



GDH

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**GDH** 粵海制革有限公司  
GUANGDONG TANNERY LIMITED

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## **BUSINESS AND FINANCIAL REVIEWS**

### **RESULTS**

The Group's unaudited profit attributable to shareholders for the six months ended 30 June 2004 was HK\$2,607,000, compared with a loss of HK\$2,382,000 for the same period last year. This encouraging result reflects the Group's success in achieving profitability during the period under review.

The unaudited net asset value of the Group as at 30 June 2004 was HK\$172,851,000, a drop of HK\$91,312,000 and a rise of HK\$2,691,000 as compared to 30 June 2003 and 31 December 2003 respectively.

No interim dividend is recommended by the Board of Directors for the six months ended 30 June 2004.

### **DEVELOPMENT OF THE GROUP – EXPANSION PLANS IN XUZHOU**

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 laid off more than 600 employees in late June, 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 interest.

To remedy the reduced production and sales volume caused by the suspension of Tongyuan Tannery's operations, we have initiated a northward shift of operations and stepped up efforts to develop Xuzhou Tanneries as a major base of production. Meanwhile, strategies are adopted to increase the proportion of outsourced upstream processing and franchising.

In the period from April to June 2004, Xuzhou Nanhai Leather Factory Co., Ltd ("Xuzhou Tannery"), and Xuzhou Gangwei Colour Packaging Limited ("Gangwei"), another subsidiary of the Group acquired from Tongyuan Tannery part of the latter's assets including inventories, machinery and equipment. We expect the monthly average production capacity of Xuzhou Tannery will increase to 1,300,000 sq.ft. after the machinery is properly installed and adjusted; Gangwei will have a monthly average production capacity of 1,000,000 sq.ft. as it is restructured into a downstream production plant for leather coating processing; and the annual capacity of downstream coating processing will reach 28,000,000 sq.ft. following the respective expansion and restructuring program of the two tanneries in Xuzhou. On the other front part of the Group's upstream leather processing was outsourced in June this year, and plans are underway to seek more other suitable processing plants in areas adjacent to Xuzhou. These strategies aim to expedite the expansion pace of Xuzhou production base at the most reasonable costs.

## BUSINESS AND FINANCIAL REVIEWS

### OPERATIONS REVIEW

Following the initiatives to consolidate its business foundation in 2002 and 2003, Xuzhou Tannery is currently in a stronger position as it benefits from steady supply and sales, as well as positive market responses to its products in terms of quality and style. While efforts have been made to stimulate the sales of existing products, new products are launched for production trial by customers, and good potential products with less satisfactory sales are vigorously promoted in order to increase orders from customers in the peak season. In the meantime, we are active in seeking new direct sales customers. As the huge potential of the Guangdong market has not yet been fully exploited, Xuzhou Tannery has intensified its efforts to develop and penetrate further in this market during the past few months.

Turnover for the period was HK\$162,836,000, a rise of 14.36% as compared to HK\$142,380,000 for the same period last year. Turnover of Xuzhou Tannery for the period was HK\$81,934,000 (2003: HK\$49,470,000), a significant increase of 66% over the same period in 2003; and turnover of Tongyuan Tannery declined to HK\$69,290,000 from HK\$92,910,000 in the same period last year. The decrease was due to the fact that Tongyuan Tannery has been focusing on clearing its finished products in stock since its suspension of operations in March 2004. Turnover of cowhides increased by 22.91% to HK\$143,446,000 (2003: HK\$116,712,000) whereas cow split and others dropped by 24.46% to HK\$19,390,000 (2003: HK\$25,668,000).

Sourcing cost for raw materials was reduced during the period as our measures to expand the supplier network, introduce competition into the sourcing process, and strengthen our market research and price negotiation efforts are firmly in place.

Given that the sales demand outstripped our production volume in the peak season last year, the Group has increased its product inventories as an earlier measure to position itself for the peak season sales in the second half of 2004. The Group's total leather production for the period was 11,434,000 sq.ft., declined by 3,835,000 sq.ft. from 15,269,000 sq.ft. in 2003. Production of cowhides dropped by 8.23% to 10,225,000 sq.ft. (2003: 11,142,000 sq.ft.) whereas cow split down by 70.71% to 1,209,000 sq.ft. (2003: 4,127,000 sq.ft.). Maintaining a strong momentum for production growth, Xuzhou Tannery produced a total of 7,090,000 sq.ft. (2003: 3,124,000 sq.ft.) in cowhides for the period, an increase of 126.95% over the same period in the previous year.

As at 30 June 2004, the Group's consolidated inventories amounted to HK\$205,457,000, reduced by HK\$23,740,000 and HK\$15,938,000 as compared to 30 June 2003 and 31 December 2003 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 the end of the period was HK\$68,274,000. After deducting the provisions for doubtful debts of HK\$33,751,000, trade receivables amounted to HK\$34,523,000, an increase of HK\$17,361,000 and a drop of HK\$5,001,000 as compared to 31 December 2003 and the same period last year. Trade receivables turnover was 12.60 times and average collection period was 29 days, markedly improved from 39 days for the same period last year. The trade receivables of Tongyuan Tannery upon its suspension of operations in March 2004 was approximately RMB39,000,000. As at 30 June 2004, these trade receivables were reduced to RMB11,778,000 as a result of the Group's active attempts to recover the receivables.

## BUSINESS AND FINANCIAL REVIEWS

### FINANCIAL REVIEW

As at 30 June 2004, the Group's interest-bearing borrowings amounted to HK\$110,012,000 (as at 31 December 2003: HK\$133,648,000). Of the total interest-bearing borrowings, HK\$18,685,000 was denominated in Hong Kong dollars, HK\$35,798,000 in Renminbi and HK\$55,529,000 in US dollars. In addition, the interest-bearing borrowings charged at fixed rate and floating rate amounted to HK\$100,748,000 and HK\$9,264,000 respectively.

As at 30 June 2004, the Group's cash and bank balances amounted to HK\$59,677,000 (as at 31 December 2003: HK\$84,332,000), denominated in Hong Kong dollars (HK\$1,347,000), Renminbi (equivalent to HK\$56,520,000) and US dollars (equivalent to HK\$1,810,000) respectively.

As at 30 June 2004, after deduction of cash and bank deposits, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 29.12% (as at 31 December 2003: 28.98%). Loan facilities bear interest at approximately 3% to 4% per annum. Of the Group's total borrowings, HK\$110,012,000 is repayable within one year. Interest expense incurred by the Group during the period was HK\$3,104,000, a rise of 19.89% as compared to the same period last year.

Net cash outflow from operating activities for the period was HK\$23,377,000 and cash outflow from financing was HK\$8,679,000. Net decrease in cash and cash equivalents for the period amounted to HK\$29,579,000.

Fixed assets as at 30 June 2004 were HK\$114,375,000, a reduction of HK\$4,031,000 as compared to 31 December 2003. The Group's capital expenditure during the period amounted to HK\$1,299,000 (2003: HK\$2,046,000). It was incurred mainly for the replacement of the leather manufacture machinery and equipment, a move to cope with the operations and development of the leather business.

As at 30 June 2004, certain of the Group's buildings, investment properties, bank deposits and plant and machinery with a total net book value of HK\$19,123,000 (31 December 2003: HK\$15,295,000) were pledged to secure general banking facilities granted to the Group.

### 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 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 the Qingdao Tannery in compliance with the above rulings.

## **BUSINESS AND FINANCIAL REVIEWS**

### **EMPLOYEES**

As at 30 June 2004, a total of 507 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. Over the past few years, there was a salary freeze for the employees of the headquarters in Hong Kong. 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 Condensed Consolidated Financial Statements.

### **PROSPECTS**

The Group is steadfast to consolidate and strengthen further the operational scale and operating profits of the two tanneries in Xuzhou. To this end, focus is placed on expanding Xuzhou Tannery's production capacity; enhancing its internal management efficiency, product quality and market competitiveness; as well as strengthening its operations in areas of supply and sales. The downstream leather production line at Gangwei is scheduled to commence operations by the end of this year. This will provide a strong platform for our future development as the leather business is poised to enter a new phase of more exciting growth.

**CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT***Six months ended 30 June 2004*

	Notes	Six months ended 30 June	
		2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)
<b>TURNOVER</b>	2	<b>162,836</b>	142,380
Cost of sales		<b>(146,262)</b>	(132,169)
Gross profit		<b>16,574</b>	10,211
Other revenue and gains		<b>1,640</b>	1,707
Selling and distribution costs		<b>(842)</b>	(1,195)
Administrative expenses		<b>(11,952)</b>	(11,511)
Other operating income, net		<b>291</b>	709
<b>PROFIT/(LOSS) FROM OPERATING ACTIVITIES</b>	2, 3	<b>5,711</b>	(79)
Finance costs	4	<b>(3,104)</b>	(2,589)
<b>PROFIT/(LOSS) BEFORE TAX</b>		<b>2,607</b>	(2,668)
Tax	5	<b>-</b>	286
<b>NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS</b>		<b>2,607</b>	(2,382)
<b>EARNINGS/(LOSS) PER SHARE</b>	7		
– Basic		<b>0.50 cent</b>	(0.45) cent
– Diluted		<b>N/A</b>	N/A

**CONDENSED CONSOLIDATED BALANCE SHEET**

30 June 2004

	Notes	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
<b>NON-CURRENT ASSETS</b>			
Fixed assets		<b>114,375</b>	118,406
<b>CURRENT ASSETS</b>			
Inventories	8	<b>205,457</b>	221,395
Receivables, prepayments and deposits	9	<b>71,395</b>	47,683
Tax recoverable		<b>7,064</b>	7,031
Loan to an officer		<b>947</b>	970
Cash and bank balances	10	<b>59,677</b>	84,332
		<b>344,540</b>	361,411
<b>CURRENT LIABILITIES</b>			
Trade and bills payables	11	<b>(69,677)</b>	(67,725)
Accruals and other liabilities		<b>(23,811)</b>	(25,720)
Due to a PRC joint venture partner	12	<b>(1,131)</b>	(1,131)
Loans from immediate holding company	13	<b>(46,148)</b>	(45,957)
Loan from a fellow subsidiary	14	<b>(54,600)</b>	(54,600)
Bank borrowings		<b>(9,264)</b>	(33,091)
Provisions	15	<b>(72,600)</b>	(72,600)
		<b>(277,231)</b>	(300,824)
<b>NET CURRENT ASSETS</b>		<b>67,309</b>	60,587
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>181,684</b>	178,993
<b>NON-CURRENT LIABILITIES</b>			
Deferred tax liabilities		<b>(8,833)</b>	(8,833)
		<b>172,851</b>	170,160
<b>CAPITAL AND RESERVES</b>			
Issued capital	16	<b>52,415</b>	52,415
Reserves	18	<b>120,436</b>	117,745
		<b>172,851</b>	170,160

**CONDENSED CONSOLIDATED SUMMARY STATEMENT OF CHANGES IN EQUITY***Six months ended 30 June 2004*

	<i>Notes</i>	<b>Six months ended 30 June</b>	
		<b>2004</b>	2003
		<b>HK\$'000</b>	HK\$'000
		<b>(Unaudited)</b>	(Unaudited)
Total equity at 1 January:		<b>170,160</b>	275,643
Deficit arising on revaluation of properties	18	–	(9,103)
Exchange differences on translation of the financial statements of subsidiaries in Mainland China	18	<b>84</b>	5
Net gains/(losses) not recognised in the profit and loss account		<b>84</b>	(9,098)
Net profit/(loss) for the period from ordinary activities attributable to shareholders		<b>2,607</b>	(2,382)
Total equity at 30 June		<b>172,851</b>	264,163

**CONDENSED CONSOLIDATED CASH FLOW STATEMENT**

Six months ended 30 June 2004

	<b>Six months ended 30 June</b>	
	<b>2004</b>	2003
<i>Note</i>	<b>HK\$'000</b>	HK\$'000
	<b>(Unaudited)</b>	(Unaudited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash used in operations	<b>(20,815)</b>	(45,584)
Interest received	<b>542</b>	94
Interest paid	<b>(3,104)</b>	(2,438)
	<hr/>	<hr/>
Net cash outflow from operating activities	<b>(23,377)</b>	(47,928)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of fixed assets	<b>(1,299)</b>	(2,046)
Proceeds from disposal of fixed assets	<b>5</b>	12,178
Disposal of a subsidiary	<b>–</b>	7,998
Repayment of loans to an officer	<b>23</b>	22
Decrease in pledged bank balances	<b>3,748</b>	9,865
	<hr/>	<hr/>
Net cash inflow from investing activities	<b>2,477</b>	28,017
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
New loans from immediate holding company	<b>10,350</b>	–
New bank loans	<b>–</b>	57,847
Repayment of a loan from a fellow subsidiary	<b>–</b>	(9,418)
Repayment of loans from immediate holding company	<b>(10,364)</b>	–
Repayment of bank loans	<b>(8,665)</b>	(55,781)
	<hr/>	<hr/>
Net cash outflow from financing activities	<b>(8,679)</b>	(7,352)
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>		
	<b>(29,579)</b>	(27,263)
Cash and cash equivalents at beginning of period	<b>76,977</b>	51,854
Effect of foreign exchange rate changes, net	<b>246</b>	–
	<hr/>	<hr/>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>47,644</b>	24,591
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>		
Cash and bank balances	<b>47,644</b>	24,591

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS***30 June 2004***1. BASIS OF PREPARATION AND ACCOUNTING POLICIES**

These unaudited condensed consolidated interim financial statements of the Group have been prepared in accordance with Statement of Standard Accounting Practice ("SSAP") 25 "Interim financial reporting" issued by the Hong Kong Institute of Certified Public Accountants. The accounting policies and basis of preparation used in the preparation of these unaudited condensed consolidated interim financial statements are consistent with those used in the Group's audited annual financial statements for the year ended 31 December 2003.

**2. SEGMENT INFORMATION**

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 the mainland of the People's Republic of China (the "PRC" or "Mainland China");
- (b) the merchandise trading segment purchases commodities from overseas and sells to customers in Mainland China;
- (c) the property investment segment invests in residential and commercial properties in Hong Kong and Mainland China for rental income purpose; and
- (d) 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.

There were no intersegment sales and transfers during the periods.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**2. SEGMENT INFORMATION** (continued)**(a) Business segments**

The following table presents revenue, profit/(loss) and other information for the Group's business segments.

	Leather processing		Merchandise trading		Property investment		Corporate and other		Consolidated	
	Six months ended 30 June		Six months ended 30 June		Six months ended 30 June		Six months ended 30 June		Six months ended 30 June	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	HK\$'000	HK\$'000								
	(Unaudited)	(Unaudited)								
Segment revenue:										
Sales to external customers	162,836	142,380	-	-	-	-	-	-	162,836	142,380
Other revenue (excluding exchange gains/(losses), net)	596	575	-	-	471	991	31	47	1,098	1,613
Exchange gains/(losses), net	1,526	54	-	-	-	-	87	(4)	1,613	50
Total	164,958	143,009	-	-	471	991	118	43	165,547	144,043
Segment results	9,360	2,107	-	-	396	1,990	(4,587)	(4,270)	5,169	(173)
Interest income									542	94
Profit/(loss) from operating activities									5,711	(79)
Finance costs									(3,104)	(2,589)
Profit/(loss) before tax									2,607	(2,668)
Tax									-	286
Net profit/(loss) for the period from ordinary activities attributable to shareholders									2,607	(2,382)
Other segment information:										
Capital expenditure	1,279	2,037	-	-	-	-	20	9	1,299	2,046
Depreciation	5,716	7,973	-	-	-	-	18	52	5,734	8,025
Revaluation deficit/(surplus) on properties	-	23	-	-	-	(1,300)	-	-	-	(1,277)
Other non-cash expenses	39	9	-	-	-	-	72	974	111	983

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**2. SEGMENT INFORMATION** (continued)**(b) Geographical segments**

The following table presents revenue for the Group's geographical segments.

	Mainland China		Hong Kong		Consolidated	
	Six months ended 30 June		Six months ended 30 June		Six months ended 30 June	
	2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)
Segment revenue:						
Sales to external customers	162,836	142,380	-	-	162,836	142,380
Other revenue (excluding exchange gains/ (losses), net)	1,037	1,168	61	445	1,098	1,613
Exchange gains/ (losses), net	1,488	54	125	(4)	1,613	50
Total	165,361	143,602	186	441	165,547	144,043

**3. PROFIT/(LOSS) FROM OPERATING ACTIVITIES**

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

	Six months ended 30 June	
	2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)
Cost of inventories sold	146,262	132,169
Depreciation of fixed assets	5,734	8,025
Staff costs (including directors' remuneration)		
Wages and salaries	7,917	10,602
Redundancy payment	1,211	-
Pension scheme contributions (defined contribution scheme)	485	662
Less: Forfeited contributions	-	-
Net pension scheme contributions	485	662
	9,613	11,264

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**3. PROFIT/(LOSS) FROM OPERATING ACTIVITIES** *(continued)*The profit/(loss) from operating activities is arrived at after charging/(crediting): *(continued)*

	<b>Six months ended 30 June</b>	
	<b>2004</b> <b>HK\$'000</b> <b>(Unaudited)</b>	2003 HK\$'000 (Unaudited)
Minimum operating lease payment in respect of land and buildings	<b>161</b>	182
Other rental income	<b>(188)</b>	(154)
Interest income	<b>(542)</b>	(94)
Gross rental income from investment properties	<b>(471)</b>	(850)
Less: Outgoings from investment properties	<b>71</b>	231
Net rental income	<b>(400)</b>	(619)
<i>Expenses/(income) included in other operating income, net</i>		
Exchange gains, net	<b>(1,613)</b>	(50)
Loss/(gain) on disposal of fixed assets, net	<b>27</b>	(380)
Surplus arising on revaluation of investment properties	<b>–</b>	(1,300)
Deficit arising on revaluation of leasehold land and buildings	<b>–</b>	23
Loss on disposal of a subsidiary	<b>–</b>	15
Write-off of fixed assets	<b>84</b>	983
Redundancy payment	<b>1,211</b>	–
	<b>(291)</b>	(709)

**4. FINANCE COSTS**

This represented interest on bank borrowings and loans from the Company's immediate holding company and a fellow subsidiary of the Company during the period.

These bank and other borrowings are wholly repayable within five years.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**5. TAX**

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

	<b>Six months ended 30 June</b>	
	<b>2004</b> <i>HK\$'000</i> <b>(Unaudited)</b>	2003 <i>HK\$'000</i> (Unaudited)
Group:		
Current – Hong Kong		
Charge for the period	-	-
Overprovision in prior periods	-	286
	<hr/>	<hr/>
Total tax credit for the period	-	286
	<hr/>	<hr/>

**6. DIVIDEND**

The directors do not recommend the payment of any interim dividend in respect of the ordinary shares of the Company for the six months ended 30 June 2004 (2003: Nil).

**7. EARNINGS/(LOSS) PER SHARE**

The calculation of basic earnings per share is based on the unaudited net profit attributable to shareholders for the period of HK\$2,607,000 (2003: net loss of HK\$2,382,000) and the 524,154,000 (2003: 524,154,000) ordinary shares in issue during the period.

A diluted earnings per share amount for the six months ended 30 June 2004 has not been disclosed as the share options outstanding during the period had an anti-dilutive effect on the basic earnings per share for the period.

A diluted loss per share amount for the six months ended 30 June 2003 has not been disclosed as no diluting events existed during that period.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**8. INVENTORIES**

	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
Raw materials	<b>37,608</b>	61,855
Work in progress	<b>106,293</b>	107,246
Finished goods	<b>61,556</b>	52,294
	<b>205,457</b>	221,395

The carrying amount of inventories carried at net realisable value included in the above balance was HK\$35,518,000 as at 30 June 2004 (31 December 2003: HK\$40,854,000).

**9. RECEIVABLES, PREPAYMENTS AND DEPOSITS**

As at 30 June 2004, included in the receivables, prepayments and deposits are trade receivables with a net balance of HK\$34,523,000 (31 December 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 for 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.

As at 30 June 2004, the ageing analysis of the Group's trade receivables, based on payment due date, is as follows:

	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
Within 3 months	<b>34,858</b>	17,479
More than 3 months and less than 6 months	–	10
More than 6 months and less than 1 year	<b>109</b>	244
More than 1 year	<b>33,307</b>	34,835
	<b>68,274</b>	52,568
Less: Provision for doubtful debts	<b>(33,751)</b>	(35,406)
	<b>34,523</b>	17,162

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**10. CASH AND BANK BALANCES**

	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
Cash and bank balances	<b>59,677</b>	84,332
Less: Pledged bank balances *	<b>(3,607)</b>	(7,355)
Frozen bank balances **	<b>(8,426)</b>	—
	<hr/>	<hr/>
Cash and cash equivalents	<b>47,644</b>	76,977
	<hr/>	<hr/>

\* These bank balances were pledged to banks for trading facilities granted.

\*\* These bank balances were frozen by the PRC authorities, details of which are set out in note 21 to the condensed consolidated financial statements.

**11. TRADE AND BILLS PAYABLES**

As at 30 June 2004, the ageing analysis of the Group's trade and bills payables, based on payment due date, is as follows:

	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
Within 3 months	<b>54,079</b>	62,672
More than 3 months and less than 6 months	<b>12,771</b>	2,831
More than 6 months and less than 1 year	<b>658</b>	67
More than 1 year	<b>2,169</b>	2,155
	<hr/>	<hr/>
	<b>69,677</b>	67,725
	<hr/>	<hr/>

**12. DUE TO A PRC JOINT VENTURE PARTNER**

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

**13. LOANS FROM IMMEDIATE HOLDING COMPANY**

The loans represented unsecured loans of RMB38,000,000 and HK\$10,350,000 advanced from GDH Limited ("GDH"), the Company's immediate holding company. The loans bear interest at a rate of 3.8% per annum and were repayable on 30 September 2004.

On 25 May 2004, GDH agreed to extend the repayment due date of the loans to 30 June 2005. Subsequent to the balance sheet date, on 9 September 2004, GDH agreed to further extend the repayment due date of the loans to 30 June 2006.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**14. LOAN FROM A FELLOW SUBSIDIARY**

The loan represented an unsecured loan of US\$7,000,000 advanced from Guangdong Assets Management Limited ("Guangdong Assets Management"), a fellow subsidiary of the Company. The loan bears interest at a rate of 3.8% per annum and was repayable on 31 December 2003.

On 25 May 2004, Guangdong Assets Management agreed to extend the repayment due date of the loan to 30 June 2005. Subsequent to the balance sheet date, on 9 September 2004, Guangdong Assets Management agreed to further extend the repayment due date of the loan to 30 June 2006.

**15. PROVISIONS**

	<b>Tax claim and tax penalty by the PRC authorities HK\$'000 (Unaudited)</b>	<b>Early termination of a joint venture agreement HK\$'000 (Unaudited)</b>	<b>Total HK\$'000 (Unaudited)</b>
At 1 January 2004 and 30 June 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 廣州海關緝私局 (the Anti-Smuggling Bureau of Guangzhou Customs) (the "Guangzhou Customs") to Foshan City Nanhai Tong Yuan Tanning Co., Ltd. ("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 by the Guangzhou Customs; and (b) the tax penalty of HK\$34,800,000 that may be imposed by the relevant PRC authorities, which has been 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 21 to the condensed consolidated financial statements.

**(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 was made as at 31 December 2001 for (a) staff redundancy payments of HK\$2,000,000; and (b) a 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.

**16. SHARE CAPITAL**

There were no changes in the ordinary share in issue of the Company during the six months ended 30 June 2003 and 2004.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**17. SHARE OPTION SCHEME**

The movements of the Company's share options under its share option scheme during the period are as follows:

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\$	Price of the Company's shares at grant date of share options*** HK\$
	At 1 January 2004	Granted during the period	At 30 June 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>				
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>				
Chen Hong	-	1,800,000	1,800,000	11/02/2004	12/05/2004 – 11/05/2009	0.246	0.240
Sub-total	<u>6,100,000</u>	<u>6,600,000</u>	<u>12,700,000</u>				
<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
Sub-total	<u>550,000</u>	<u>2,100,000</u>	<u>2,650,000</u>				
Total	<u>6,650,000</u>	<u>8,700,000</u>	<u>15,350,000</u>				

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**17. SHARE OPTION SCHEME** (continued)

- \* 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 issues, 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 of Hong Kong Limited on the business day on which the options were granted.

