Notes to the Financial Statements

For the year ended 31st December 2006

1. GENERAL

The Company was incorporated as an exempted company with limited liability in the Cayman Islands under the Companies Law of the Cayman Islands and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Its registered office is at P.O. Box 309, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands, British West Indies and principal place of business in Hong Kong is at Unit 2513A, 25th Floor, 113 Argyle Street, Mongkok, Kowloon, Hong Kong. Its ultimate holding company is Joyce Services Limited ("Joyce"), a company which is incorporated in the British Virgin Islands.

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 30.

The consolidated financial statements are presented in Hong Kong dollars, which is the same as the functional currency of the Company.

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

In the current year, the Group has applied, for the first time, a number of new standards, amendments and interpretations (the "new HKFRSs") by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are either effective for accounting periods beginning on or after 1st December 2005 or 1st January 2006. The adoption of the new HKFRSs has no material effect on how the results for the current or prior accounting periods have been prepared and presented.

The Group has not early applied the following new standards, amendments or interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these new standards, amendments or interpretations will have no material impact on the results and the financial position of the Group.

HKAS 1 (Amendment)	Capital Disclosures [1]
HKFRS 7	Financial Instruments: Disclosures [1]
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economics [2]
HK(IFRIC)-Int 8	Scope of HKFRS 2 [3]
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives [4]
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment [5]

[1] Effective for annual periods beginning on or after 1st January 2007
[2] Effective for annual periods beginning on or after 1st March 2006
[3] Effective for annual periods beginning on or after 1st May 2006
[4] Effective for annual periods beginning on or after 1st June 2006
[5] Effective for annual periods beginning on or after 1st November 2006

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the HKICPA.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31st December each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gain or loss on the disposal of an entity included the carrying amount of goodwill relating to the entity sold.

In previous years, the goodwill arising on acquisitions prior to 1st January 2001 was held in reserves. The Group has applied the relevant transitional provisions in the HKFRS 3 for non-restatement of such goodwill and the non-recognition of such goodwill in the profit or loss upon disposal or impairment.

Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment loss.

Turnover

Turnover represents the net amounts received and receivable for goods supplied to outside customers, less returns and discounts during the year.

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Property, plant and equipment

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and amortisation and accumulated impairment losses.

Construction in progress is stated at cost less any identified impairment loss which includes all construction costs and other direct costs attributable to such projects. Construction in progress is not depreciated until completion of construction and the asset is being put into use. