



粤海制革有限公司  
GUANGDONG TANNERY LIMITED

Interim Report 中期報告書

2005



## CONTENTS

Business and Financial Reviews	2
Unaudited Interim Financial Report	
Condensed Consolidated Profit and Loss Account	5
Condensed Consolidated Balance Sheet	6
Condensed Consolidated Summary Statement of Changes in Equity	7
Condensed Consolidated Cash Flow Statement	8
Notes to Condensed Consolidated Interim Financial Statements	9
Independent Auditors' Review Report	32
Directors' Interests in Securities	34
Substantial Shareholders' Interests	37
Corporate Governance and Other Information	38
Corporate Information	40

## BUSINESS AND FINANCIAL REVIEWS

### RESULTS

The Group's unaudited loss attributable to shareholders for the six months ended 30 June 2005 was HK\$515,000, compared with a profit (restated) of HK\$2,775,000 for the same period last year.

The unaudited net asset value of the Group as at 30 June 2005 was HK\$160,089,000, an increase of HK\$519,000 and HK\$942,000 as compared to the net asset value (restated) as at 30 June 2004 and 31 December 2004 respectively.

No interim dividend is recommended by the Board of Directors (the "Board") for the six months ended 30 June 2005.

### PROPOSED PRIVATISATION

On 12 July 2005, the Board of the Company announced that GDH Limited ("GDH"), the major shareholder of the Company, requested the Board of the Company to put forward a proposal (the "Proposal") to our shareholders regarding a proposed privatisation of the Company by way of a scheme of arrangement (the "Scheme") under section 166 of the Companies Ordinances. GDH will pay to other shareholders HK\$0.28 in cash consideration for each ordinary share of the Company held by them. Upon the successful implementation of the Proposal, the Company will become a wholly-owned subsidiary of GDH, and will withdraw the listing of its shares on The Stock Exchange of Hong Kong Limited after the date on which the Scheme becomes effective. Details of the proposed privatisation mentioned above were set out in the Company's announcement dated 12 July 2005 and the circular to shareholders dated 26 August 2005.

### OPERATIONS REVIEW

The Group was steadfast in clearing inventories during the period through a number of astute and responsive measures, such as the processing of low-quality leather by refined production technologies, and the tie-in sale of well-received, profitable products with those that are less popular and unprofitable. These measures have proved effective in reducing our inventory level, while facilitating our efforts in recovering trade receivables. As at 30 June 2005, the Group's consolidated inventories amounted to HK\$131,665,000, reduced by HK\$73,792,000 and HK\$9,424,000 as compared to 30 June 2004 and 31 December 2004 respectively.

The Group's production capacity was further strengthened after Xuzhou Gangwei Leather Co. Ltd. ("Xuzhou Gangwei Tannery") commenced operations in March this year. Total leather production for the period was 5,432,000 sq. ft., declined by 6,002,000 sq. ft. from 11,434,000 sq. ft. in 2004. Production of cowhides dropped by 52.11% to 4,897,000 sq. ft. (2004: 10,225,000 sq. ft.) whereas cow split, coated cow split and others down by 55.75% to 535,000 sq. ft. (2004: 1,209,000 sq. ft.).

## BUSINESS AND FINANCIAL REVIEWS

Consolidated turnover for the period was HK\$95,077,000, a drop of 41.61% as compared to HK\$162,836,000 for the same period last year. Turnover of cowhides decreased by 40.24% to HK\$85,730,000 (2004: HK\$143,446,000) whereas cow split, coated cow split and others dropped by 51.79% to HK\$9,347,000 (2004: HK\$19,390,000).

Balance of trade receivables as at 30 June 2005 was HK\$37,463,000. After deducting the provisions for doubtful debts of HK\$2,319,000, trade receivables amounted to HK\$35,144,000, an increase of HK\$621,000 and HK\$9,235,000 as compared to 30 June 2004 and 31 December 2004 respectively. Trade receivables turnover was 6.2 times and average collection period was 59 days, an increase of 30 days as compared to 29 days for the same period in 2004.

### FINANCIAL REVIEW

As at 30 June 2005, the Group's interest-bearing borrowings amounted to HK\$83,728,000 (as at 31 December 2004: HK\$100,626,000). Of the total interest-bearing borrowings, HK\$10,350,000 was denominated in Hong Kong dollars, HK\$18,778,000 in Renminbi and HK\$54,600,000 in US dollars. In addition, all interest-bearing borrowings are charged at fixed rate.

As at 30 June 2005, the Group's cash and bank balances amounted to HK\$56,790,000 (as at 31 December 2004: HK\$98,040,000), and denominated in Hong Kong dollars (HK\$1,399,000), Renminbi (equivalent to HK\$48,548,000) and US dollars (equivalent to HK\$6,843,000) respectively.

As at 30 June 2005, after deduction of cash and bank deposits, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 16.83% (as at 31 December 2004 (restated): 1.62%). Loan facilities bear interest at approximately 3% to 5% per annum. All of the Group's total borrowings are repayable beyond one year. Interest expense incurred by the Group during the period was HK\$1,788,000, a drop of 42.4% as compared to the same period last year.

Net cash outflow from operating activities for the period was HK\$24,066,000 and net cash outflow from financing activities was HK\$16,934,000. Net decrease in cash and cash equivalents for the period amounted to HK\$38,609,000.

Net fixed assets as at 30 June 2005 were HK\$89,951,000, a reduction of HK\$1,345,000 as compared to the net fixed assets (restated) as at 31 December 2004. The Group's capital expenditure during the period amounted to HK\$578,000 (2004: HK\$1,299,000). It was incurred mainly for the replacement of the leather manufacture machinery and equipment, a move to cope with the commenced operations of the Xuzhou Gangwei Tannery.

As at 30 June 2005, certain of the Group's buildings, investment properties, bank deposits and plant and machinery with a total net book value of HK\$17,319,000 (31 December 2004: HK\$20,969,000) were pledged to secure general banking facilities granted to the Group.

## BUSINESS AND FINANCIAL REVIEWS

### **FREEZING OF TONGYUAN TANNERY'S BANK ACCOUNTS**

Details of the freezing of bank accounts of Foshan City Nanhai Tong Yuan Tanning Co., Ltd by the Guangzhou Customs in the PRC were set out in the Contingent Liabilities section of the financial statements.

### **EMPLOYEES**

As at 30 June 2005, a total of 499 employees (2004: 448 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 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.

### **PROSPECTS**

The Group has been operating in a highly competitive and difficult environment during the past few years. Our operations were further affected as the European Union announced this July to launch an anti-dumping investigation into Chinese shoe exports, and the PRC Government continues to impose stricter standards on environmental protection. Despite these adversities, the Group will continue its efforts in meeting the challenges ahead, and will strive to open up a new path for development.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT  
Six months ended 30 June 2005

		<b>Six months ended 30 June</b>	
		<b>2005</b>	2004
		<b>HK\$'000</b>	HK\$'000
		<b>(Unaudited)</b>	(Unaudited)
			(Restated)
	<i>Notes</i>		
<b>TURNOVER</b>	2	<b>95,077</b>	162,836
Cost of sales		<b>(82,922)</b>	(146,094)
Gross profit		<b>12,155</b>	16,742
Other income and gains	3	<b>2,208</b>	1,640
Selling and distribution costs		<b>(776)</b>	(842)
Administrative expenses		<b>(12,143)</b>	(11,952)
Other operating profit/(expenses), net		<b>(116)</b>	291
Finance costs	4	<b>(1,788)</b>	(3,104)
<b>PROFIT/(LOSS) BEFORE TAX</b>	5	<b>(460)</b>	2,775
Tax	6	<b>(55)</b>	—
<b>PROFIT/(LOSS) FOR THE PERIOD</b>		<b>(515)</b>	2,775
<b>EARNINGS/(LOSS) PER SHARE</b>	7		
— Basic		<b>HK(0.10) cent</b>	HK0.53 cent
— Diluted		<b>N/A</b>	N/A

## CONDENSED CONSOLIDATED BALANCE SHEET

30 June 2005

	<i>Notes</i>	<b>30 June 2005 HK\$'000 (Unaudited)</b>	31 December 2004 HK\$'000 (Audited) (Restated)
<b>NON-CURRENT ASSETS</b>			
Fixed assets		<b>89,951</b>	91,296
Land lease payments		<b>3,781</b>	3,828
Total non-current assets		<b>93,732</b>	95,124
<b>CURRENT ASSETS</b>			
Inventories		<b>131,665</b>	141,089
Receivables, prepayments and deposits	9	<b>79,541</b>	54,698
Tax recoverable		<b>7,038</b>	7,040
Loan to an officer		<b>898</b>	923
Pledged and frozen bank balances	10	<b>12,195</b>	14,794
Cash and bank balances	10	<b>44,595</b>	83,246
Total current assets		<b>275,932</b>	301,790
<b>CURRENT LIABILITIES</b>			
Trade and bills payables	11	<b>19,838</b>	38,864
Accruals and other liabilities		<b>26,928</b>	19,781
Due to a PRC joint venture partner	12	<b>1,131</b>	1,131
Loans from the immediate holding company	13	<b>29,128</b>	46,026
Loan from a fellow subsidiary	14	<b>54,600</b>	54,600
Provisions	15	<b>72,600</b>	72,600
Total current liabilities		<b>204,225</b>	233,002
<b>NET CURRENT ASSETS</b>		<b>71,707</b>	68,788
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>165,439</b>	163,912
<b>NON-CURRENT LIABILITIES</b>			
Deferred tax liabilities		<b>(5,350)</b>	(4,765)
		<b>160,089</b>	159,147
<b>CAPITAL AND RESERVES</b>			
Issued capital		<b>52,415</b>	52,415
Reserves	17	<b>107,674</b>	106,732
		<b>160,089</b>	159,147

CONDENSED CONSOLIDATED SUMMARY STATEMENT OF CHANGES IN EQUITY  
Six months ended 30 June 2005

	Notes	Six months ended 30 June	
		2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited) (Restated)
Total equity at 1 January:			
As previously reported		171,072	170,160
Prior period adjustment — HKAS 17	1(a), 17	(11,925)	(13,449)
As restated		159,147	156,711
Changes in equity during the period:			
Surplus on revaluation of properties	17	2,021	—
Deferred tax debited to the property revaluation reserve account	17	(530)	—
Exchange differences on translation of the financial statements of subsidiaries in Mainland China	17	(34)	84
Net gains recognised directly in equity		1,457	84
Net profit/(loss) for the period		(515)	2,775
Total equity at 30 June		160,089	159,570

## CONDENSED CONSOLIDATED CASH FLOW STATEMENT

Six months ended 30 June 2005

	<b>Six months ended 30 June</b>	
	<b>2005</b> <b>HK\$'000</b> <b>(Unaudited)</b>	<b>2004</b> <b>HK\$'000</b> <b>(Unaudited)</b>
<i>Note</i>		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>(24,066)</b>	<b>(23,377)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	<b>2,391</b>	<b>2,477</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>	<b>(16,934)</b>	<b>(8,679)</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(38,609)</b>	<b>(29,579)</b>
Cash and cash equivalents at beginning of period	<b>83,246</b>	<b>76,977</b>
Effect of foreign exchange rate changes, net	<b>(42)</b>	<b>246</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>44,595</b>	<b>47,644</b>
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>		
Cash and bank balances	<b>44,595</b>	<b>47,644</b>
	<i>10</i>	

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 1. ACCOUNTING POLICIES

The unaudited condensed consolidated interim financial statements are prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting”. The accounting policies and basis of preparation adopted in the preparation of the unaudited condensed consolidated interim financial statements are the same as those used in the preparation of the Group’s audited annual financial statements for the year ended 31 December 2004, except in relation to the following new and revised Hong Kong Financial Reporting Standards (“HKFRSs”, which also include HKASs and interpretations) that affect the Group and are adopted for the first time for the current period’s financial statements:

- HKAS 1 Presentation of Financial Statements
- HKAS 2 Inventories
- HKAS 7 Cash Flow Statements
- HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- HKAS 10 Events after the Balance Sheet Date
- HKAS 12 Income Taxes
- HKAS 16 Property, Plant and Equipment
- HKAS 17 Leases
- HKAS 18 Revenue
- HKAS 19 Employee Benefits
- HKAS 21 The Effects of Changes in Foreign Exchange Rates
- HKAS 23 Borrowing Costs
- HKAS 24 Related Party Disclosures
- HKAS 27 Consolidated and Separate Financial Statements
- HKAS 28 Investment in Associates
- HKAS 32 Financial Instruments: Disclosure and Presentation
- HKAS 33 Earnings per Share
- HKAS 36 Impairment of Assets
- HKAS 37 Provisions, Contingent Liabilities and Contingent Assets
- HKAS 38 Intangible Assets
- HKAS 39 Financial Instruments: Recognition and Measurement
- HKAS 40 Investment Property
- HKFRS 2 Share-based Payment
- HKFRS 3 Business Combinations
- HK(SIC)-Int 21 Income Taxes — Recovery of Revalued Non-depreciable Assets
- HK-Int 4 Leases — Determination of the Length of Lease Term in respect of Hong Kong Land Leases

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 1. ACCOUNTING POLICIES *(continued)*

The adoption of HKASs 1, 2, 7, 8, 10, 12, 16, 18, 19, 21, 23, 24, 27, 28, 32, 33, 37, 39, HK(SIC)-Int 21 and HK-Int 4 has had no material impact on the accounting policies of the Group and the methods of computation in the Group's unaudited condensed consolidated interim financial statements. The impact of adopting the other HKFRSs is summarised as follows:

#### (a) HKAS 17 — Leases

In prior periods, leasehold land and buildings held for own use were stated at valuation less accumulated depreciation.

Upon adoption of HKAS 17, the Group's leasehold interests in land and buildings is separated into leasehold land and leasehold buildings. The Group's leasehold land is classified as an operating lease, because the title of the land is not expected to pass to the Group by the end of the lease term, and is reclassified from fixed assets to land lease payments, while leasehold buildings continue to be classified as part of fixed assets. Land lease payments under operating leases are initially stated at cost and subsequently amortised on the straight-line basis over the lease term. When the lease payments cannot be allocated reliably between the land and building elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in fixed assets.

This change in accounting policy has had effects on the unaudited condensed consolidated interim financial statements as follows:

	31 December 2004 HK\$'000 (Unaudited)	1 January 2004 HK\$'000 (Unaudited)
Effect of new policy on equity:		
Decrease in property revaluation reserve	16,020	17,208
Decrease in accumulated losses	<u>(4,095)</u>	<u>(3,759)</u>
Total	<u><u>11,925</u></u>	<u><u>13,449</u></u>

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

1. ACCOUNTING POLICIES (continued)

(a) HKAS 17 — Leases (continued)

	Six months ended 30 June	
	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)
Effect of new policy on profit/(loss):		
Decrease in cost of sales	168	168
Decrease in loss/increase in profit for the period	168	168
Decrease in basic loss/increase in basic earnings per share	<u>HK0.03 cent</u>	<u>HK0.03 cent</u>

(b) HKAS 40 — Investment Properties

In prior periods, changes in the fair values of investment properties were dealt with as movements in the property revaluation reserve. If the total of this reserve was insufficient to cover a deficit, on a portfolio basis, the excess of the deficit was charged to the profit and loss account. Any subsequent revaluation surplus was credited to the profit and loss account to the extent of the deficit previously charged.

Upon the adoption of HKAS 40, gains or losses arising from changes in the fair values of investment properties are included in the profit and loss account in the year in which they arise. Any gains or losses on the retirement or disposal of an investment property are recognised in the profit and loss account in the year of the retirement or disposal.

The adoption of HKAS 40 has had no effect on these unaudited condensed consolidated interim financial statements because the Group's investment properties had a net revaluation deficit position as at 30 June 2005 and 2004 and 1 January 2005 and 2004 and the changes in valuation thereof had been dealt with in the profit and loss account.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 1. ACCOUNTING POLICIES *(continued)*

#### (c) HKFRS 2 — Share-based Payment

In prior periods, no recognition and measurement of share-based transactions in which employees (including directors) were granted share options over shares in the Company was required until such options were exercised by employees, at which time the share capital and share premium were credited with the proceeds received.

Upon the adoption of HKFRS 2, when employees (including directors) render services as consideration for equity instruments (“equity-settled transactions”), the cost of the equity-settled transactions with employees is measured by reference to the fair value at the date at which the instruments are granted. The fair value is determined by an external valuer using a binominal model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company, if applicable.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (the “vesting date”). The cumulative expense recognised for equity-settled transactions at each balance sheet date until the vesting date reflects the extent to which the vesting period has expired and the Group’s best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the profit and loss account for a period represents the movement in cumulative expense recognised as the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

The Group has taken advantage of the transitional provision of HKFRS 2 in respect of equity-settled awards and has applied HKFRS 2 only to share options granted after 7 November 2002 that had not vested on or before 1 January 2005. The adoption of this new HKFRS has no impact to the unaudited condensed consolidated interim financial statements of the Group as the Group has neither share options granted after 7 November 2002 and not vested before 1 January 2005 nor liabilities settled based on shares or other rights over shares.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 1. ACCOUNTING POLICIES *(continued)*

#### (d) **HKFRS 3 — Business Combinations, HKAS 36 — Impairment of Assets, and HKAS 38 — Intangible Assets**

In prior periods, goodwill arising on acquisitions prior to 1 January 2001 was eliminated against consolidated capital reserve in the year of acquisition and was not recognised in the profit and loss account until disposal or impairment of the acquired business.

Goodwill arising on acquisitions on or after 1 January 2001 was capitalised and amortised on the straight-line basis over its estimated useful life and was subject to impairment testing when there was any indication of impairment.

Upon the adoption of HKFRS 3 and HKAS 36, goodwill arising on acquisitions is no longer amortised but subject to an annual impairment review (or more frequently if events or changes in circumstances indicate that the carrying value may be impaired). Any impairment loss recognised for goodwill is not reversed in a subsequent period.

The transitional provisions of HKFRS 3 have required the Group to eliminate at 1 January 2005 the carrying amounts of accumulated amortisation with a corresponding entry to the cost of goodwill and to derecognise the carrying amounts of negative goodwill (including that remaining in consolidated capital reserve) against retained earnings. Goodwill previously eliminated against consolidated capital reserve remains eliminated against consolidated capital reserve and is not recognised in the profit and loss account when all or part of the business to which the goodwill relates is disposed of or when a cash-generating unit to which the goodwill relates become impaired.

The change in accounting policy has had no effect on these unaudited condensed consolidated interim financial statements.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

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.