**18. RESERVES**

	Share premium account HK\$'000 (Unaudited)	General reserve fund HK\$'000 (Unaudited)	Capital redemption reserve HK\$'000 (Unaudited)	Exchange translation reserve HK\$'000 (Unaudited)	Property revaluation reserve HK\$'000 (Unaudited)	Accumulated losses HK\$'000 (Unaudited)	Total HK\$'000 (Unaudited)
At 1 January 2004	412,116	167,746	445	(152)	23,484	(485,894)	117,745
Net profit for the period	-	-	-	-	-	2,607	2,607
Exchange adjustment	-	-	-	84	-	-	84
<b>At 30 June 2004</b>	<b>412,116</b>	<b>167,746</b>	<b>445</b>	<b>(68)</b>	<b>23,484</b>	<b>(483,287)</b>	<b>120,436</b>
	Share premium account HK\$'000 (Unaudited)	General reserve fund HK\$'000 (Unaudited)	Capital redemption reserve HK\$'000 (Unaudited)	Exchange translation reserve HK\$'000 (Unaudited)	Property revaluation reserve HK\$'000 (Unaudited)	Accumulated losses HK\$'000 (Unaudited)	Total HK\$'000 (Unaudited)
At 1 January 2003	412,116	167,746	445	969	26,552	(384,600)	223,228
Net loss for the period	-	-	-	-	-	(2,382)	(2,382)
Deficit arising on revaluation of leasehold land and buildings	-	-	-	-	(9,103)	-	(9,103)
Exchange adjustment	-	-	-	5	-	-	5
<b>At 30 June 2003</b>	<b>412,116</b>	<b>167,746</b>	<b>445</b>	<b>974</b>	<b>17,449</b>	<b>(386,982)</b>	<b>211,748</b>

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**19. 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.

As at 30 June 2004, the Group had total future minimum lease receivables under non-cancellable operating leases with their lessees falling due as follows:

	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
Within one year	<b>1,137</b>	1,117
In the second to fifth years, inclusive	<b>1,746</b>	2,639
	<b>2,883</b>	3,756

**(b) As lessee**

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

As at 30 June 2004, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
Within one year	<b>134</b>	145
In the second to fifth years, inclusive	<b>125</b>	–
	<b>259</b>	145

**20. COMMITMENTS**

In addition to the operating lease commitments detailed in note 19 above, the Group had capital commitments, which were contracted but not provided for, in respect of the purchase of fixed assets amounting to approximately HK\$323,000 (31 December 2003: Nil).

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS***30 June 2004***21. 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 People's Republic of China.

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, Foshan City Nanhai Tong Yuan Tanning Co., Ltd. ("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.

On 31 December 2003, the Company entered into a conditional sale and purchase agreement with Yong Sheng Limited, a subsidiary of 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 廣州海關緝私局 (the Anti-Smuggling Bureau of Guangzhou Customs) (the "Guangzhou Customs").

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS***30 June 2004***21. CONTINGENT LIABILITIES** *(continued)*

The directors and management of the Company are satisfied that all the business 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. Therefore, the Company's directors and management concluded that the actions taken by the Guangzhou Customs cannot be related to the business or operations of Tongyuan Tannery and must be related to the irregularities of Nanhai Tannery in 2002. Further details of the above are set out in the announcement of the Company dated 17 March 2004.

On 22 March 2004, the Guangzhou Customs issued a demand letter to Tongyuan Tannery/Nanhai Tannery (i) claiming a 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/Nanhai Tannery failed to notify the Guangzhou Customs of the change from Nanhai Tannery to Tongyuan Tannery.

Although the Group has 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 its fixed assets and inventories to Tongyuan Tannery after the commencement of the investigations taken by the Guangzhou Customs. The directors have sought PRC legal advice on such matters and consider that Tongyuan Tannery will be liable for the tax claim of HK\$34,800,000 from the Guangzhou Customs if the Guangzhou Customs consider that Tongyuan Tannery and Nanhai Tannery are one and the same entity. Accordingly, a provision of HK\$34,800,000 has been made as at 31 December 2003.

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 is appropriate.

As the actions taken by the PRC authorities have not yet been concluded, it is not possible to ascertain 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 in 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 Tongyuan Tannery would have adequate net assets and resources to fulfill such obligation should it arise.

