08/2008	1	1.22	-	3,000,000
	-	06/02/2004	3,000,000	07/05/2004 – 06/05/2009	1	1.59	-	3,000,000
	-	24/05/2004	2,500,000	25/08/2004 – 24/08/2009	1	1.25	-	2,500,000
Ho Lam Lai Ping Theresa	1,000,000	-	-	08/11/2002 – 07/11/2007	-	0.814	1,000,000	-
	1,200,000	-	-	05/03/2003 – 04/03/2008	1	0.96	300,000	900,000
	1,500,000	-	-	08/08/2003 – 07/08/2008	1	1.22	-	1,500,000
	-	06/02/2004	1,500,000	07/05/2004 – 06/05/2009	1	1.59	-	1,500,000
	-	24/05/2004	1,000,000	25/08/2004 – 24/08/2009	1	1.25	-	1,000,000

Note: If the last day of any of the option period is not a business day in Hong Kong, the option period shall end at the close of business on the business day preceding that day.



## Report of the Directors

### (3) Interests and short positions in Kingway Brewery Holdings Limited (“Kingway”) – Interest in ordinary shares of Kingway

Name of director	Nature of interests	Number of shares	% of issued share capital of Kingway	Long/short positions
Ho Lam Lai Ping Theresa	Personal	80,000	0.0057	Long position

*Note:* The number of ordinary shares of Kingway in issue as at 31 December 2004 was 1,395,568,000.

### (4) Interests and short positions in Guangnan (Holdings) Limited (“Guangnan”) – Interest in options relating to ordinary shares of Guangnan

Name of director	No. of options held on 01/01/2004	Options granted during the year Date (dd/mm/yyyy)	Number	Period during which option is exercisable (dd/mm/yyyy)	Total consideration paid for options (HK\$)	Price per Ordinary Share payable on exercise of option (HK\$)	Number of options exercised during the year	No. of options held on 31/12/2004
Hui Wai Man Lawrence	-	06/02/2004	2,500,000	06/05/2004 – 05/05/2009	10	0.1582	-	2,500,000

*Note:* If the last day of any of the option period is not a business day in Hong Kong, the option period shall end at the close of business on the business day preceding that day.

Save as disclosed above, as at 31 December 2004, to the knowledge of the Company, none of the Directors or chief executives of the Company had or was deemed to have any interests or short position in the shares, underlying shares or debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO) (a) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which the Directors and the chief executives were taken or deemed to have under such provisions of the SFO); or (b) which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) which are required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules.



## Report of the Directors

### SHARE OPTIONS OF THE COMPANY

In assessing the theoretical aggregate value of the share options granted during the year, the Black-Scholes option pricing model has been used.

#### Share options granted during the year ended 31 December 2004:

Date of Grant	:	11/02/2004
Vesting Period	:	11/02/2004 – 11/05/2004
Exercise Period	:	12/05/2004 – 11/05/2009
Exercise Price	:	HK\$0.246

	Number of Options At 11/02/04	Options Value At 11/02/04 <i>(Note (2))</i> HK\$	Number of Options At 31/12/04	Options Value At 31/12/04 <i>(Note (3))</i> HK\$
Grantee:				
Zhang Chunting	2,000,000	380,000	2,000,000	420,000
Chen Hong	1,800,000	342,000	1,800,000	378,000
Xiong Guangyang	2,200,000	418,000	2,200,000	462,000
Cheng Hok Lai James	300,000	57,000	300,000	63,000
Fung Lak	300,000	57,000	300,000	63,000
Other employees	2,100,000	399,000	2,100,000	441,000
Total	<u>8,700,000</u>	<u>1,653,000</u>	<u>8,700,000</u>	<u>1,827,000</u>

#### Notes:

- (1) The closing price of the Ordinary Shares of the Company immediately before the date on which the options were granted was HK\$0.24.
- (2) According to the Black-Scholes model<sup>#</sup>, the total value of the options was estimated at HK\$1,653,000 as at 11 February 2004 (when the options were granted) with the following variables and assumptions:

Risk Free Rate	:	2.72%, being the approximate yield of 5-year Exchange Fund Note traded on 11/02/2004
Expected Volatility	:	112.0%, being the annualized volatility of the closing price of the Ordinary Shares of the Company from 11/02/2003 – 11/02/2004.



## Report of the Directors

- Expected Dividend Yield : Nil, being the approximate yield of the shares of the Company over the period of 11/02/2003 – 11/02/2004.
- Expected Life of the Options : 5.25 years
- Assumptions : There is no material difference between the expected volatility over the whole life of the options and the historical volatility of the Ordinary Shares of the Company over the period of 11/02/2003 – 11/02/2004.
- (3) According to the Black-Scholes model<sup>#</sup>, the total value of the options was estimated at HK\$1,827,000 as at 31 December 2004 with the following variables and assumptions:
- Risk Free Rate : 2.66%, being the approximate yield of 5-year Exchange Fund Note traded on 31/12/2004.
- Expected Volatility : 108.4%, being the annualized volatility of the closing price of the Ordinary Shares of the Company from 01/01/2004 – 31/12/2004.
- Expected Dividend Yield : Nil, being the approximate yield of the shares of the Company over the period of 01/01/2004 – 31/12/2004.
- Expected Life of the Options : 4.86 years
- Assumptions : There is no material difference between the expected volatility over the whole life of the options and the historical volatility of the Ordinary Shares of the Company over the period of 01/01/2004 – 31/12/2004.
- (4) Options forfeited, if any, before expiry of the options will be treated as lapsed options which will be added back to the number of Ordinary Shares available to be issued under the relevant share option scheme.
- <sup>#</sup> The Black-Scholes model (the "Model") is developed to estimate the fair value of publicly traded options that have no vesting restriction and are fully transferable. The Model is only one of the commonly used models to estimate the fair value of an option. The value of an option varies with different variables of certain subjective assumptions. Any change in the variables so adopted may materially affect the estimation of the fair value of an option.
- <sup>\*</sup> According to Listing Rules Chapter 17.08, the risk-free rate should be the rate prevailing on debt securities issued by the state, such as the Exchange Fund Notes in case of Hong Kong based entities.



## Report of the Directors

### SUBSTANTIAL SHAREHOLDERS' INTERESTS

*Persons who have an interest or short position which is discloseable under Divisions 2 and 3 of Part XV of the SFO and substantial shareholders*

So far as is known to any Director or chief executive of the Company, as at 31 December 2004, the persons or companies (not being a Director or chief executive of the Company) who have interests or short positions in the Ordinary Shares or underlying Ordinary Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO were as follows:

Name of Shareholders	Capacity/nature of interest	Number of Ordinary Shares of the Company held			Long/short position	Percentage of issued capital
		Direct Interests	Deemed Interests			
廣東粵港投資控股有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) (Note)	Beneficial owner/ Interest of controlled corporation	-	375,100,000		Long position	71.56
GDH Limited	Beneficial owner/ Interest of controlled corporation	375,100,000	-		Long position	71.56

*Note:* The attributable interest which 廣東粵港投資控股有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) has in the Company is held through its 100% direct interest in GDH Limited.

Save as disclosed above, as at 31 December 2004, the Directors are not aware of any other person who had an interest or short position in the shares, underlying Shares or debentures which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO.

### ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Save as disclosed in the sections headed "Share Options of the Company" and "Directors' Interests in Securities" of this report, and in note 27 to the financial statements, at no time during the year was the Company, any subsidiaries or holding company of the Company or any subsidiaries of the Company's holding company, a party to any arrangements to enable the Directors of the Company or their spouse or children under 18 years of age to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.





## Report of the Directors

### CODE OF BEST PRACTICE

The Company has complied throughout the year ended 31 December 2004 with the Code of Best Practices, as set out in Appendix 14 of the Listing Rules of The Stock Exchange of Hong Kong Limited of which is effective before 31 December 2004.

The Company has adopted the Model Code set out in Appendix 10 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited as the code of conduct regarding Director's securities transactions. All Directors have confirmed, following specific enquiry by the Company that they have complied with the required standard set out in the Model Code during the year.

### PUBLIC FLOAT

As at the date of this report, the Company has maintained the prescribed public float under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited based on the information that is publicly available to the Company and within the knowledge of the Directors.

### AUDIT COMMITTEE

The Company has established an Audit Committee comprising all of the Independent Non-Executive Directors of the Company in accordance with the Code of Corporate Governance Practice as set out in Appendix 14 to the Listing Rules. The principal duties of the Audit Committee include the review of the completeness, accuracy and fairness of the Company's financial reports and the effectiveness of the Company's internal control system. The Audit Committee has reviewed the results of the Group for the year ended 31 December 2004.

### AUDITORS

A resolution will be proposed at the forthcoming Annual General Meeting for the re-appointment of Messrs. Ernst & Young as the auditors of the Company.

By Order of the Board  
**Zhang Chunting**  
*Chairman*

Hong Kong, 8 April 2005



## Report of the Auditors



安永會計師事務所

### To the members

#### Guangdong Tannery Limited

*(Incorporated in Hong Kong with limited liability)*

We have audited the financial statements on pages 27 to 83 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

### Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with Section 141 of the Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.



## Report of the Auditors

### **Fundamental uncertainty – Contingent liabilities**

In arriving at our audit opinion, we have considered the adequacy of the disclosures made in note 32 to the financial statements concerning the irregularities involving certain former executives of a former subsidiary of the Company in a previous year and the related provision of HK\$69,600,000 for the tax claim and tax penalty made by the Group as detailed in note 24(a) to the financial statements. As the actions taken by the authorities of the People's Republic of China (the "PRC") have not yet been concluded, it is not possible to ascertain with any degree of reasonable certainty the amount of any tax penalty which may finally be imposed by the PRC authorities and the other consequential actions that may be taken by the PRC authorities for the apparent breaches of certain PRC laws and regulations, or the existence or otherwise of any other penalties and claims arising as a result of the aforesaid irregularities. As of the date of this report, no further provision other than that disclosed in notes 24(a) and 32 to the financial statements has been made in the financial statements for such contingencies. We consider that appropriate disclosures and estimates have been made in the financial statements and our audit opinion is therefore not qualified in this respect.

### **Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2004 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

### **Ernst & Young**

*Certified Public Accountants*

Hong Kong  
8 April 2005



## Consolidated Profit and Loss Account

Year ended 31 December 2004

	<i>Notes</i>	<b>2004</b> <i>HK\$'000</i>	<b>2003</b> <i>HK\$'000</i>
<b>TURNOVER</b>	5	<b>281,951</b>	381,601
Cost of sales		<u>(255,849)</u>	<u>(376,238)</u>
Gross profit		<b>26,102</b>	5,363
Other revenue and gains	5	<b>2,922</b>	19,663
Selling and distribution costs		<b>(1,630)</b>	(2,941)
Administrative expenses		<b>(20,015)</b>	(28,963)
Other operating profit/(expenses), net		<u><b>4,226</b></u>	<u>(88,754)</u>
<b>PROFIT/(LOSS) FROM OPERATING ACTIVITIES</b>	6	<b>11,605</b>	(95,632)
Finance costs	7	<u><b>(5,734)</b></u>	<u>(5,948)</u>
<b>PROFIT/(LOSS) BEFORE TAX</b>		<b>5,871</b>	(101,580)
Tax	8	<u><b>(1,203)</b></u>	<u>286</u>
<b>NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS</b>	10	<u><b>4,668</b></u>	<u>(101,294)</u>
<b>EARNINGS/(LOSS) PER SHARE</b>	11		
– Basic		<u><b>0.89 cents</b></u>	<u>(19.33 cents)</u>
– Diluted		<u><b>N/A</b></u>	<u>N/A</u>



## Consolidated Balance Sheet

31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	12	<u>111,296</u>	<u>118,406</u>
<b>CURRENT ASSETS</b>			
Inventories	15	141,089	221,395
Receivables, prepayments and deposits	16	54,698	47,683
Tax recoverable		7,040	7,031
Loan to an officer	17	923	970
Pledged and frozen deposits	18	14,794	7,355
Cash and cash equivalents	18	<u>83,246</u>	<u>76,977</u>
		<b>301,790</b>	<b>361,411</b>
<b>CURRENT LIABILITIES</b>			
Trade and bills payables	19	(38,864)	(67,725)
Accruals and other liabilities		(19,781)	(25,720)
Due to a PRC joint venture partner	20	(1,131)	(1,131)
Loans from the immediate holding company	21	(46,026)	(45,957)
Loan from a fellow subsidiary	22	(54,600)	(54,600)
Interest bearing bank borrowings	23	-	(33,091)
Provisions	24	(72,600)	(72,600)
		<u>(233,002)</u>	<u>(300,824)</u>
<b>NET CURRENT ASSETS</b>		<b>68,788</b>	<b>60,587</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>180,084</b>	<b>178,993</b>
<b>NON-CURRENT LIABILITIES</b>			
Deferred tax liabilities	25	(9,012)	(8,833)
		<u>171,072</u>	<u>170,160</u>
<b>CAPITAL AND RESERVES</b>			
Issued capital	26	52,415	52,415
Reserves	28	<u>118,657</u>	<u>117,745</u>
		<b>171,072</b>	<b>170,160</b>

Zhang Chunting  
Director

Hui Wai Man Lawrence  
Director



## Consolidated Summary Statement of Changes in Equity

Year ended 31 December 2004

	<i>Notes</i>	<b>2004</b> <b>HK\$'000</b>	2003 <i>HK\$'000</i>
Total equity at 1 January		<b>170,160</b>	275,643
Deficit on revaluation of properties	12, 28	<b>(4,969)</b>	(4,028)
Deferred tax credited to the property revaluation reserve account	25, 28	<b>1,024</b>	960
Exchange differences on translation of the financial statements of subsidiaries in Mainland China	28	<u><b>189</b></u>	<u>(152)</u>
Net losses not recognised in the profit and loss account		<u><b>(3,756)</b></u>	<u>(3,220)</u>
Release of exchange translation reserve upon disposal of subsidiaries	28, 29	-	(969)
Net profit/(loss) for the year from ordinary activities attributable to shareholders		<u><b>4,668</b></u>	<u>(101,294)</u>
Total equity at 31 December		<u><b>171,072</b></u>	<u>170,160</u>



## Consolidated Cash Flow Statement

Year ended 31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit/(loss) before tax		5,871	(101,580)
Adjustments for:			
Finance costs	7	5,734	5,948
Interest income	5	(417)	(194)
Write off of fixed assets	6	83	8,021
Loss/(gain) on disposal of fixed assets, net	6	13	(630)
Gain on disposal of subsidiaries	5	–	(16,609)
Depreciation of fixed assets	6	9,408	16,315
Reversal of impairment of fixed assets	6	(5,162)	–
Impairment of fixed assets	6	–	10,320
Provision for doubtful debts	6	–	816
Deficit/(surplus) arising on revaluation of properties, net	6	96	(704)
Provisions for tax claim and tax penalty by the PRC authorities	6	–	69,600
Operating profit/(loss) before working capital changes		15,626	(8,697)
Decrease/(increase) in inventories		80,306	(30,399)
Increase in receivables, prepayments and deposits		(6,991)	(9,522)
Increase in frozen bank balances		(8,685)	–
Increase/(decrease) in trade and bills payables, accruals and other liabilities		(34,800)	44,489
Decrease in trust receipt loans		(16,091)	(12,457)
Cash generated from/(used in) operations		29,365	(16,586)
Interest received		417	194
Interest paid		(5,734)	(5,948)
Overseas taxes paid		–	(7,031)
Net cash inflow/(outflow) from operating activities		24,048	(29,371)



## Consolidated Cash Flow Statement

Year ended 31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
Net cash inflow/(outflow) from operating activities		<u>24,048</u>	<u>(29,371)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of fixed assets	12	(2,186)	(3,044)
Proceeds from disposal of fixed assets		50	16,128
Disposal of subsidiaries	29	–	12,276
Repayment of a loan to an officer		47	45
Decrease in pledged bank balances		<u>1,246</u>	<u>5,617</u>
Net cash inflow/(outflow) from investing activities		<u>(843)</u>	<u>31,022</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
New loan from a fellow subsidiary		–	54,600
Repayment of a loan from a fellow subsidiary		–	(9,418)
New loans from the immediate holding company		10,350	–
Repayment of loans from the immediate holding company		(10,281)	–
New bank loans		–	48,817
Repayment of bank loans		<u>(17,000)</u>	<u>(70,327)</u>
Net cash inflow/(outflow) from financing activities		<u>(16,931)</u>	<u>23,672</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>			
Cash and cash equivalents at beginning of year		76,977	51,854
Effect of foreign exchange rate changes, net		<u>(5)</u>	<u>(200)</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>		<u><b>83,246</b></u>	<u><b>76,977</b></u>
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>			
Cash and bank balances	18	<u><b>83,246</b></u>	<u><b>76,977</b></u>





## Balance Sheet

31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	12	31	111
Interests in subsidiaries	13	<u>139,294</u>	<u>123,808</u>
		<u>139,325</u>	<u>123,919</u>
<b>CURRENT ASSETS</b>			
Prepayments and deposits		28	–
Loan to an officer	17	923	970
Cash and cash equivalents	18	<u>501</u>	<u>1,095</u>
		<u>1,452</u>	<u>2,065</u>
<b>CURRENT LIABILITIES</b>			
Accruals and other liabilities		(985)	(1,911)
Loans from the immediate holding company	21	<u>(46,026)</u>	<u>(45,957)</u>
		<u>(47,011)</u>	<u>(47,868)</u>
<b>NET CURRENT LIABILITIES</b>			
		<u>(45,559)</u>	<u>(45,803)</u>
		<u>93,766</u>	<u>78,116</u>
<b>CAPITAL AND RESERVES</b>			
Issued capital	26	52,415	52,415
Reserves	28	<u>41,351</u>	<u>25,701</u>
		<u>93,766</u>	<u>78,116</u>

Zhang Chunting  
Director

Hui Wai Man Lawrence  
Director



# Notes to Financial Statements

31 December 2004

## 1. CORPORATE INFORMATION

The registered office of Guangdong Tannery Limited is located at 29/F, Guangdong Investment Tower, 148 Connaught Road, Central, Hong Kong.

During the year, the Group was principally engaged in the processing and sale of semi-finished and finished leather and property investment.

In the opinion of the directors, the ultimate holding company of the Company is Guangdong Yue Gang Investment Holdings Company Limited (廣東粵港投資控股有限公司) ("Yue Gang Investment"), a company established in the mainland of the People's Republic of China (the "PRC" or "Mainland China").

## 2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs") AND INTERPRETATIONS

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and interpretations, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005.

The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the Companies Ordinance. They have been prepared under the historical cost convention, except for the periodic remeasurement of investment properties and leasehold land and buildings, as further explained below.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### **Basis of consolidation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

#### **Subsidiaries**

A subsidiary is a company in which the Company, directly or indirectly, controls more than half of its voting power or issued share/registered capital or controls the composition of its board of directors.

The results of subsidiaries are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

#### **Joint venture companies**

A joint venture company is a company set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture company's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture company is treated as a subsidiary if the Group has unilateral control, directly or indirectly, over the joint venture company or an associate if the Group does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture company's registered capital and is in a position to exercise significant influence over the joint venture company.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Associates

An associate is a company, not being a subsidiary or jointly-controlled entity, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of an associate is included in the consolidated profit and loss account and consolidated reserves, respectively. The Group's interest in an associate is stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

#### Goodwill

Goodwill arising on the acquisition of subsidiaries represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset and amortised on the straight-line basis over its estimated useful life.

Prior to the adoption of SSAP 30 "Business combinations" in 2001, goodwill arising on acquisitions was eliminated against consolidated reserves in the year of acquisition. On the adoption of SSAP 30, the Group applied the transitional provision of the SSAP that permitted such goodwill to remain eliminated against consolidated reserves. Goodwill on acquisitions subsequent to the adoption of the SSAP is treated according to the SSAP 30 goodwill accounting policy above.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of goodwill which remains unamortised and any relevant reserves, as appropriate. Any attributable goodwill previously eliminated against consolidated reserves at the time of acquisition is written back and included in the calculation of the gain or loss on disposal.

The carrying amount of goodwill, including goodwill remaining eliminated against consolidated reserves, is reviewed annually and written down for impairment when it is considered necessary. A previously recognised impairment loss for goodwill is not reversed unless the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events have occurred which have reversed the effect of that event.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### **Related parties**

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

#### **Impairment of assets**

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation) had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Fixed assets and depreciation

Fixed assets, other than construction in progress and investment properties, are stated at cost or valuation less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Changes in the values of leasehold land and buildings are dealt with as movements in the property revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the profit and loss account. Any subsequent revaluation surplus is credited to the profit and loss account to the extent of the deficit previously charged. On disposal of a revalued asset, the relevant portion of the revaluation reserve realised in respect of previous valuations is transferred to retained profits as a movement in reserves.

Depreciation is calculated on the straight-line basis to write off the cost or valuation of each asset over its estimated useful life. The principal annual rates used for this purpose are as follows:

Leasehold land held under medium term leases	Over the lease terms
Buildings	2% – 10%
Leasehold improvements	4% – 20%
Plant and machinery	10% – 12.5%
Electronic equipment	20%
Motor vehicles	15% – 20%
Furniture, fixtures and equipment	15% – 20%

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents buildings, machinery and equipment under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction during the period of construction. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### **Investment properties**

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are intended to be held on a long term basis for their investment potential, any rental income being negotiated at arm's length. Such properties are not depreciated and are stated at their open market values, on the basis of annual professional valuations performed at the end of each financial year, except where the unexpired term of the lease is 20 years or less, in which case depreciation is provided on the carrying amount over the remaining term of the lease.

Changes in the values of investment properties are dealt with as movements in the property revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on a portfolio basis, the excess of the deficit is charged to the profit and loss account. Any subsequent revaluation surplus is credited to the profit and loss account to the extent of the deficit previously charged.

On disposal of an investment property, the relevant portion of the property revaluation reserve realised in respect of previous valuations is released to the profit and loss account.

#### **Operating leases**

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets and rentals receivable under the operating leases are credited to the profit and loss account on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

#### **Inventories**

Inventories are stated at the lower of cost and net realisable value after making due allowance for obsolete or slow-moving items. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including time deposits, which are not restricted as to use.

#### Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the profit and loss account.

Provisions for staff redundancy payments and compensation to a PRC joint venture partner for early termination of a joint venture agreement are determined based on employment contracts and the terms of the joint venture agreement.

Provisions for a tax claim and a tax penalty by the PRC authorities is determined based on the amount set out in a demand letter issued by the PRC authorities to a subsidiary and a former subsidiary of the Company, and with reference to the relevant PRC laws and regulations and a PRC legal opinion.





## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the profit and loss account, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and associates, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised:

- except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Income tax (Cont'd)

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

#### Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;
- (b) rental income, on a time proportion basis over the lease terms; and
- (c) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Employee benefits

##### *Retirement benefits schemes*

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and are charged to the profit and loss account as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund.

The employees of the Group's subsidiaries which operate in Mainland China are required to participate in central pension schemes (the "PRC Scheme") operated by the local municipal government. These subsidiaries are required to contribute a certain percentage of their payroll to the PRC Scheme to fund their benefits. The only obligation of the Group with respect to the PRC Scheme is to pay the ongoing required contributions under the PRC Scheme. Contributions under the PRC Scheme are charged to the profit and loss account as they become payable in accordance with the rules of the PRC Scheme.

##### *Share option scheme*

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The financial impact of share options granted under the share option scheme is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the profit and loss account or balance sheet for their cost. Upon the exercise of share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise dates, or which lapse, are deleted from the register of outstanding options.



## Notes to Financial Statements

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Foreign currencies

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of subsidiaries and an associate operating in Mainland China and overseas are translated into Hong Kong dollars using the net investment method. The profit and loss accounts of overseas subsidiaries and an associate are translated into Hong Kong dollars at the weighted average exchange rates for the year, and their balance sheets are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. The resulting translation differences are included in the exchange translation reserve.

For the purpose of the consolidated cash flow statement, the cash flows of subsidiaries and an associate operating in Mainland China and overseas are translated into Hong Kong dollars at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of subsidiaries and an associate operating in Mainland China and overseas which arise throughout the year are translated into Hong Kong dollars at the weighted average exchange rates for the year.



## Notes to Financial Statements

31 December 2004

### 4. SEGMENT INFORMATION

Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments. Summary details of the business segments are as follows:

- (a) the leather processing segment processes raw leather to finished leather for use in the leather ware products manufacturing industry mainly in Mainland China;
- (b) the property investment segment invests in residential and commercial properties in Mainland China for rental income purposes; and
- (c) the corporate and other segment mainly comprises the Group's corporate income and expense items.

In determining the Group's geographical segments, revenues and results are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets. Intersegment transactions mainly represented management services provided and charged by the Company to its subsidiaries at the bases determined by the Group.



## Notes to Financial Statements

31 December 2004

### 4. SEGMENT INFORMATION (Cont'd)

#### (a) Business segments

The following tables present revenue, profit/(loss) and certain assets, liability and expenditure information for the Group's business segments.

#### Group

	Leather processing		Property investment		Corporate and other		Eliminations		Consolidated	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Segment revenue:										
Sales to external customers	281,951	381,601	-	-	-	-	-	-	281,951	381,601
Intersegment sales	-	-	-	-	480	480	(480)	(480)	-	-
Other revenue (excluding exchange gains/(losses), net)	1,408	941	1,066	1,825	31	16,703	-	-	2,505	19,469
Exchange gains/(losses), net	491	(1,171)	-	-	22	(160)	-	-	513	(1,331)
<b>Total</b>	<b>283,850</b>	<b>381,371</b>	<b>1,066</b>	<b>1,825</b>	<b>533</b>	<b>17,023</b>	<b>(480)</b>	<b>(480)</b>	<b>284,969</b>	<b>399,739</b>
Segment results	<b>18,379</b>	<b>(106,898)</b>	<b>342</b>	<b>2,075</b>	<b>(7,533)</b>	<b>8,997</b>	<b>-</b>	<b>-</b>	<b>11,188</b>	<b>(95,826)</b>
Interest income									417	194
Profit/(loss) from operating activities									11,605	(95,632)
Finance costs									(5,734)	(5,948)
Profit/(loss) before tax									5,871	(101,580)
Tax									(1,203)	286
Net profit/(loss) from ordinary activities attributable to shareholders									<b>4,668</b>	<b>(101,294)</b>



## Notes to Financial Statements

31 December 2004

### 4. SEGMENT INFORMATION (Cont'd)

#### (a) Business segments (Cont'd)

##### Group

	Leather processing		Property investment		Corporate and other		Eliminations		Consolidated	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Segment assets	386,012	469,165	12,924	12,848	19,331	2,684	(6,104)	(5,850)	412,163	478,847
Unallocated assets									923	970
Total assets									413,086	479,817
Segment liabilities	(136,312)	(163,886)	(433)	(359)	(1,829)	(8,781)	6,104	5,850	(132,470)	(167,176)
Unallocated liabilities									(109,544)	(142,481)
Total liabilities									(242,014)	(309,657)
Other segment information:										
Capital expenditure	2,165	2,985	-	-	21	59	-	-	2,186	3,044
Depreciation	8,956	15,531	-	-	452	784	-	-	9,408	16,315
Reversal of impairment of fixed assets	(5,162)	-	-	-	-	-	-	-	(5,162)	-
Impairment of fixed assets	-	10,320	-	-	-	-	-	-	-	10,320
Revaluation deficit/(surplus) of investment properties	-	-	234	(662)	-	-	-	-	234	(662)
Revaluation surplus of leasehold land and buildings	(138)	(42)	-	-	-	-	-	-	(138)	(42)
Other non-cash expenses	25	8,098	-	(681)	71	790	-	-	96	8,207
Provisions for tax claim and tax penalty by the PRC authorities	-	69,600	-	-	-	-	-	-	-	69,600



## Notes to Financial Statements

31 December 2004

### 4. SEGMENT INFORMATION (Cont'd)

#### (b) Geographical segments

The following tables present revenue, profit/(loss) and certain asset and expenditure information for the Group's geographical segments.

#### Group

	Mainland China		Hong Kong		Eliminations		Consolidated	
	2004	2003	2004	2003	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Segment revenue:								
Sales to external customers	281,951	381,601	-	-	-	-	281,951	381,601
Other revenue (excluding exchange gains/(losses), net)	2,505	18,843	-	626	-	-	2,505	19,469
Exchange gains/(losses), net	675	(1,171)	(162)	(160)	-	-	513	(1,331)
<b>Total</b>	<b>285,131</b>	<b>399,273</b>	<b>(162)</b>	<b>466</b>	<b>-</b>	<b>-</b>	<b>284,969</b>	<b>399,739</b>
Other segment information:								
Segment assets	388,033	445,487	24,130	33,360	-	-	412,163	478,847
Unallocated assets							923	970
<b>Total assets</b>							<b>413,086</b>	<b>479,817</b>
Capital expenditure	2,165	3,035	21	9	-	-	2,186	3,044





## Notes to Financial Statements

31 December 2004

### 5. TURNOVER AND OTHER REVENUE AND GAINS

Turnover represents gross proceeds received and receivable on the processing and sale of leather, net of goods returned, trade discounts and value-added tax, during the year.

An analysis of turnover, other revenue and gains is as follows:

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
<u>Turnover</u>		
Processing and sale of leather	<u>281,951</u>	<u>381,601</u>
<u>Other revenue and gains</u>		
Rental income	1,304	2,068
Interest income	417	194
Gain on disposal of subsidiaries (note 29)	–	16,609
Others	<u>1,201</u>	<u>792</u>
	<u>2,922</u>	<u>19,663</u>
	<u><b>284,873</b></u>	<u><b>401,264</b></u>



## Notes to Financial Statements

31 December 2004

### 6. PROFIT/(LOSS) FROM OPERATING ACTIVITIES

The Group's profit/(loss) from operating activities is arrived at after charging/(crediting):

	<i>Notes</i>	<b>2004</b> <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Cost of inventories sold		<b>255,849</b>	376,238
Auditors' remuneration		<b>720</b>	799
Depreciation	12	<b>9,408</b>	16,315
Staff costs (excluding directors' remuneration (note 9)):			
Wages and salaries		<b>9,912</b>	20,741
Redundancy payments (included in other operating profit/(expenses), net below)		<b>1,257</b>	–
Pension scheme contributions (defined contributions scheme) *		<b>714</b>	1,153
		<hr/> <b>11,883</b> <hr/>	<hr/> 21,894 <hr/>
Minimum lease payments under operating leases in respect of land and buildings		<b>251</b>	359
Other rental income		<b>(449)</b>	(384)
Gross rental income from investment properties		<b>(855)</b>	(1,684)
Less: Outgoings from investment properties		<b>158</b>	320
		<hr/> <b>(697)</b> <hr/>	<hr/> (1,364) <hr/>
Net rental income		<b>(697)</b>	(1,364)



## Notes to Financial Statements

31 December 2004

### 6. PROFIT/(LOSS) FROM OPERATING ACTIVITIES (Cont'd)

The Group's profit/(loss) from operating activities is arrived at after charging/(crediting): (Cont'd)

	<i>Notes</i>	<b>2004</b> <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Expenses/(income) included in other operating profit/(expenses), net:			
Deficit/(surplus) arising on revaluation of investment properties	12	<b>234</b>	(662)
Surplus arising on revaluation of leasehold land and buildings	12	<b>(138)</b>	(42)
Provision for doubtful debts		-	816
Write off of fixed assets	12	<b>83</b>	8,021
Loss/(gain) on disposal of fixed assets, net		<b>13</b>	(630)
Reversal of impairment of fixed assets		<b>(5,162)</b>	-
Impairment of fixed assets		-	10,320
Exchange losses/(gains), net		<b>(513)</b>	1,331
Redundancy payments		<b>1,257</b>	-
Provisions for tax claim and tax penalty by the PRC authorities	24	-	69,600
		<u><b>(4,226)</b></u>	<u>88,754</u>

\* The amount of forfeited pension scheme contributions available at the current and the prior year ends to reduce contributions in future years is not material.

### 7. FINANCE COSTS

	<b>Group</b>	
	<b>2004</b> <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Interest on:		
Bank loans	<b>1,847</b>	3,585
Loans from the former immediate holding company	-	434
Loans from the immediate holding company	<b>1,778</b>	1,343
Loans from a fellow subsidiary	<b>2,109</b>	586
	<u><b>5,734</b></u>	<u>5,948</u>



## Notes to Financial Statements

31 December 2004

### 8. TAX

No provision for Hong Kong profits tax has been made as the Group had no assessable profits arising in Hong Kong during the year (2003: Nil). No provision for Mainland China and overseas profits tax has been made (2003: Nil) as there were no assessable profits arising from certain subsidiaries of the Company operating in Mainland China and overseas during the year and certain subsidiaries of the Company operating in Mainland China and overseas had tax losses brought forward from prior years to offset the assessable profits during the year.

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Group:		
Current – Hong Kong		
Charge for the year	–	–
Overprovision in prior years	–	(286)
Deferred (note 25)	<u>1,203</u>	–
Total tax charge/(credit) for the year	<u><u>1,203</u></u>	<u><u>(286)</u></u>

A reconciliation of the tax expense applicable to profit/(loss) before tax using the statutory rates for the regions in which the Company and its subsidiaries are domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates (i.e., the statutory tax rates) to the effective tax rates, are as follows:

#### Group – 2004

	Hong Kong		Mainland China		Total	
	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%
Profit/(loss) before tax	<u>(10,487)</u>		<u>16,358</u>		<u>5,871</u>	
Tax at the statutory tax rate	(1,835)	17.5	5,398	33.0	3,563	60.7
Lower tax rate for specific provinces or local authority	–	–	323	2.0	323	5.5
Income not subject to tax	(349)	3.3	(8,942)	(54.7)	(9,291)	(158.3)
Expenses not deductible for tax	598	(5.7)	3,563	21.8	4,161	70.9
Tax losses not recognised	<u>1,586</u>	<u>(15.1)</u>	<u>861</u>	<u>5.3</u>	<u>2,447</u>	<u>41.7</u>
Tax charge at the Group's effective rate	<u><u>–</u></u>	<u><u>–</u></u>	<u><u>1,203</u></u>	<u><u>7.4</u></u>	<u><u>1,203</u></u>	<u><u>20.5</u></u>



## Notes to Financial Statements

31 December 2004

### 8. TAX (Cont'd)

Group – 2003

	Hong Kong		Mainland China		Total	
	HK\$'000	%	HK\$'000	%	HK\$'000	%
Profit/(loss) before tax	<u>560</u>		<u>(102,140)</u>		<u>(101,580)</u>	
Tax at the statutory tax rate	98	17.5	(33,706)	33.0	(33,608)	33.1
Lower tax rate for specific provinces or local authority	–	–	10,137	(9.9)	10,137	(9.9)
Income not subject to tax	(3,792)	(677.2)	(7,701)	7.5	(11,493)	11.3
Expenses not deductible for tax	3,321	593.0	19,336	(18.9)	22,657	(22.3)
Adjustments in respect of current tax of previous periods	(286)	(51.1)	–	–	(286)	0.3
Tax losses utilised from previous periods	(861)	(153.7)	–	–	(861)	0.8
Tax losses not recognised	<u>1,234</u>	<u>220.4</u>	<u>11,934</u>	<u>(11.7)</u>	<u>13,168</u>	<u>(13.0)</u>
Tax credit at the Group's effective rate	<u>(286)</u>	<u>(51.1)</u>	<u>–</u>	<u>–</u>	<u>(286)</u>	<u>0.3</u>

Certain subsidiaries of the Company established in the PRC were exempt from PRC corporate income tax for two years starting from their first profit-making year of operations, and are eligible for a 50% relief from PRC corporate income tax for the following three years under the PRC tax laws. The standard PRC corporate income tax rate applicable to those PRC subsidiaries ranged from 24% to 33% for the year ended 31 December 2004.



## Notes to Financial Statements

31 December 2004

### 9. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID EMPLOYEES

- (a) Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance, is as follows:

	Group	
	2004 HK\$'000	2003 HK\$'000
Fees:		
Executive directors	–	–
Non-executive directors	–	–
Independent non-executive directors	225	200
	<u>225</u>	<u>200</u>
Other emoluments to executive directors:		
Salaries, allowances and benefits in kind	1,794	791
Performance related bonuses	330	–
Pension scheme contributions	303	89
	<u>2,427</u>	<u>880</u>
	<u>2,652</u>	<u>1,080</u>

The number of directors whose remuneration fell within the following band is as follows:

	Number of directors	
	2004	2003
Nil – HK\$1,000,000	8	12
HK\$1,000,001 – HK\$1,500,000	1	–
	<u>9</u>	<u>12</u>

No director's fee was paid to Mr. Xiong Guangyang, Mr. Hui Wai Man Lawrence, Mrs. Ho Lam Lai Ping Theresa, Mr. Chan Hee Kwan, Mr. Zeng Hai Peng, Mr. Yuen Lam Fai Antony, Mr. Tam Chiu Pang Jaffe, Mr. Wang Man Kwan Paul, Mr. Luo Fan Yu and Mr. Li Wai Keung, directors of the Company, for the year ended 31 December 2003.

During the year, certain directors were granted 6,600,000 share options in respect of their services to the Group under the share option scheme, further details of which are set out in note 27 to the financial statements. The estimated value of such options, which has not been charged to the profit and loss account, was HK\$1,254,000 as at the date of grant. This was determined by using the Black-Scholes option pricing model. No value in respect of the share options granted during the year has been charged to the profit and loss account, or is otherwise included in the above directors' remuneration disclosures.



## Notes to Financial Statements

31 December 2004

### 9. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID EMPLOYEES (Cont'd)

- (b) The five highest paid employees of the Group during the year included three (2003: two) directors, details of whose remuneration are set out in (a) above. Details of the remuneration of the remaining two (2003: three) non-director, highest paid employees for the year are as follows:

	Group	
	2004	2003
	HK\$'000	HK\$'000
Salaries, allowances and benefits in kind	813	1,372
Performance related bonuses	–	100
Pension scheme contributions	159	153
	<u>972</u>	<u>1,625</u>

The number of non-director, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2004	2003
Nil – HK\$1,000,000	<u>2</u>	<u>3</u>

During the year, 1,800,000 share options were granted to the two non-director, highest paid employees in respect of their services to the Group, further details of which are included in the disclosures in note 27 to the financial statements. The estimated value of such options, which has not been charged to the profit and loss account, was HK\$342,000 as at the date of grant. This was determined by using the Black-Scholes option pricing model. No value in respect of the share options granted during the year has been charged to the profit and loss account, or is otherwise included in the above non-director, highest paid employees' remuneration disclosures.



## Notes to Financial Statements

31 December 2004

### 10. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company was HK\$15,650,000 (2003: HK\$49,542,000) (note 28).

### 11. EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of HK\$4,668,000 (2003: net loss of HK\$101,294,000) and the 524,154,000 (2003: 524,154,000) ordinary shares in issue during the year.

Diluted earnings/(loss) per share amounts for the years ended 31 December 2004 and 2003 have not been disclosed, as the share options outstanding during these years had an anti-dilutive effect on the basic earnings/(loss) per share for these years.





## Notes to Financial Statements

31 December 2004

### 12. FIXED ASSETS

#### Group

	Leasehold land and buildings	Investment properties	Leasehold improve- ments	Plant and machinery	Electronic equipment	Motor vehicles	Furniture, fixtures and equipment	Construction in progress	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost or valuation:									
At beginning of year	77,820	6,970	6,349	123,929	2,883	11,024	1,114	318	230,407
Additions	-	-	105	14	18	-	21	2,028	2,186
Disposals	-	-	-	-	(6)	(853)	(29)	-	(888)
Write off	-	-	(44)	-	-	-	(536)	-	(580)
Transfers	-	-	191	1,388	28	-	-	(1,607)	-
Deficit on revaluation, net	(9,001)	(234)	-	-	-	-	-	-	(9,235)
Exchange realignment	21	4	7	155	4	2	-	-	193
At 31 December 2004	<u>68,840</u>	<u>6,740</u>	<u>6,608</u>	<u>125,486</u>	<u>2,927</u>	<u>10,173</u>	<u>570</u>	<u>739</u>	<u>222,083</u>
Analysis of cost or valuation:									
At cost	-	-	6,608	125,486	2,927	10,173	570	739	146,503
At 2004 valuation	<u>68,840</u>	<u>6,740</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>75,580</u>
	<u>68,840</u>	<u>6,740</u>	<u>6,608</u>	<u>125,486</u>	<u>2,927</u>	<u>10,173</u>	<u>570</u>	<u>739</u>	<u>222,083</u>
Accumulated depreciation and impairment:									
At beginning of year	-	-	4,226	94,966	2,162	9,653	994	-	112,001
Depreciation provided for the year	4,229	-	426	3,968	176	581	28	-	9,408
Reversal of impairment during the year recognised in the profit and loss account	-	-	-	(5,162)	-	-	-	-	(5,162)
Disposals	-	-	-	-	(5)	(806)	(14)	-	(825)
Write off	-	-	(22)	-	-	-	(475)	-	(497)
Written back on revaluation	(4,170)	-	-	-	-	-	-	-	(4,170)
Exchange realignment	(59)	-	3	88	2	(2)	-	-	32
At 31 December 2004	<u>-</u>	<u>-</u>	<u>4,633</u>	<u>93,860</u>	<u>2,335</u>	<u>9,426</u>	<u>533</u>	<u>-</u>	<u>110,787</u>
Net book value:									
At 31 December 2004	<u>68,840</u>	<u>6,740</u>	<u>1,975</u>	<u>31,626</u>	<u>592</u>	<u>747</u>	<u>37</u>	<u>739</u>	<u>111,296</u>
At 31 December 2003	<u>77,820</u>	<u>6,970</u>	<u>2,123</u>	<u>28,963</u>	<u>721</u>	<u>1,371</u>	<u>120</u>	<u>318</u>	<u>118,406</u>



## Notes to Financial Statements

31 December 2004

### 12. FIXED ASSETS (Cont'd)

#### Company

	<b>Furniture, fixtures and equipment</b> <i>HK\$'000</i>
Cost:	
At beginning of year	833
Additions	20
Disposals	(24)
Write off	(536)
	<hr/>
At 31 December 2004	293
	<hr/>
Accumulated depreciation:	
At beginning of year	722
Provided for the year	25
Disposals	(10)
Write off	(475)
	<hr/>
At 31 December 2004	262
	<hr/>
Net book value:	
At 31 December 2004	31
	<hr/> <hr/>
At 31 December 2003	111
	<hr/> <hr/>

The leasehold land and buildings and investment properties of the Group were held under medium term leases in Mainland China.

The leasehold land and buildings and investment properties of the Group were revalued at 31 December 2004 by an independent professionally qualified valuer, RHL Appraisal Ltd., at open market value, based on their existing use.



## Notes to Financial Statements

31 December 2004

### 12. FIXED ASSETS (Cont'd)

As at 31 December 2004, the Group's investment properties were revalued at HK\$6,740,000 (2003: HK\$6,970,000) with a revaluation deficit of HK\$234,000 (2003: revaluation surplus of HK\$662,000) charged (2003: credited) to the profit and loss account.