(a) Business segments

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

	Leather processing Six months ended 30 June		Property investment Six months ended 30 June		Corporate and other Six months ended 30 June		Consolidated Six months ended 30 June	
	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited) (Restated)	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited) (Restated)
Segment revenue:								
Sales to external customers	95,077	162,836	—	—	—	—	95,077	162,836
Other revenue (excluding exchange gains/(losses), net)	1,359	596	345	471	—	31	1,704	1,098
Exchange gains/(losses), net	(32)	1,526	—	—	(111)	87	(143)	1,613
Total	96,404	164,958	345	471	(111)	118	96,638	165,547
Segment results	7,198	9,528	74	396	(6,448)	(4,587)	824	5,337
Interest income							504	542
Finance costs							(1,788)	(3,104)
Profit/(loss) before tax							(460)	2,775
Tax							(55)	—
Profit/(loss) for the period							(515)	2,775
Other segment information:								
Capital expenditure	545	1,279	—	—	33	20	578	1,299
Depreciation	3,663	5,504	—	—	9	18	3,672	5,522
Amortisation of land lease payments	47	44	—	—	—	—	47	44
Deficit arising on revaluation of leasehold buildings	25	—	—	—	—	—	25	—
Other non-cash expenses	52	39	—	—	—	72	52	111

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

2. SEGMENT INFORMATION (continued)

(b) Geographical segments

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

	Mainland China Six months ended 30 June		Hong Kong Six months ended 30 June		Consolidated Six months ended 30 June	
	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)
Segment revenue:						
Sales to external customers	95,077	162,836	—	—	95,077	162,836
Other revenue (excluding exchange gains/ (losses), net)	1,704	1,037	—	61	1,704	1,098
Exchange gains/ (losses), net	(20)	1,488	(123)	125	(143)	1,613
Total	<u>96,761</u>	<u>165,361</u>	<u>(123)</u>	<u>186</u>	<u>96,638</u>	<u>165,547</u>

3. OTHER INCOME AND GAINS

	Six months ended 30 June	
	2005 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)
Other rental income	184	188
Interest income	504	542
Rental income from investment properties	345	471
Others	1,175	439
	<u>2,208</u>	<u>1,640</u>

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

**4. FINANCE COSTS**

	<b>Six months ended 30 June</b>	
	<b>2005</b> <b>HK\$'000</b> <b>(Unaudited)</b>	2004 HK\$'000 (Unaudited)
Interests on:		
Bank loans	<b>104</b>	1,171
Loans from the immediate holding company	<b>641</b>	885
Loan from a fellow subsidiary	<b>1,043</b>	1,048
	<b>1,788</b>	3,104

**5. PROFIT/(LOSS) BEFORE TAX**

Profit/(loss) before tax is arrived at after charging/(crediting):

	<b>Six months ended 30 June</b>	
	<b>2005</b> <b>HK\$'000</b> <b>(Unaudited)</b>	2004 HK\$'000 (Unaudited)
Depreciation	<b>3,672</b>	5,522
Amortisation of land lease payments	<b>47</b>	44
Redundancy payments	<b>—</b>	1,211

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

**6. 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 (2004: Nil). No provision for Mainland China and overseas profits tax has been made (2004: Nil) as there were no assessable profits arising from certain subsidiaries of the Company operating in Mainland China and overseas during the period and certain subsidiaries of the Company operating in Mainland China and overseas had tax losses brought forward from prior years to offset the assessable profit during the period.

	<b>Six months ended 30 June</b>	
	<b>2005</b>	2004
	<b>HK\$'000</b>	HK\$'000
	<b>(Unaudited)</b>	(Unaudited)
Group:		
Current — Hong Kong		
Charge for the period	—	—
Deferred	<b>55</b>	—
	<hr/>	<hr/>
Total tax charge for the period	<b>55</b>	—
	<hr/> <hr/>	<hr/> <hr/>

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 six months ended 30 June 2005.

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

The calculation of basic earnings/(loss) per share is based on the loss for the period of HK\$515,000 (2004: profit of HK\$2,775,000 (as restated)) and 524,154,000 (2004: 524,154,000) ordinary shares in issue during the period.

Diluted earnings/(loss) per share amounts for the six months ended 30 June 2005 and 2004 have not been disclosed as the share options outstanding during these periods had an anti-dilutive effect on the basic earnings/(loss) per share for these periods, respectively.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 8. DIVIDEND

At a meeting of the board of directors held on 9 September 2005, the directors resolved not to pay an interim dividend to shareholders (2004: Nil).

### 9. RECEIVABLES, PREPAYMENTS AND DEPOSITS

As at 30 June 2005, included in the Group's receivables, prepayments and deposits are trade receivables with a net balance of HK\$35,144,000 (31 December 2004: HK\$25,909,000) 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 2005, the aged analysis of the Group's trade receivables, based on payment due date, is as follows:

	<b>30 June 2005 HK\$'000 (Unaudited)</b>	31 December 2004 HK\$'000 (Audited)
Within 3 months	<b>30,163</b>	25,855
More than 3 months and less than 6 months	<b>3,917</b>	471
More than 6 months and less than 1 year	<b>3,383</b>	3,056
	<b>37,463</b>	29,382
Less: Provision for doubtful debts	<b>(2,319)</b>	(3,473)
	<b>35,144</b>	25,909

A provision is made when there is objective evidence that the Group will not be able to collect the amounts due according to the original terms of the receivables.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

**10. CASH AND BANK BALANCES**

	<b>30 June 2005 HK\$'000 (Unaudited)</b>	31 December 2004 HK\$'000 (Audited)
Cash and bank balances	<b>56,790</b>	98,040
Less: Pledged bank balances*	<b>(3,450)</b>	(6,109)
Frozen bank balances**	<b>(8,745)</b>	(8,685)
	<b>44,595</b>	<u>83,246</u>
Cash and cash equivalents	<b>44,595</b>	<u>83,246</u>

\* 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 19 to the condensed consolidated interim financial statements.