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 condensed consolidated financial statements.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**22. RELATED PARTY TRANSACTIONS**

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

	Notes	Six months ended 30 June	
		2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)
Office rental paid to the immediate holding company	(a)	37	–
Office rental paid to a fellow subsidiary	(b)	104	162
Computer system maintenance service fees paid to the immediate holding company	(c)	57	–
Interest expense to the former immediate holding company	(d)	–	434
Interest expense to the immediate holding company	(e)	885	448
Interest expense to fellow subsidiaries	(f)	1,048	14
Sale of a subsidiary to a fellow subsidiary	(g)	–	8,076
		<b>1,974</b>	<b>8,620</b>

Notes:

- (a) The office rental was charged by the immediate holding company of the Company at approximately HK\$9,000 per month commencing from 1 March 2004. At the balance sheet date, the Company had a rental deposit of approximately HK\$28,000 (31 December 2003: Nil) with the immediate holding company of the Company.
- (b) The office rental was charged by a fellow subsidiary at HK\$26,000 per month for the first four months of 2004 (HK\$28,000 per month for the first quarter of 2003 and HK\$26,000 per month for the second quarter of 2003) in accordance with the terms of rental agreements between the Group and the fellow subsidiary. The rental agreement between the Group and fellow subsidiary was surrendered in May 2004 and the rental deposit of HK\$103,000 was refunded from the fellow subsidiary to the Group during the period.
- (c) The immediate holding company of the Company charged maintenance service fees for the computer system used by the Company commencing from 1 May 2003.
- (d) The interest 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.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

30 June 2004

**22. RELATED PARTY TRANSACTIONS** *(continued)*

- (e) The interest to the immediate holding company of the Company arose from the loans advanced from GDH. Further details of the loans, including the terms, are disclosed in note 13 to the condensed consolidated financial statements.
- (f) The interest expense to a fellow subsidiary of the Company for the current period arose from a loan advanced from Guangdong Assets Management. Further details of the loan, including the terms, are disclosed in note 14 to the condensed consolidated financial statements.

The interest expense to a fellow subsidiary for the six months ended 30 June 2003 arose from an unsecured loan advanced from Yue Hai Hotel, Zhuhai, a fellow subsidiary of the Company, through an entrusted loan agreement. The loan bore interest at 4.2% per annum and was fully repaid in January 2003.

- (g) 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 loan of HK\$8,335,000 as at 30 June 2004 was secured by certain bank deposits of the immediate holding company of the Company at nil consideration.

**23. PLEDGED OF ASSETS**

As at 30 June 2004, assets of the Group pledged to banks to secure banking facilities granted to the Group were as follows:

	<b>30 June 2004 HK\$'000 (Unaudited)</b>	31 December 2003 HK\$'000 (Audited)
Leasehold land and buildings	<b>3,235</b>	3,370
Investment properties	<b>4,583</b>	4,570
Bank balances	<b>3,607</b>	7,355
Plant and machinery	<b>7,698</b>	–
	<b>19,123</b>	15,295

**24. APPROVAL OF THE INTERIM FINANCIAL STATEMENTS**

The condensed consolidated interim financial statements were approved and authorised for issue by the board of directors on 10 September 2004.

**INDEPENDENT AUDITORS' REVIEW REPORT****To the Board of Directors****Guangdong Tannery Limited**

*(Incorporated in Hong Kong with limited liability)*

We have been instructed by the Company to review the interim financial report set out on pages 6 to 24.

**RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS**

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with SSAP 25 "Interim financial reporting" issued by the Hong Kong Institute of Certified Public Accountants and the relevant provisions thereof. The interim financial report is the responsibility of, and has been approved by, the directors. It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

**REVIEW WORK PERFORMED**

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

**INDEPENDENT AUDITORS' REVIEW REPORT** *(continued)***FUNDAMENTAL UNCERTAINTY – CONTINGENT LIABILITIES**

In arriving at our review conclusion, we have considered the adequacy of the disclosures made in note 21 to the condensed consolidated financial statements concerning the irregularities involving certain former executives of a former subsidiary of the Company in the previous year and the related provision of HK\$69,600,000 for the tax claim and tax penalty made by the Group as at 30 June 2004. As the actions taken by the PRC authorities 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 as a result of the aforesaid irregularities. As of the date of this report, no further provision other than that disclosed in notes 15 and 21 to the condensed consolidated financial statements has been made in the interim financial report for such contingencies. We consider that appropriate disclosures and estimates have been made in the interim financial report and our review conclusion is therefore not modified in this respect.

**REVIEW CONCLUSION**

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 June 2004.

**Ernst & Young**

*Certified Public Accountants*

Hong Kong

10 September 2004

## DIRECTORS' INTERESTS IN SECURITIES

### DIRECTORS' INTEREST AND SHORT POSITION IN THE SECURITIES

As at 30 June 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 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 30 June 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 period	Period during which option is exercisable	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 30/06/2004
		Date	(dd/mm/yyyy)				
Zhang Chunting	2,500,000	-	-	10/09/2003 - 09/09/2008	1	0.22	-
	-	11/02/2004	2,000,000	12/05/2004-11/05/2009	1	0.246	-
Chen Hong	-	11/02/2004	1,800,000	12/05/2004-11/05/2009	1	0.246	-
Xiong Guangyang	3,000,000	-	-	10/09/2003 - 09/09/2008	1	0.22	-
	-	11/02/2004	2,200,000	12/05/2004-11/05/2009	1	0.246	-
Cheng Hok Lai James	300,000	-	-	10/09/2003 - 09/09/2008	1	0.22	-
	-	11/02/2004	300,000	12/05/2004-11/05/2009	1	0.246	-
Fung Lak	300,000	-	-	10/09/2003 - 09/09/2008	1	0.22	-
	-	11/02/2004	300,000	12/05/2004-11/05/2009	1	0.246	-

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.