As at 31 December 2004, the Group's leasehold land and buildings were individually revalued at an aggregate open market value of HK\$68,840,000 (2003: HK\$77,820,000) with a net revaluation deficit of HK\$4,831,000 (2003: HK\$3,986,000), including a revaluation deficit of HK\$4,969,000 (2003: HK\$4,028,000) charged to property revaluation reserve (note 28) and a revaluation surplus of HK\$138,000 (2003: HK\$42,000) credited to the profit and loss account in the current year.

Had the leasehold land and buildings of the Group been carried at historical cost less accumulated depreciation and impairment, their carrying values as at 31 December 2004 would have been HK\$40,289,000 (2003: HK\$45,503,000).

At 31 December 2004, an amount of HK\$2,280,000 (2003: HK\$2,400,000) and HK\$490,000 (2003: HK\$490,000) included in the Group's investment properties and leasehold land and buildings, respectively, were leasehold properties situated in Mainland China, in respect of which the land use right certificates were in the process of being obtained.

At 31 December 2004, certain of the Group's plant and machinery, leasehold land and buildings and investment properties of HK\$7,100,000 (2003: Nil), HK\$3,300,000 (2003: HK\$3,370,000) and HK\$4,460,000 (2003: HK\$4,570,000), respectively, were pledged to secure general banking facilities granted to the Group (note 34).

During the year, certain items of plant and machinery of a wholly-owned subsidiary of the Group, which had previously been impaired, were sold to another wholly-owned subsidiary of the Group. The recoverable amount of these items of plant and machinery was determined as the value in use. The discount rate used in estimating the amount of the value in use was the average rate of borrowings of the Group. Based on the change in the current and previous estimates of the value in use for these items of plant and machinery, a reversal of impairment of HK\$5,162,000 was credited to the profit and loss account during the year.



## Notes to Financial Statements

31 December 2004

### 13. INTERESTS IN SUBSIDIARIES

	Company	
	2004 HK\$'000	2003 HK\$'000
Unlisted investments, at cost	161,955	161,955
Due from subsidiaries	318,464	304,675
Due to subsidiaries	<u>(38,511)</u>	<u>(23,739)</u>
	441,908	442,891
Provision for impairment	<u>(302,614)</u>	<u>(319,083)</u>
	<u><b>139,294</b></u>	<u><b>123,808</b></u>

Included in the amounts due from subsidiaries are unsecured loans of HK\$126,007,000 (2003: HK\$126,599,000), which bear interest at rates ranging from 3.8% to 8.5% (2003: 3.8% to 8.5%) per annum and have no fixed terms of repayment. The remaining amounts due from subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

The amounts due to subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

As certain amounts due from certain subsidiaries of the Company, which had previously been impaired, were repaid during the year, a reversal of impairment to the extent of such amounts was made during the year.



## Notes to Financial Statements

31 December 2004

### 13. INTERESTS IN SUBSIDIARIES (Cont'd)

Particulars of the subsidiaries are as follows:

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity attributable to the Company		Principal activities
			Directly	Indirectly	
Crown South (Hong Kong) Limited	Hong Kong	HK\$2	-	100	Dormant
Gastor Enterprises Limited	British Virgin Islands	US\$150	100	-	Investment holding
Gold Star Assets Limited	Hong Kong	HK\$2	-	100	Investment holding
Harbour Hill International Limited	Hong Kong	HK\$1,000,000	100	-	Dormant
Jadeford Investments Limited	British Virgin Islands	US\$1	100	-	Dormant
Foshan City Nanhai Tong Yuan Tanning Co., Ltd. (formerly Nanhai City Tongyuan Tanning Company Limited)+	Mainland China	US\$3,000,000	-	100	Dormant
Qingdao Nanhai Tannery Co., Ltd. #	Mainland China	US\$2,500,000	100	-	Dormant
Sun Po (Hong Kong) Leather Ware Company Limited	Hong Kong	HK\$2	-	100	Property investment
Team Up Profits Limited	British Virgin Islands	US\$1	100	-	Investment holding



## Notes to Financial Statements

31 December 2004

### 13. INTERESTS IN SUBSIDIARIES (Cont'd)

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity attributable to the Company		Principal activities
			Directly	Indirectly	
Time Wise Profits Limited	British Virgin Islands	US\$1	100	–	Dormant
Vermont Property Limited	British Virgin Islands	US\$1	100	–	Investment holding
Xuzhou Gangwei Colour Package Co., Ltd. +	Mainland China	RMB18,000,000	100	–	Processing of cowhides, leather trading and lessor of plant and machinery
Xuzhou Nanhai Leather Factory Co., Ltd. +	Mainland China	RMB12,000,000	100	–	Processing of cowhides and leather trading

+ Wholly-foreign-owned enterprises.

# This is a Sino-foreign co-operative joint venture. Pursuant to the joint venture agreement, the registered capital of Qingdao Nanhai Tannery Co., Ltd. ("Qingdao Nanhai") was solely contributed by the Company. The PRC joint venture partner contributed its plant and equipment for the operations of Qingdao Nanhai. The Company is entitled to all its distributable profits after the payment of an agreed annual fee to the PRC joint venture partner. In the event of liquidation, the initial injected assets will be distributed to the respective original contributors and thereafter, any remaining surplus will vest with the Company.



## Notes to Financial Statements

31 December 2004

### 14. INTEREST IN AN ASSOCIATE

	Group	
	2004	2003
	HK\$'000	HK\$'000
Share of net assets	907	907
Due from an associate	7,270	7,270
	<u>8,177</u>	<u>8,177</u>
Less: Provision for impairment	(8,177)	(8,177)
	<u><u>-</u></u>	<u><u>-</u></u>

The amount due from an associate is unsecured, interest-free and has no fixed terms of repayment.

Particulars of the associate, which is a corporation are as follows:

Name	Place of incorporation/ operations	Issued share capital	Percentage of ownership interest attributable to the Group	Principal activities
Essential Holdings Limited	British Virgin Islands	US\$100	32	Investment holding



## Notes to Financial Statements

31 December 2004

### 15. INVENTORIES

	Group	
	2004	2003
	HK\$'000	HK\$'000
Raw materials	24,319	61,855
Work in progress	85,338	107,246
Finished goods	31,432	52,294
	<u>141,089</u>	<u>221,395</u>

The carrying amount of inventories carried at net realisable value included in the above balance was HK\$40,804,000 (2003: HK\$40,854,000) as at 31 December 2004.

### 16. RECEIVABLES, PREPAYMENTS AND DEPOSITS

As at 31 December 2004, included in the Group's receivables, prepayments and deposits are trade receivables with a net balance of HK\$25,909,000 (2003: HK\$17,162,000) due from the Group's customers.

The Group's trading terms with customers are mainly on credit, except for new customers, where payment in advance is normally required. Invoices are normally payable within 30 days of issuance, except for certain well-established customers, where the terms are extended to two to three months. Credit limits are set for customers. The Group seeks to maintain tight control over its outstanding receivables in order to minimise credit risk. Overdue balances are regularly reviewed by senior management.





## Notes to Financial Statements

31 December 2004

### 16. RECEIVABLES, PREPAYMENTS AND DEPOSITS (Cont'd)

As at 31 December 2004, the aged analysis of the Group's trade receivables, based on the payment due date, is as follows:

	Group	
	2004 HK\$'000	2003 HK\$'000
Within 3 months	25,855	17,479
More than 3 months and less than 6 months	471	10
More than 6 months and less than 1 year	3,056	244
More than 1 year	—	34,835
	<u>29,382</u>	<u>52,568</u>
Less: Provisions for doubtful debts	(3,473)	(35,406)
	<u>25,909</u>	<u>17,162</u>

### 17. LOAN TO AN OFFICER

Loan to an officer, disclosed pursuant to Section 161B of the Companies Ordinance, is as follows:

#### Group and Company

Name	Terms of the loan	31 December 2004 HK\$'000	1 January 2004 HK\$'000	Maximum amount outstanding during the year HK\$'000
Ms. Chan Miu Ting (Company Secretary)	Secured by her property, bears interest at 5% per annum and is repayable by monthly instalments	<u>923</u>	<u>970</u>	<u>970</u>

The loan is a staff housing loan used by Ms. Chan Miu Ting to purchase a flat as her main residence. During the year, the interest income earned from the officer amounted to HK\$47,000 (2003: HK\$50,000).



## Notes to Financial Statements

31 December 2004

### 18. CASH AND BANK BALANCES

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Cash and bank balances	98,040	84,332	501	1,095
Less: Pledged bank balances *	(6,109)	(7,355)	–	–
Frozen bank balances **	(8,685)	–	–	–
Cash and cash equivalents	<u>83,246</u>	<u>76,977</u>	<u>501</u>	<u>1,095</u>

\* These bank balances were pledged to banks for banking facilities granted (note 34).

\*\* These bank balances were frozen by the PRC authorities, details of which are set out in note 32 to the financial statements.

### 19. TRADE AND BILLS PAYABLES

As at 31 December 2004, the aged analysis of the Group's trade and bills payables, based on the payment due date, is as follows:

	Group	
	2004 HK\$'000	2003 HK\$'000
Within 3 months	32,453	62,672
More than 3 months and less than 6 months	2,205	2,831
More than 6 months and less than 1 year	1,855	67
More than 1 year	2,351	2,155
	<u>38,864</u>	<u>67,725</u>

### 20. DUE TO A PRC JOINT VENTURE PARTNER

The Group's amount due to a PRC joint venture partner is unsecured, interest-free and has no fixed terms of repayment.



## Notes to Financial Statements

31 December 2004

### 21. LOANS FROM THE IMMEDIATE HOLDING COMPANY

The Group's and the Company's loans represented unsecured loans of RMB37,990,000 (2003: RMB49,000,000) (equivalent to approximately HK\$35,676,000 (2003: HK\$45,957,000)) and HK\$10,350,000 (2003: Nil) advanced from GDH Limited ("GDH"), the Company's immediate holding company. The loans bore interest at 3.8% (2003: 3.8%) per annum and were repayable on 30 June 2005. Subsequent to the balance sheet date, on 26 January 2005, GDH agreed to extend the repayment due date of the loans to 30 June 2006 and the interest rate of the RMB37,990,000 loan was adjusted to 4.15% per annum for the period from 1 January 2005 to 30 June 2006.

### 22. LOAN FROM A FELLOW SUBSIDIARY

The Group's loan represented an unsecured loan of US\$7,000,000 (2003: US\$7,000,000) advanced from Guangdong Assets Management Limited ("Guangdong Assets Management"), a fellow subsidiary of the Company. The loan bore interest at 3.8% (2003: 3.8%) per annum and was repayable on 30 June 2005. Subsequent to the balance sheet date, on 26 January 2005, Guangdong Assets Management agreed to extend the repayment due date of the loan to 30 June 2006.