**11. TRADE AND BILLS PAYABLES**

As at 30 June 2005, the aged analysis of the Group's trade and bills payables, based on the payment due date, is as follows:

	<b>30 June 2005 HK\$'000 (Unaudited)</b>	31 December 2004 HK\$'000 (Audited)
Within 3 months	<b>11,633</b>	32,453
More than 3 months and less than 6 months	<b>4,620</b>	2,205
More than 6 months and less than 1 year	<b>255</b>	1,855
More than 1 year	<b>3,330</b>	2,351
	<b>19,838</b>	<u>38,864</u>

**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.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

**13. LOANS FROM THE IMMEDIATE HOLDING COMPANY**

The loans represented unsecured loans of RMB20,000,000 (31 December 2004: RMB37,990,000) (equivalent to approximately HK\$18,778,000 (31 December 2004: HK\$35,676,000)) and HK\$10,350,000 (31 December 2004: HK\$10,350,000) advanced from GDH Limited ("GDH"), the Company's immediate holding company. The loans bore interest at a rate of 4.15% (31 December 2004: 3.8%) and 3.8% (31 December 2004: 3.8%) per annum, respectively, and were repayable on 30 June 2006 (31 December 2004: repayable on 30 June 2005).

Subsequent to the balance sheet date, on 2 August 2005, GDH agreed to extend the repayment due date of the loans to 31 December 2006.

**14. LOAN FROM A FELLOW SUBSIDIARY**

The loan represented an unsecured loan of US\$7,000,000 (31 December 2004: US\$7,000,000) (equivalent to approximately HK\$54,600,000 (31 December 2004: HK\$54,600,000)) advanced from Guangdong Assets Management Limited ("Guangdong Assets Management"), a fellow subsidiary of the Company. The loan bore interest at a rate of 3.8% (31 December 2004: 3.8%) per annum and was repayable on 30 June 2006 (31 December 2004: repayable on 30 June 2005).

Subsequent to the balance sheet date, on 2 August 2005, Guangdong Assets Management agreed to extend the repayment due date of the loan to 31 December 2006.

**15. PROVISIONS**

	<b>Tax claim and tax penalty by the PRC authorities</b>	<b>Early termination of a joint venture agreement</b>	<b>Total</b>
	HK\$'000	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)	(Unaudited)
At 1 January 2005 and 30 June 2005	<u>69,600</u>	<u>3,000</u>	<u>72,600</u>

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

**15. PROVISIONS** *(continued)*

**(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 RMB73,978,000 (equivalent to approximately HK\$69,600,000) was made as at 31 December 2003 for (a) the tax claim of RMB36,989,000 (equivalent to approximately HK\$34,800,000) by the Guangzhou Customs; and (b) the tax penalty of RMB36,989,000 (equivalent to approximately 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 19 to the condensed consolidated interim 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.

In 2004, 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 period. Accordingly, there was no movement in the provisions during the period.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 16. SHARE OPTION SCHEME

Details of the Company's share options under its share option scheme 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 2005	Granted during the period	At 30 June 2005				
<b>Directors</b>							
Zhang Chunting	2,500,000	—	2,500,000	09/06/2003	10/09/2003–09/09/2008	0.220	0.220
	<u>2,000,000</u>	<u>—</u>	<u>2,000,000</u>	11/02/2004	12/05/2004–11/05/2009	0.246	0.240
	<u>4,500,000</u>	<u>—</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
	<u>2,200,000</u>	<u>—</u>	<u>2,200,000</u>	11/02/2004	12/05/2004–11/05/2009	0.246	0.240
	<u>5,200,000</u>	<u>—</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
	<u>300,000</u>	<u>—</u>	<u>300,000</u>	11/02/2004	12/05/2004–11/05/2009	0.246	0.240
	<u>600,000</u>	<u>—</u>	<u>600,000</u>				
Fung Lak	300,000	—	300,000	09/06/2003	10/09/2003–09/09/2008	0.220	0.220
	<u>300,000</u>	<u>—</u>	<u>300,000</u>	11/02/2004	12/05/2004–11/05/2009	0.246	0.240
	<u>600,000</u>	<u>—</u>	<u>600,000</u>				
Sub-total	<u>10,900,000</u>	<u>—</u>	<u>10,900,000</u>				
<b>Former Director</b>	<u>1,800,000</u>	<u>—</u>	<u>1,800,000</u>	11/02/2004	12/05/2004–11/05/2009	0.246	0.240
<b>Other employees</b>							
In aggregate	550,000	—	550,000	09/06/2003	10/09/2003–09/09/2008	0.220	0.220
	<u>2,100,000</u>	<u>—</u>	<u>2,100,000</u>	11/02/2004	12/05/2004–11/05/2009	0.246	0.240
Sub-total	<u>2,650,000</u>	<u>—</u>	<u>2,650,000</u>				
Total	<u>15,350,000</u>	<u>—</u>	<u>15,350,000</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 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 trading day on which the options were granted.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

17. RESERVES

	Attributable to equity holders of the Company						
	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:							
As previously reported	412,116	167,746	445	(152)	23,484	(485,894)	117,745
Prior period adjustment							
— HKAS 17 (note 1(a))	—	—	—	—	(17,208)	3,759	(13,449)
As restated	412,116	167,746	445	(152)	6,276	(482,135)	104,296
Exchange adjustments	—	—	—	84	—	—	84
Net profit for the period (restated)	—	—	—	—	—	2,775	2,775
At 30 June 2004 and 1 July 2004 (as restated)	412,116	167,746	445	(68)	6,276	(479,360)	107,155
Deficit on revaluation of properties (restated)	—	—	—	—	(3,392)	—	(3,392)
Deferred tax credited to the property revaluation reserve account (restated)	—	—	—	—	635	—	635
Exchange adjustments	—	—	—	105	—	—	105
Net profit for the period (restated)	—	—	—	—	—	2,229	2,229
At 31 December 2004 (as restated)	412,116	167,746	445	37	3,519	(477,131)	106,732
<b>At 1 January 2005:</b>							
As previously reported	412,116	167,746	445	37	19,539	(481,226)	118,657
Prior period adjustment							
— HKAS 17 (note 1(a))	—	—	—	—	(16,020)	4,095	(11,925)
As restated	412,116	167,746	445	37	3,519	(477,131)	106,732
Surplus on revaluation of properties	—	—	—	—	2,021	—	2,021
Deferred tax debited to the property revaluation reserve account	—	—	—	—	(530)	—	(530)
Exchange adjustments	—	—	—	(34)	—	—	(34)
Net loss for the period	—	—	—	—	—	(515)	(515)
At 30 June 2005	412,116	167,746	445	3	5,010	(477,646)	107,674

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 18. COMMITMENTS

The Group did not have any significant capital commitments as at 30 June 2005 (31 December 2004: Nil).