**DIRECTORS' INTERESTS IN SECURITIES****DIRECTORS' INTEREST AND SHORT POSITION IN THE SECURITIES** (Continued)**(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	0.2929	Long position
Ho Lam Lai Ping Theresa	Personal	600,000	0.011	Long position

Note: The number of ordinary shares of GDI in issue as at 30 June 2004 was 5,463,382,672.

*(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 period	Period during which option is exercisable	Total consideration paid for options (HK\$)	Ordinary Share payable on exercise of option (HK\$)	Number of options exercised during the year	No. of options held on 30/06/2004
		Date granted	Number granted	(dd/mm/yyyy)			
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	-
	3,000,000	-	-	08/08/2003-07/08/2008	1	1.22	-
	-	06/02/2004	3,000,000	07/05/2004-06/05/2009	1	1.59	-
	-	24/05/2004	2,500,000	25/08/2004-24/08/2009	1	1.25	-
Ho Lam Lai Ping Theresa	1,000,000	-	-	08/11/2002-07/11/2007	-	0.814	400,000
	1,200,000	-	-	05/03/2003-04/03/2008	1	0.96	-
	1,500,000	-	-	08/08/2003-07/08/2008	1	1.22	-
	-	06/02/2004	1,500,000	07/05/2004-06/05/2009	1	1.59	-
	-	24/05/2004	1,000,000	25/08/2004-24/08/2009	1	1.25	-

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.

**DIRECTORS' INTERESTS IN SECURITIES****DIRECTORS' INTEREST AND SHORT POSITION IN THE SECURITIES** (Continued)**(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 GDB	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 30 June 2004 was 1,394,368,000

**(4) Interest 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 period	Period during which option is exercisable	Total consideration paid for options	Price per Ordinary Share payable on exercise of option	Number of options exercised during the year	No. of options held on 30/06/2004	
		Date granted	(dd/mm/yyyy)	(HK\$)	(HK\$)			
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 30 June 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.

Save as disclosed above, at no time during the year was the Company, its holding companies or any of its subsidiaries or associated corporation 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.

**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 30 June 2004, the persons or companies (not being a Director or chief executive of the Company) who have interests or short positions in the Shares or underlying 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 廣東粵港投資有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) has in the Company is held through its 100 per cent. direct interest in GDH Limited.

Save as disclosed above, as at 30 June 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.

## SHARE OPTION SCHEME

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

### Share options granted during the six-month period ended 30 June 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

	<b>Number of Options at 11/02/04</b>	<b>Options Value at 11/02/04 (Note (2)) HK\$</b>	<b>Number of Options at 30/06/04</b>	<b>Options Value at 30/06/04 (Note (3)) HK\$</b>
Grantee:				
Zhang Chunting	2,000,000	380,000	2,000,000	340,000
Chen Hong	1,800,000	342,000	1,800,000	306,000
Xiong Guangyang	2,200,000	418,000	2,200,000	374,000
Cheng Hok Lai James	300,000	57,000	300,000	51,000
Fung Lak	300,000	57,000	300,000	51,000
Other employees	2,100,000	399,000	2,100,000	357,000
	<u>8,700,000</u>	<u>1,653,000</u>	<u>8,700,000</u>	<u>1,479,000</u>
Total				

#### 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\*, 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.
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.

**SHARE OPTION SCHEME**

- (3) According to the Black-Scholes model<sup>#</sup>, the total value of the options was estimated at HK\$1,479,000 as at 30 June 2004 with the following variables and assumptions:

Risk Free Rate : 3.72%, being the approximate yield of 5-year Exchange Fund Note traded on 30/06/2004.

Expected Volatility : 116.7%, being the annualized volatility of the closing price of the shares of the Company from 01/07/2003 – 30/06/2004.

Expected Dividend Yield : Nil, being the approximate yield of the shares of the Company over the period of 01/07/2003 – 30/06/2004.

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 01/07/2003 – 30/06/2004.

- (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 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.*

## OTHER INFORMATION

### CORPORATE GOVERNANCE

None of the Directors is aware of information that would reasonably indicate that the Company is not, or was not for any part of the accounting period covered by this interim report, in compliance with Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

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 period under review.

The Group's interim financial report for the six months ended 30 June 2004 has not been audited, but has been reviewed by the audit committee of the Company and the auditors Messrs. Ernst & Young.

### PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not redeemed any of its shares during the six months ended 30 June 2004. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the period.

By Order of the Board

**Zhang Chunting**

*Chairman*

Hong Kong  
10 September 2004

**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 \*

Ho Lam Lai Ping Theresa

Chan Hee Kwan

\* *Independent Non-Executive Director*

**COMPANY SECRETARY**

Chan Miu Ting

**AUDITORS**

Ernst & Young

**SHARE REGISTRAR**

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