### 23. INTEREST BEARING BANK BORROWINGS

	Group	
	2004	2003
	HK\$'000	HK\$'000
Secured bank loans	-	17,000
Secured trust receipt loans	-	16,091
	<u>-</u>	<u>33,091</u>

The bank borrowings which were repaid during the year, were secured by certain bank deposits of the immediate holding company of the Company detailed in note 33 to the financial statements.



## Notes to Financial Statements

31 December 2004

### 24. PROVISIONS

#### Group

	Tax claim and tax penalty by the PRC authorities <i>HK\$'000</i>	Early termination of a joint venture agreement <i>HK\$'000</i>	Total <i>HK\$'000</i>
At beginning of year and 31 December 2004	<u>69,600</u>	<u>3,000</u>	<u>72,600</u>

#### (a) Tax claim by the PRC authorities

With respect to the tax claim of RMB36,989,000 (equivalent to approximately HK\$34,800,000) made by the Anti-Smuggling Bureau of Guangzhou Customs (廣州海關緝私局) (the "Guangzhou Customs") to Foshan City Nanhai Tong Yuan Tanning Co., Ltd. (formerly Nanhai City Tongyuan Tanning Company Limited) ("Tongyuan Tannery"), a wholly-owned subsidiary of the Company established in Mainland China, provisions of HK\$69,600,000 was made as at 31 December 2003 for (a) the tax claim of HK\$34,800,000 made by the Guangzhou Customs; and (b) the tax penalty of HK\$34,800,000 that may be imposed by the relevant PRC authorities, which were provided for by the directors with reference to a PRC legal opinion obtained by them. Details of the claim by the Guangzhou Customs are set out in note 32 to the financial statements.



## Notes to Financial Statements

31 December 2004

### 24. PROVISIONS (Cont'd)

#### (b) Provisions for termination of a joint venture agreement

With respect to the Group's decision in August 2001 to curtail the operations of Qingdao Nanhai Tannery Co., Ltd. ("Qingdao Tannery") due to its continuous losses, provisions of HK\$3,000,000 were made as at 31 December 2001 for (a) staff redundancy payments of HK\$2,000,000; and (b) compensation of HK\$1,000,000 to the PRC joint venture partner for early termination of the joint venture agreement of Qingdao Tannery. These provisions were determined based on the relevant employment contracts and the terms of the joint venture agreement.

During the year, the arbitration proceedings undertaken by the Group and the PRC joint venture partner were concluded by the China International Economic and Trade Arbitration Commissions in Shenzhen and Beijing determined that (i) the joint venture agreement of Qingdao Tannery was terminated with effect from 23 August 2001; (ii) Qingdao Tannery should be liquidated in accordance with the joint venture agreement and with the relevant laws and regulations in the PRC; and (iii) the PRC joint venture partner's claim against the Company for an economic loss of RMB15 million due to the termination of the joint venture agreement be revoked.

As the liquidation of Qingdao Tannery has not been completed, no payment for the provisions was made during the year. Accordingly, there was no movement in the provisions during the year.



## Notes to Financial Statements

31 December 2004

### 25. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year are as follows:

#### Group

	Accelerated tax depreciation <i>HK\$'000</i>	Revaluation of properties <i>HK\$'000</i>	Losses available for offset against future taxable profit <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2003	2,641	9,793	(2,641)	9,793
Deferred tax credited to the property revaluation reserve account during the year	–	(960)	–	(960)
Deferred tax charged/(credited) to the profit and loss account during the year	(483)	–	483	–
Disposal of a subsidiary	<u>(1,107)</u>	<u>–</u>	<u>1,107</u>	<u>–</u>
Deferred tax liabilities at 31 December 2003 and 1 January 2004	1,051	8,833	(1,051)	8,833
Deferred tax credited to the property revaluation reserve account during the year	–	(1,024)	–	(1,024)
Deferred tax charged to the profit and loss account during the year	<u>152</u>	<u>–</u>	<u>1,051</u>	<u>1,203</u>
Deferred tax liabilities at 31 December 2004	<u><u>1,203</u></u>	<u><u>7,809</u></u>	<u><u>–</u></u>	<u><u>9,012</u></u>



## Notes to Financial Statements

31 December 2004

### 25. DEFERRED TAX (Cont'd)

The Group has tax losses arising in Hong Kong of HK\$71,914,000 (2003: HK\$62,851,000) that are available indefinitely for offsetting against future taxable profits of the companies in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as they have arisen in subsidiaries that have been loss-making for some time.

At 31 December 2004, there is no significant unrecognised deferred tax liability (2003: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries as the Group has no liability to additional tax should such amounts be remitted.

### 26. SHARE CAPITAL

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Authorised:		
700,000,000 ordinary shares of HK\$0.10 each	<u>70,000</u>	<u>70,000</u>
Issued and fully paid:		
524,154,000 ordinary shares of HK\$0.10 each	<u>52,415</u>	<u>52,415</u>

There were no changes in the ordinary share capital of the Company during the year.

### 27. SHARE OPTION SCHEME

The Company adopts a share option scheme (the "Scheme") since 31 May 2002 for the purpose of providing incentives and rewards to eligible participants who contribute to the Group, to enable the Group to recruit and retain quality employees to serve the Group on a long term basis, to maintain good relationships with its consultants, professional advisers, suppliers of goods and services and customers, and to attract human resources that are valuable to the Group. Eligible participants of the Scheme include the Company's directors (including non-executive and independent non-executive directors), employees or executives of the Group, customers of the Group, and substantial shareholders of the Group. The Scheme, unless otherwise terminated or amended, will remain in force for 10 years from 31 January 2003.



## Notes to Financial Statements

31 December 2004

### 27. SHARE OPTION SCHEME (Cont'd)

The maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be granted under the Scheme and any other schemes of the Company may not exceed 30% of its shares in issue at any time. The total number of shares which may be issued upon exercise of all options to be granted under the Scheme and any other schemes of the Company may not in aggregate exceed 10% of the shares of the Company in issue as at the date of adopting the Scheme, but the Company may seek approval of its shareholders at a general meeting to refresh the 10% limit under the Scheme.

The total number of shares issued and to be issued upon exercise of the share options granted and to be granted to each eligible participant (including both exercised and outstanding options) in any 12-month period up to the date of grant may not exceed 1% of the shares in issue at the date of grant. Any grant of share options in excess of this limit is subject to shareholders' approval in a general meeting of the Company.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their associates, are subject to approval in advance by the independent non-executive directors of the Company. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time and with an aggregate value (based on the price of the Company's shares at the date of grant) in excess of HK\$5 million, within any 12-month period, are subject to shareholders' approval in a general meeting.

The offer of a grant of share options may be accepted within 14 days from the date of the offer upon payment of a consideration of HK\$1 by the grantee. The exercise period of the share options granted is determinable by the directors of the Company, commences after a certain vesting period and ends on a date which is not later than 10 years from the date of grant of the share options.

The exercise price of the share options is determinable by the directors, but may not be less than the higher of (i) the closing price of the Company's shares as stated in the daily quotation sheet of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on the date of grant of the share options, which must be a business day; (ii) the average closing price of the Company's shares as stated in the Stock Exchange's daily quotation sheet for the five trading days immediately preceding the date of the offer; and (iii) the nominal value of the Company's shares.





## Notes to Financial Statements

31 December 2004

### 27. SHARE OPTION SCHEME (Cont'd)

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

No share options were exercised by the directors of the Company under the Scheme during the year.

The following share options were outstanding under the Share Option Scheme during the year:

Name or category of participant	Number of share options			Date of grant of share options* (dd/mm/yyyy)	Exercise period of share options (dd/mm/yyyy)	Exercise price of share options** HK\$	Company's shares at grant date of options*** HK\$
	At 1 January 2004	Granted during the year	At 31 December 2004				
<b>Directors</b>							
Zhang Chunting	2,500,000	-	2,500,000	09/06/2003	10/09/2003 – 09/09/2008	0.220	0.220
	-	2,000,000	2,000,000	11/02/2004	12/05/2004 – 11/05/2009	0.246	0.240
	<u>2,500,000</u>	<u>2,000,000</u>	<u>4,500,000</u>				
Chen Hong	-	1,800,000	1,800,000	11/02/2004	12/05/2004 – 11/05/2009	0.246	0.240
Xiong Guangyang	3,000,000	-	3,000,000	09/06/2003	10/09/2003 – 09/09/2008	0.220	0.220
	-	2,200,000	2,200,000	11/02/2004	12/05/2004 – 11/05/2009	0.246	0.240
	<u>3,000,000</u>	<u>2,200,000</u>	<u>5,200,000</u>				
Cheng Hok Lai James	300,000	-	300,000	09/06/2003	10/09/2003 – 09/09/2008	0.220	0.220
	-	300,000	300,000	11/02/2004	12/05/2004 – 11/05/2009	0.246	0.240
	<u>300,000</u>	<u>300,000</u>	<u>600,000</u>				
Fung Lak	300,000	-	300,000	09/06/2003	10/09/2003 – 09/09/2008	0.220	0.220
	-	300,000	300,000	11/02/2004	12/05/2004 – 11/05/2009	0.246	0.240
	<u>300,000</u>	<u>300,000</u>	<u>600,000</u>				
Subtotal	<u>6,100,000</u>	<u>6,600,000</u>	<u>12,700,000</u>				



## Notes to Financial Statements

31 December 2004

### 27. SHARE OPTION SCHEME (Cont'd)

Name or category of participant	Number of share options			Date of grant of share options* (dd/mm/yyyy)	Exercise period of share options (dd/mm/yyyy)	Exercise price of share options** HK\$	Company's shares at grant date of options*** HK\$
	At 1 January 2004	Granted during the year	At 31 December 2004				
<b>Other employees</b>							
In aggregate	550,000	-	550,000	09/06/2003	10/09/2003 – 09/09/2008	0.220	0.220
	-	2,100,000	2,100,000	11/02/2004	12/05/2004 – 11/05/2009	0.246	0.240
Subtotal	<u>550,000</u>	<u>2,100,000</u>	<u>2,650,000</u>				
Total	<u><u>6,650,000</u></u>	<u><u>8,700,000</u></u>	<u><u>15,350,000</u></u>				

\* The vesting period of the share options is from the date of the grant until the commencement of the exercise period.

\*\* The exercise price of the share options is subject to adjustment in the case of rights or bonus issue, or other similar changes in the Company's share capital.

\*\*\* The price of the Company's shares disclosed as at the date of the grant of the share options is the closing price on the Stock Exchange on the trading day on which the options were granted.

At the balance sheet date, the Company had 15,350,000 share options outstanding under the Scheme. The exercise in full of all the share options would, under the present capital structure of the Company, result in the issue of 15,350,000 additional ordinary shares of the Company and additional share capital of HK\$1,535,000 and share premium of HK\$2,068,200 (before issue expenses).