### 19. 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 until 31 December 2003 a 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 were of the opinion that the Parallel Operation should not be (and it had not been) incorporated in the financial statements of the Group and that the Parallel Operation appeared 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 CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 19. CONTINGENT LIABILITIES *(continued)*

On 31 December 2003, the Company entered into a conditional sale and purchase agreement with Yong Sheng Limited, a former subsidiary of GDH and a former 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 Yong Sheng Limited and ceased to be a 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 balance 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 30 June 2005 (note 10).

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 since its establishment, 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 Yong Sheng Limited and the tax evasion was related to the Parallel Operation of Nanhai Tannery, the PRC legal advice obtained by the Company in April 2004 indicated that if, which is denied by the Company, Tongyuan Tannery and Nanhai Tannery are considered to be one and the same entity, then it may be possible for the Guangzhou Customs to impose Nanhai Tannery's liability of approximately HK\$34,800,000 (the "Potential Tax Liability") on Tongyuan Tannery. Accordingly, the Company made a provision of RMB36,989,000 (equivalent to approximately HK\$34,800,000) for the Potential Tax Liability in its annual results for the year ended 31 December 2003 (note 15(a)). The same provision was carried in the Company's annual results for the year ended 31 December 2004.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 19. CONTINGENT LIABILITIES *(continued)*

In addition, the PRC legal advice indicated that, 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 Potential Tax Liability, i.e. RMB36,989,000 to RMB184,945,000 (equivalent to approximately HK\$34,800,000 to HK\$174,000,000) (the "Potential Penalty"). In light of the PRC legal advice, the directors of the Company considered it appropriate to make a provision of RMB36,989,000 (equivalent to approximately HK\$34,800,000) for the Potential Penalty in the Company's annual results for the year ended 31 December 2003 (note 15(a)). The same provision was carried in the Company's annual results for the year ended 31 December 2004.

In April 2005, a prosecution was initiated in the Guangzhou Intermediate People's Court (the "Guangzhou Court") against, amongst others, Nanhai Tannery, in relation to alleged tax evasion activities on the part of Nanhai Tannery and others between January 2000 and May 2002 (the "Guangzhou Proceedings"). Although Tongyuan Tannery was not made a party to the Guangzhou Proceedings, allegations were made in these proceedings that Tongyuan Tannery was set up as a vehicle to take over the assets of Nanhai Tannery, and to place obstacles on the Guangzhou Customs' attempt to recover the evaded tax. Tongyuan Tannery filed its objections to these allegations with the Guangzhou Court in June 2005 to explain that (i) Tongyuan Tannery and Nanhai Tannery were separate legal entities; (ii) the acquisition of Nanhai Tannery's assets (including factory premises, machinery and raw materials) by Tongyuan Tannery were legitimate and genuine transactions at fair market prices; and (iii) the balances in the bank accounts of Tongyuan Tannery which were frozen by Guangzhou Customs were the proceeds of the normal operations of Tongyuan Tannery, and were not related to the operations of Nanhai Tannery.

Judgment in the Guangzhou Proceedings (the "Judgment") was rendered, subsequent to the balance sheet date, on 2 September 2005. Nanhai Tannery, amongst others, is found liable for tax evasion and it was ordered that all illegal gains from the tax evasion activities be recovered and confiscated by the State (such order is to be executed by the Guangzhou Customs). Further, a fine of RMB8,000,000 is imposed on Nanhai Tannery.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 19. CONTINGENT LIABILITIES *(continued)*

On 9 September 2005, the Company obtained PRC legal advice on the potential effects of the Judgment on Tongyuan Tannery. The PRC legal advice indicated that the parties have 10 days within which to lodge an appeal. The Judgment does not take effect before the expiry of this period. The PRC legal advice analysed the potential effects of the Judgment on Tongyuan Tannery in three alternative scenarios:

- (1) If no appeal is lodged within the 10-day period, the Judgment will take effect. The PRC legal advice indicated that:
  - (i) The Judgment made no finding to the effect that Tongyuan Tannery is in fact the same entity as Nanhai Tannery. Therefore, Tongyuan Tannery has not been held liable for any of the penalties which is imposed on Nanhai Tannery;
  - (ii) The Judgment made no finding to the effect that the balances in the bank accounts of Tongyuan Tannery which were frozen by Guangzhou Customs are the proceeds of Nanhai Tannery's illegal activities. This gives Tongyuan Tannery grounds to seek to apply to Guangzhou Customs for such bank accounts to be unfrozen; and
  - (iii) The Judgment made no finding to the effect that the acquisition of Nanhai Tannery's assets by Tongyuan Tannery was an attempt to dispose of Nanhai Tannery's assets in order to place obstacles on the Guangzhou Customs' attempt to recover evaded tax. It is arguable that Guangzhou Customs should not therefore seek to recover Nanhai Tannery's illegal gains from its illegal activities from Tongyuan Tannery.

The PRC legal advice noted that as it was ordered that all "illegal gains" obtained by Nanhai Tannery from the tax evasion activities be recovered and confiscated by the State, the amount of such "illegal gains" will exceed the amount of tax evaded by Nanhai Tannery to include all gains obtained by Nanhai Tannery as a result of the tax evasion activities. Also according to the PRC legal advice, the possibility that, notwithstanding the apparent absence in the Judgment of any findings directly incriminating Tongyuan Tannery, the Guangzhou Customs may nevertheless still seek to apply the balances in Tongyuan Tannery's bank accounts towards (or otherwise resort to the other assets of Tongyuan Tannery for) discharging Nanhai Tannery's liabilities cannot be excluded.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 19. CONTINGENT LIABILITIES *(continued)*

- (2) If Nanhai Tannery (or other defendants to the Guangzhou Proceedings) lodges an appeal and the Guangzhou Prosecution Office does not lodge an appeal, the Judgment will not take effect pending the resolution of the appeal by the Guangdong High Court. The PRC legal advice indicated that there are three possible outcomes in this scenario:
- (i) If the Guangdong High Court confirms the Guangzhou Court's findings of facts and findings of law and also the penalties imposed by the Guangzhou Court, the appeal will be dismissed and the Judgment will take effect;
  - (ii) If the Guangdong High Court confirms the Guangzhou Court's findings of facts but find that the Guangzhou Court made errors of law or that the penalties imposed are not appropriate, the Guangdong High Court may vary the Judgment;
  - (iii) If the Guangdong High Court finds that the Guangzhou Court made incorrect findings of facts, the High Court may vary the Judgment or order a re-trial by the Guangzhou Court.

The PRC legal advice further indicated that under the relevant PRC legislation, in the event that an appeal is lodged by Nanhai Tannery (or other defendants to the Guangzhou Proceedings) but no appeal is lodged by the Guangzhou Prosecution Office and the Guangdong High Court decides in the appeal that the Judgment should be varied, it cannot impose penalties which are heavier than those imposed pursuant to the Judgment. However, the effect of any decision of the Guangdong High Court upon Tongyuan Tannery will be dependent upon the actual content of the Guangdong High Court's decision.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

30 June 2005

### 19. CONTINGENT LIABILITIES *(continued)*

- (3) If the Guangzhou Prosecution Office lodges an appeal against the Judgment, it is possible that:
- (i) The Guangdong High Court may impose on Nanhai Tannery penalties which are heavier than those imposed pursuant to the Judgment; and
  - (ii) The Guangdong High Court may make findings which are different from those made by the Guangzhou Court on a number of issues including the relationship between Nanhai Tannery and Tongyuan Tannery, and whether the balances in the bank accounts of Tongyuan Tannery which are currently frozen by Guangzhou Customs are proceeds of Nanhai Tannery's illegal activities.

The PRC legal advice indicated that the Guangzhou Prosecution Office may decide to lodge an appeal against the Judgment on the bases that: (i) the RMB8 million penalty imposed is lower than that prescribed by the relevant PRC legislation; (ii) the Judgment made no finding to the effect that Nanhai Tannery and Tongyuan Tannery are the same entity, nor was there any finding that balances in the bank accounts of Tongyuan Tannery which are currently frozen by Guangzhou Customs are proceeds of Nanhai Tannery's illegal activities.

The Company is not currently aware of the parties' intention as to appeal. Although the Judgment has been rendered, it remains uncertain what the impact of the Judgment, or the ruling in any appeal against the Judgment, on Tongyuan Tannery is going to be. If an appeal is lodged against the Judgment, the effect of any decision of the Guangdong High Court upon Tongyuan Tannery will be dependent upon the actual content of the Guangdong High Court's decision. Even if no appeal is lodged against the Judgment, in light of the PRC legal advice as detailed above, it remains unclear whether the PRC authorities will seek to enforce the Judgment against Tongyuan Tannery, and if so, what the amount of penalty which may finally be imposed against it is going to be, and the other possible 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 so arising as a result of the aforesaid irregularities. Accordingly, the directors are of the opinion that the provision for Potential Tax Liability and Potential Penalty made in the Company's annual results for the year ended 31 December 2003 and carried in the Company's annual results for the year ended 31 December 2004 should continue to be carried in the condensed consolidated interim financial statements. Should additional penalties in excess of the amount of the provision 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.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

**20. RELATED PARTY TRANSACTIONS**

**(a) Transactions with related parties**

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

	<b>Six months ended 30 June</b>	
	<b>2005</b> <b>HK\$'000</b> <b>(Unaudited)</b>	2004 HK\$'000 (Unaudited)
Office rental paid to the immediate holding company	<b>56</b>	37
Office rental paid to a fellow subsidiary	<b>—</b>	103
Computer system maintenance service fees paid to the immediate holding company	<b>63</b>	57
Interest expense to the immediate holding company	<b>640</b>	885
Interest expense to a fellow subsidiary	<b>1,043</b>	1,048

**(b) Compensation of key management personnel of the Group**

	<b>Six months ended 30 June</b>	
	<b>2005</b> <b>HK\$'000</b> <b>(Unaudited)</b>	2004 HK\$'000 (Unaudited)
Short term employee benefits	<b>1,726</b>	966
Post-employment benefits	<b>213</b>	120
Total compensation paid to key management personnel	<b>1,939</b>	1,086

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
30 June 2005

**21. PLEDGED OF ASSETS**

As at 30 June 2005, assets of the Group pledged to banks to secure general banking facilities granted to the Group were as follows:

	<b>30 June 2005 HK\$'000 (Unaudited)</b>	31 December 2004 HK\$'000 (Audited)
Leasehold building	<b>3,300</b>	3,300
Investment property	<b>4,460</b>	4,460
Bank balances	<b>3,450</b>	6,109
Plant and machinery	<b>6,109</b>	7,100
	<b>17,319</b>	20,969

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

The condensed consolidated interim financial statements were approved and authorised for issue by the board of directors on 9 September 2005.

## 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 5 to 31.

### **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 Hong Kong Accounting Standard 34 “Interim financial reporting” issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) 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 HKICPA. A review consists principally of making enquiries of Group’s 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

### FUNDAMENTAL UNCERTAINTY — CONTINGENT LIABILITIES

In arriving at our review conclusion, we have considered the adequacy of the disclosures made in note 19 to the condensed consolidated interim 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 RMB73,978,000 (equivalent to approximately HK\$69,600,000) for the tax claim and tax penalty made by the Group as detailed in note 15(a) to the condensed consolidated interim financial statements. As more fully explained in note 19 to the condensed consolidated interim financial statements, although judgment for the proceeding in the Guangzhou Intermediate People's Court (the "Judgment") has been rendered on 2 September 2005, the impacts of the Judgment or the ruling in any appeal against the Judgment, including the other possible 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 so arising as a result of the aforesaid irregularities, remain uncertain. As of the date of this report, no further provision other than that disclosed in notes 15(a) and 19 to the condensed consolidated interim 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 2005.

#### **Ernst & Young**

*Certified Public Accountants*

Hong Kong  
9 September 2005

## DIRECTORS' INTERESTS IN SECURITIES

As at 30 June 2005, the interests and short positions of the directors and chief executive of the Company in the shares, underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, were as follows:

### (1) INTERESTS AND SHORT POSITIONS IN THE COMPANY

#### a. Interest in ordinary shares

Name of director	Type of interests	Number of shares held	% of the issued share capital	Long/short positions
Cheng Hok Lai James	Personal	400,000	0.0763	Long position

Note: The number of ordinary shares of the Company in issue as at 30 June 2005 was 524,154,000.

#### b. Interest in options relating to ordinary shares

Name of director	No. of options held on 01/01/2005	Options granted during the period	Period during which option is exercisable (dd/mm/yyyy) (Note)	Total consideration paid for options (HK\$)	Price per Ordinary Share payable on exercise of option (HK\$)	Number of options exercised during the period	No. of options held on 30/06/2005
Zhang Chunting	2,500,000	—	10/09/2003–09/09/2008	1	0.22	—	2,500,000
	2,000,000	—	12/05/2004–11/05/2009	1	0.246	—	2,000,000
Xiong Guangyang	3,000,000	—	10/09/2003–09/09/2008	1	0.22	—	3,000,000
	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
	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
	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.