## Notes to Financial Statements

31 December 2004

### 28. RESERVES

#### Group

	Notes	Share premium account HK\$'000	General reserve fund HK\$'000 (Note)	Capital redemption reserve HK\$'000	Exchange translation reserve HK\$'000	Property revaluation reserve HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
At 1 January 2003		412,116	167,746	445	969	26,552	(384,600)	223,228
Deficit on revaluation of properties	12	-	-	-	-	(4,028)	-	(4,028)
Deferred tax credited to the property revaluation reserve account	25	-	-	-	-	960	-	960
Exchange adjustments		-	-	-	(152)	-	-	(152)
Release of reserve upon disposal of subsidiaries	29	-	-	-	(969)	-	-	(969)
Net loss for the year		-	-	-	-	-	(101,294)	(101,294)
At 31 December 2003 and 1 January 2004		412,116	167,746	445	(152)	23,484	(485,894)	117,745
Deficit on revaluation of properties	12	-	-	-	-	(4,969)	-	(4,969)
Deferred tax credited to the property revaluation reserve account	25	-	-	-	-	1,024	-	1,024
Exchange adjustments		-	-	-	189	-	-	189
Net profit for the year		-	-	-	-	-	4,668	4,668
At 31 December 2004		<u>412,116</u>	<u>167,746</u>	<u>445</u>	<u>37</u>	<u>19,539</u>	<u>(481,226)</u>	<u>118,657</u>
Reserves retained by								
Company and subsidiaries		412,116	167,746	445	44	19,539	(479,609)	120,281
Associate		-	-	-	(7)	-	(1,617)	(1,624)
At 31 December 2004		<u>412,116</u>	<u>167,746</u>	<u>445</u>	<u>37</u>	<u>19,539</u>	<u>(481,226)</u>	<u>118,657</u>
Company and subsidiaries		412,116	167,746	445	(145)	23,484	(484,277)	119,369
Associate		-	-	-	(7)	-	(1,617)	(1,624)
At 31 December 2003		<u>412,116</u>	<u>167,746</u>	<u>445</u>	<u>(152)</u>	<u>23,484</u>	<u>(485,894)</u>	<u>117,745</u>



## Notes to Financial Statements

31 December 2004

### 28. RESERVES (Cont'd)

Company		Share premium account	General reserve fund	Capital redemption reserve	Accumulated losses	Total
	Notes	HK\$'000	HK\$'000 (Note)	HK\$'000	HK\$'000	HK\$'000
At 1 January 2003		412,116	167,746	445	(604,148)	(23,841)
Net profit for the year	10	–	–	–	49,542	49,542
At 31 December 2003 and 1 January 2004		412,116	167,746	445	(554,606)	25,701
Net profit for the year	10	–	–	–	15,650	15,650
At 31 December 2004		<u>412,116</u>	<u>167,746</u>	<u>445</u>	<u>(538,956)</u>	<u>41,351</u>

Note : The general reserve fund of the Company is an undistributable reserve and may not be treated as realised profits.

On 25 November 1996, a court order confirming the reduction of the share premium account by HK\$133,349,000 was registered by the Registrar of Companies in Hong Kong and the credit arising therefrom was transferred to the general reserve fund against which goodwill arising on the acquisition of a subsidiary was eliminated in the consolidated financial statements. In 2002, there was a release of goodwill of HK\$133,349,000 in respect of impairment of an investment in a subsidiary related to the goodwill arising from acquisition of that subsidiary in 1996.

Pursuant to a special resolution passed in the Company's extraordinary general meeting held on 23 January 1998 and confirmed by the Order of the High Court of Hong Kong dated 2 March 1998, the share premium account was reduced by the amount of HK\$34,397,000 and, as undertaken by the Company, a general reserve fund was credited in the books of account of the Company in the same amount for the purpose of setting off, in the consolidated accounts of the Company and its subsidiaries, goodwill arising on consolidation in 1997. In 2000 and 2001, there was a release of goodwill of HK\$12,478,000 and HK\$21,919,000, respectively, in respect of impairment of investments in subsidiaries related to the goodwill arising from the acquisition of the subsidiaries in 1997.



## Notes to Financial Statements

31 December 2004

### 29. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

#### Disposal of subsidiaries

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Net assets disposed of:		
Fixed assets	-	11,660
Cash and bank balances	-	6
Receivables, prepayments and deposits	-	5,291
Inventories	-	260
Trade payables, accruals and other payables	-	(20,575)
	<hr/>	<hr/>
	-	(3,358)
Release of exchange translation reserve	-	(969)
	<hr/>	<hr/>
	-	(4,327)
Gain on disposal of subsidiaries	-	16,609
	<hr/>	<hr/>
	-	12,282
	<hr/> <hr/>	<hr/> <hr/>
Satisfied by:		
Cash (net of expenses of HK\$233,000)	-	12,282
	<hr/> <hr/>	<hr/> <hr/>

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of subsidiaries is as follows:

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Cash consideration (net of expenses of HK\$233,000)	-	12,282
Cash and bank balances disposed of	-	(6)
	<hr/>	<hr/>
Net inflow of cash and cash equivalents in respect of the disposal of subsidiaries	-	12,276
	<hr/> <hr/>	<hr/> <hr/>

The results of the subsidiaries disposed of in the year ended 31 December 2003 had no significant impact on the Group's consolidated turnover or loss after tax for that year.



## Notes to Financial Statements

31 December 2004

### 30. OPERATING LEASE ARRANGEMENTS

#### (a) As lessor

The Group leases its investment properties and certain plant and machinery under operating lease arrangements, with leases negotiated for terms ranging from 1 to 5 years.

At 31 December 2004, the Group had total future minimum lease receivables under non-cancellable operating leases with their lessees falling due as follows:

	Group	
	2004	2003
	HK\$'000	HK\$'000
Within one year	1,028	1,117
In the second to fifth years, inclusive	<u>1,381</u>	<u>2,639</u>
	<u><u>2,409</u></u>	<u><u>3,756</u></u>

#### (b) As lessee

The Group leases certain of its office properties under operating lease arrangements. Leases for properties are negotiated for terms arranging from 2 to 3 years.

At 31 December 2004, the Group had total future minimum lease payments under non-cancellable operating lease falling due as follows:

	Group	
	2004	2003
	HK\$'000	HK\$'000
Within one year	121	145
In the second to fifth years, inclusive	<u>71</u>	<u>–</u>
	<u><u>192</u></u>	<u><u>145</u></u>



## Notes to Financial Statements

31 December 2004

### 31. COMMITMENTS

At the balance sheet date, the Company and the Group did not have any significant capital commitments (2003: Nil).

### 32. CONTINGENT LIABILITIES

Following the change in senior management of the Company in June 2002, it was discovered that certain former executives (the "Former Executives") of Nanhai Tannery & Leather Products Co., Ltd. ("Nanhai Tannery") (one of whom was also a former director of the Company) had been involved in certain irregularities. Nanhai Tannery was a former wholly-owned subsidiary of the Company established in Nanhai, the PRC.

Upon discovery of the irregularities, an internal audit team of the Company's holding companies, working with the new management, conducted a preliminary investigation of the irregularities. The investigation revealed that the Former Executives apparently operated a business in parallel to the operations of Nanhai Tannery (the "Parallel Operation") for their own personal gain.

The incident was reported by the Company to the relevant PRC authorities who have detained the Former Executives and seized documents related to the Parallel Operation for investigation. The Company also instructed its auditors and the PRC lawyers to carry out special investigations with a view to ascertaining the effects of the Parallel Operation on the business of Nanhai Tannery and to advise management of the Group's possible recourse against the Former Executives.

Based on the findings of the special investigations and having regard to the professional advice received, the directors of the Company are of the opinion that the Parallel Operation should not be incorporated in the financial statements of the Group and that the Parallel Operation appears to have involved various irregularities in its transactions under the applicable PRC laws and regulations.

Pursuant to a business restructuring plan implemented by the Group, Tongyuan Tannery was established to operate the Group's tannery operations and businesses in the Guangdong province in January 2003. Tongyuan Tannery is a wholly-owned subsidiary of the Company which owns and operates a factory and distribution operations in Nanhai, the PRC. Tongyuan Tannery had purchased from Nanhai Tannery most of its fixed assets and inventories in 2003.



## Notes to Financial Statements

31 December 2004

### 32. CONTINGENT LIABILITIES (Cont'd)

On 31 December 2003, the Company entered into a conditional sale and purchase agreement with Yong Sheng Limited, a subsidiary of GDH Limited ("GDH") and a fellow subsidiary of the Company, for the disposal of the Company's entire 100% interest in Nanhai Tannery. The transaction was completed on 31 December 2003 and Nanhai Tannery became a wholly-owned subsidiary of GDH and a fellow subsidiary of the Company.

In February and March 2004, certain bank accounts of Tongyuan Tannery in the PRC containing in total approximately RMB7 million were frozen by the Guangzhou Customs. Subsequently, additional bank balances of RMB2 million were frozen by the Guangzhou Customs. Accordingly, bank balances of RMB9 million (equivalent to approximately HK\$8.7 million) were frozen as at 31 December 2004 (note 18).

The directors and management of the Company are satisfied that all the businesses and operations of Tongyuan Tannery have been conducted strictly in accordance with all the applicable PRC laws and regulations, and that there has been no wrongdoing on the part of Tongyuan Tannery or any of its management or staff.

On 22 March 2004, the Guangzhou Customs issued a demand letter to Tongyuan Tannery and Nanhai Tannery (i) claiming tax of RMB36,989,000 (equivalent to approximately HK\$34,800,000) payable within 30 days from the date of the demand letter in relation to the tax evaded by Nanhai Tannery during the period from 2000 to 2002; and (ii) asserting that Tongyuan Tannery and Nanhai Tannery failed to notify the Guangzhou Customs of the change from Nanhai Tannery to Tongyuan Tannery.

Although the Group had disposed of its entire interest in Nanhai Tannery to GDH and the tax evasion was related to the Parallel Operation of Nanhai Tannery, it cannot be precluded that the Guangzhou Customs may still claim the tax evaded by Nanhai Tannery against Tongyuan Tannery on the ground that Nanhai Tannery had transferred most of its fixed assets and inventories to Tongyuan Tannery after the commencement of the investigations undertaken by the Guangzhou Customs. The directors have sought PRC legal advice on such matters and consider that Tongyuan Tannery will be liable for the above-mentioned tax claim of HK\$34,800,000 by the Guangzhou Customs if the Guangzhou Customs considers that Tongyuan Tannery and Nanhai Tannery are one and the same entity. Accordingly, the Group made a provision of HK\$34,800,000 (note 24(a)).





## Notes to Financial Statements

31 December 2004

### 32. CONTINGENT LIABILITIES (Cont'd)

In addition, based on a PRC legal opinion, under the existing PRC laws and regulations, the relevant PRC authorities may also impose a tax penalty on Tongyuan Tannery of an amount equal to 1 to 5 times the tax evaded by the Parallel Operation of Nanhai Tannery, ie. HK\$34,800,000 to HK\$174,000,000. The directors have sought legal advice on such matters and consider that a provision of HK\$34,800,000 for the tax penalty (note 24(a)) is appropriate.