## DIRECTORS' INTERESTS IN SECURITIES

### (2) INTERESTS AND SHORT POSITIONS IN GUANGDONG INVESTMENT LIMITED ("GDI")

#### a. Interest in ordinary shares of GDI

Name of director	Type of interests	Number of shares held	% of the issued share capital of GDI	Long/short positions
Ho Lam Lai Ping Theresa	Personal	700,000	0.012	Long position

Note: The number of ordinary shares of GDI in issue as at 30 June 2005 was 5,614,492,672.

#### b. Interest in options relating to ordinary shares of GDI

Name of director	No. of options held on 01/01/2005	Options granted during the period	Number granted	Period during which option is exercisable (dd/mm/yyyy) (Note)	Total consideration paid for options (HK\$)	Price per Ordinary Share payable on exercise of option (HK\$)	Number of options exercised during the period	No. of options held on 30/06/2005
Ho Lam Lai Ping Theresa	900,000	—	—	05/03/2003–04/03/2008	1	0.96	—	900,000
	1,500,000	—	—	08/08/2003–07/08/2008	1	1.22	—	1,500,000
	1,500,000	—	—	07/05/2004–06/05/2009	1	1.59	—	1,500,000
	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.

### (3) INTERESTS AND SHORT POSITIONS IN KINGWAY BREWERY HOLDINGS LIMITED ("KINGWAY")

#### Interest in ordinary shares

Name of director	Type of interests	Number of shares held	% of the 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 30 June 2005 was 1,395,568,000.

## DIRECTORS' INTERESTS IN SECURITIES

### (4) INTEREST AND SHORT POSITIONS IN GUANGNAN (HOLDINGS) LIMITED ("GUANGNAN")

#### Interest in options relating to ordinary shares of Guanganan

Name of director	No. of options held on 01/01/2005	Options granted during the period Date granted	Number granted	Period during which option is exercisable (dd/mm/yyyy) (Note)	Total consideration paid for options (HK\$)	Price per Ordinary Share payable on exercise of option (HK\$)	Number of options exercised during the period	No. of options held on 30/06/2005
Hui Wai Man Lawrence	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, no interests and short positions were held or deemed or taken to be held under Part XV of the SFO by any director or the chief executive of the Company or their respective associates in the shares, underlying shares and debentures of the Company or any of its associated corporations which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to Part XV of the SFO or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies or which are required pursuant to Section 352 of the SFO to be entered in the register referred to therein. Nor any of the directors and the chief executive (including their spouses and children under the age of 18) had, as at 30 June 2005, any interest in, or had been granted any right to subscribe for the securities and options of the Company and its associated corporations within the meaning of the SFO, or had exercised any such rights.

## SUBSTANTIAL SHAREHOLDERS' INTERESTS

As at 30 June 2005, so far as is known to any director or chief executive of the Company, shareholders who have interests or short positions in the shares or underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO, were as follows:

<b>Name of Shareholder</b>	<b>Type of securities</b>	<b>Number of securities held</b>	<b>Long/Short position</b>	<b>Approximate percentage of the Company's issued capital</b>
廣東粵港投資控股有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) <i>(Note)</i>	Shares	375,100,000	Long position	71.56
GDH Limited	Shares	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 per cent. direct interest in GDH.

## CORPORATE GOVERNANCE AND OTHER INFORMATION

### **CODE ON CORPORATE GOVERNANCE PRACTICES**

The Company has applied the principles and complied with the code provisions of the Code on Corporate Governance Practices (“Code on CG Practices”) as set out in Appendix 14 of the Listing Rules throughout the six months ended 30 June 2005.

### **AUDIT COMMITTEE**

The Company established an audit committee (“Audit Committee”) in September 1998. The terms of reference of the Audit Committee adopted by the board of directors of the Company are in line with the Code on CG Practices. The existing Audit Committee comprises the three independent non-executive directors, Mr. Cheng Hok Lai James, Mr. Choi Kam Fai Thomas and Mr. Fung Lak as members. The principal duties of the Audit Committee include the review of the effectiveness of the completeness, accuracy and fairness of the Company’s financial reports and internal control systems.

### **REMUNERATION COMMITTEE**

The Company has also established a remuneration committee (“Remuneration Committee”) in accordance with the Listing Rules. The terms of reference of the Remuneration Committee adopted by the board of directors of the Company are in line with the Code on CG Practices. The existing Remuneration Committee comprises Mr. Zhang Chunting, Mr. Cheng Hok Lai James, Mr. Choi Kam Fai Thomas and Mr. Fung Lak as members. The principal duties of the Remuneration Committee include the review of the remuneration policy and compensation of the directors and senior management of the Company.

### **NOMINATION COMMITTEE**

The Company has also established a nomination committee (“Nomination Committee”) in accordance with the Listing Rules. The terms of reference of the Nomination Committee adopted by the board of directors of the Company are in line with the Code on CG Practices. The existing Nomination Committee comprises Mr. Zhang Chunting, Mr. Cheng Hok Lai James, Mr. Choi Kam Fai Thomas and Mr. Fung Lak as members. The principal duties of the Nomination Committee include the process of nominating and recommending candidates to fill vacancies on the Board of Directors.

### **MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS**

The Company has adopted the Model Code set out in Appendix 10 of the Listing Rules as the code of conduct regarding Directors’ 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 throughout the six months ended 30 June 2005.

## CORPORATE GOVERNANCE AND OTHER INFORMATION

### REVIEW OF INTERIM RESULTS

The Group's interim financial report for the six months ended 30 June 2005 has not been audited, but has been reviewed by the Audit Committee and the Company's auditors Messrs. Ernst & Young.

### PURCHASE, SALE AND REDEMPTION OF LISTED SECURITIES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the six months ended 30 June 2005.

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

Hong Kong  
9 September 2005

## CORPORATE INFORMATION

### **Board of Directors**

Zhang Chunting (*Chairman*)  
Xiong Guangyang  
Hui Wai Man Lawrence  
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**

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

Telephone: (852) 23081013

Facsimile: (852) 23947836