As the actions taken by the PRC authorities have not yet been concluded, it is not possible to determine with any degree of reasonable certainty the amount of tax penalty which may finally be imposed by the PRC authorities against Tongyuan Tannery, which may be within the range of HK\$34,800,000 to HK\$174,000,000, other consequential actions that may be taken by the PRC authorities for the apparent breaches of certain PRC laws and regulations, and the existence or otherwise of any other penalties and claims as a result of the aforesaid irregularities. Should additional tax penalty in excess of the amount provided of HK\$34,800,000 be imposed against Tongyuan Tannery, the directors are of the opinion that the Group would have adequate net assets and resources to continue its operations.

As of the date of this report, no further action has been taken by the Guangzhou Customs or any other PRC authorities against Tongyuan Tannery and there have been no further claims made against Tongyuan Tannery. Accordingly, based on the current available information, no further provision for the tax penalty and other claims or liabilities has been made in the financial statements.



## Notes to Financial Statements

31 December 2004

### 33. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following significant transactions with related parties during the year:

		Group	
		2004	2003
	Notes	HK\$'000	HK\$'000
Office rental paid to the immediate holding company	(a)	93	–
Office rental paid to a fellow subsidiary	(b)	103	316
Computer system maintenance service fees paid to the immediate holding company	(c)	111	54
Tax consultancy fee paid to the immediate holding company	(d)	50	–
Interest expense to the former immediate holding company	(e)	–	434
Interest expense to the immediate holding company	(f)	1,778	1,343
Interest expense to a fellow subsidiary	(g)	2,109	586
Gain on disposal of subsidiaries, net	(h)	–	(14,881)
Loss on disposal of a subsidiary	(i)	–	15
		<u>          </u>	<u>          </u>

Notes:

- (a) The office rental was charged by the immediate holding company at HK\$9,276 (2003: Nil) per month commencing from 1 March 2004 in accordance with the terms of the rental agreement between the Group and the immediate holding company. At the balance sheet date, the Group had a rental deposit of HK\$27,828 (2003: Nil) with the immediate holding company of the Company.
- (b) The office rental was charged by a fellow subsidiary at HK\$25,740 per month for the first four months of 2004 (2003: HK\$28,311 per month for the first quarter of 2003 and HK\$25,740 per month for the remainder of 2003) in accordance with the terms of the rental agreement between the Group and the fellow subsidiary. The rental agreement between the Group and the fellow subsidiary was surrendered in May 2004 and the rental deposit of HK\$102,974 was returned from the fellow subsidiary to the Company.
- (c) The immediate holding company charged maintenance service fees at HK\$6,750 per month for the first 2 months of 2004 and HK\$9,750 per month for the remainder of 2004 (2003: HK\$6,750) for the computer system used by the Company commencing from 1 May 2003.
- (d) The immediate holding company charged consultancy fee for the tax consultancy services rendered in respect of reviewing the Group's tax matters for the year.



## Notes to Financial Statements

31 December 2004

### 33. RELATED PARTY TRANSACTIONS (Cont'd)

*Notes: (Cont'd)*

- (e) The interest expense to the former immediate holding company arose from the loans advanced from Guangdong Investment Limited ("GDI") in 2002. On 31 March 2003, GDI disposed of its entire shareholdings in the Company and its interests in the loans to GDH, GDI's immediate holding company. Since then, the Company ceased to pay interest to GDI.
- (f) The interest expense to the immediate holding company arose from the loans advanced from GDH. Further details of the loans, including the terms, are disclosed in note 21 to the financial statements.
- (g) The interest expense to a fellow subsidiary arose from a loan advanced from Guangdong Assets Management. Further details of the loan, including the terms, are disclosed in note 22 to the financial statements.
- (h) During the year ended 31 December 2003, pursuant to a conditional sale and purchase agreement entered into between the Company and Yong Sheng Limited, a fellow subsidiary of the Company, the Company disposed of its entire 100% interest in Guangdong Tannery (Nominees) Limited and Nanhai Tannery at a cash consideration of HK\$10,000. The transaction was completed on 31 December 2003.
- (i) During the year ended 31 December 2003, pursuant to a sale and purchase agreement entered into between the Company and Guangdong Assets Management on 26 April 2003, the Company disposed of its entire 100% interest in Prized Time Limited to Guangdong Assets Management at a cash consideration of HK\$7,998,000 (net of expenses).

In addition to the above, the Group's bank loans of HK\$17,000,000 as at 31 December 2003 were secured by certain bank deposits of the immediate holding company of the Company at nil consideration. The bank loans were fully repaid by the Group during the year (note 23).



## Notes to Financial Statements

31 December 2004

### 34. PLEDGE OF ASSETS

As at 31 December 2004, assets of the Group pledged to banks to secure general banking facilities granted to the Group were as follows:

	<i>Notes</i>	<b>Group</b>	
		<b>2004</b>	<b>2003</b>
		<b><i>HK\$'000</i></b>	<b><i>HK\$'000</i></b>
Leasehold land and buildings	12	<b>3,300</b>	3,370
Investment properties	12	<b>4,460</b>	4,570
Bank balances	18	<b>6,109</b>	7,355
Plant and machinery	12	<b>7,100</b>	–
		<b><u>20,969</u></b>	<b><u>15,295</u></b>

### 35. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 8 April 2005.



## Notice of Annual General Meeting

**NOTICE IS HEREBY GIVEN THAT** the Annual General Meeting of Guangdong Tannery Limited (the “Company”) will be held at The Boardroom, Basement II, The Wharney Hotel Hong Kong, 57-73 Lockhart Road, Wanchai, Hong Kong on Wednesday, 8 June 2005 at 11:30 a.m. for the purposes of transacting the following businesses:

As Ordinary Business:

1. To receive and consider the audited Consolidated Financial Statements and the Reports of the Directors and the Auditors for the year ended 31 December 2004.
2. To re-elect retiring Directors and to authorise the Board of Directors to fix the remuneration of the Directors.
3. To re-appoint Auditors and to authorise the Board of Directors to fix their remuneration.

And as Special Business, to consider and, if thought fit, to pass with or without amendments, the following resolution as an ordinary resolution:

4. “THAT:
  - (a) subject to the other provisions of this resolution and pursuant to Section 57B of the Companies Ordinance, the exercise by the Directors of the Company during the Relevant Period (as defined in paragraph (d) of this resolution) of all the powers of the Company to issue, allot and deal with additional ordinary shares of HK\$0.10 each in the capital of the Company (the “Ordinary Shares”) or options, warrants or instruments carrying similar rights to subscribe for any Ordinary Shares or securities convertible into Ordinary Shares, and to make or grant offers, agreements and options which would or might require the exercise of such powers be and is hereby generally and unconditionally approved;
  - (b) the approval in paragraph (a) of this resolution shall be in addition to any other authorisation given to the Directors of the Company and shall authorise the Directors of the Company during the Relevant Period to make or grant offers, agreements and options which would or might require the exercise of such powers after the end of the Relevant Period;
  - (c) the aggregate nominal amount of the Ordinary Shares allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) by the Directors of the Company pursuant to the approval given under paragraph (a) of this resolution, otherwise than pursuant to (i) a Rights Issue (as defined in paragraph (d) of this resolution), (ii) the exercise of the subscription or conversion rights attaching to any warrants, convertible bonds or other securities issued by the Company which are convertible into



## Notice of Annual General Meeting

Ordinary Shares, (iii) the exercise of options granted by the Company under any option scheme or similar arrangement for the time being adopted for the grant to Directors, officers and/or employees of the Company and/or any of its subsidiaries and other eligible person (if any) of rights to acquire Ordinary Shares, or (iv) any scrip dividend or similar arrangement providing for the allotment of Ordinary Shares in lieu of the whole or part of a dividend on the Ordinary Shares in accordance with the Articles of Association of the Company (the "Articles"), shall not exceed 20 per cent. of the aggregate nominal amount of the Ordinary Shares in issue as at the date of the passing of this resolution, and the said approval shall be limited accordingly; and

(d) for the purposes of this resolution:

"Relevant Period" means the period from the passing of this resolution until whichever is the earliest of:

- (i) the conclusion of the next annual general meeting of the Company;
- (ii) the expiration of the period within which the next annual general meeting of the Company is required by the Articles or any applicable laws of the Hong Kong Special Administrative Region of the People's Republic of China ("Hong Kong") to be held; and
- (iii) the revocation or variation of the authority given under this resolution by an ordinary resolution of the shareholders of the Company in general meeting;

and,

"Rights Issue" means an offer of Ordinary Shares open for a period fixed by the Company (or by the Directors of the Company) to the holders of Ordinary Shares on the Register of Members (Ordinary Shares) of the Company on a fixed record date in proportion to their then holdings of such Ordinary Shares (subject to such exclusions or other arrangements as the Directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of, any recognised regulatory body or any stock exchange in any territory outside Hong Kong).

By Order of the Board  
**Chan Miu Ting**  
*Company Secretary*

Hong Kong, 8 April 2005

*Registered office:*

29th Floor, Guangdong Investment Tower  
148 Connaught Road Central  
Hong Kong



## Notice of Annual General Meeting

*Notes:*

- (i) A shareholder entitled to attend and vote at the above meeting may appoint one or more proxies to attend and, on a poll, vote in his place and such proxy need not be a shareholder of the Company.
- (ii) A form of proxy is enclosed. To be valid, the form of proxy together with the power of attorney (if any) or other authority (if any) under which it is signed (or a notarially certified copy of such power or authority) must be delivered to the Company's registrar and share transfer office, Tengis Limited, at G/F., Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong, not less than 48 hours before the time fixed for holding the meeting or adjourned meeting. The appointment of a proxy will not prevent a shareholder from subsequently attending and voting at the meeting or any adjourned meeting if he so wishes. If a shareholder who has lodged a form of proxy attends the meeting, his form of proxy will be deemed to have been revoked.
- (iii) In the case of joint shareholders, the vote of the senior who tenders a vote, whether in person, or by proxy, shall be accepted to the exclusion of the votes of the other joint holders, and for this purpose seniority will be determined by the order in which the names stand in the Company's register of shareholders in respect of the joint holding.
- (iv) The Register of Members of the Company will be closed on Tuesday, 7 June 2005 and Wednesday, 8 June 2005, during such period no transfer of shares will be effected.
- (v) In order to determine the identity of the Members who are entitled to attend and vote at the Meeting, all transfer documents accompanied by the relevant share certificates must be lodged at the office of the Company's registrar and share transfer office, Tengis Limited at G/F., Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong, not later than 4:30 p.m. on Monday, 6 June 2005.
- (vi) In relation to item no. 2 in this notice, the biographical details and interests in shares of the Company of all the directors to be re-elected at the Meeting are provided in the sections titled "Biographical Details of Directors and Senior Management" and "Report of the Directors" in the Annual Report.
- (vii) In relation to item no. 4 in this notice, approval is being sought from the shareholders for a general mandate to authorise the issue of shares in the share capital of the Company. The Directors of the Company wish to state that they have no immediate plans to issue any new Ordinary Shares pursuant to the general mandate so given.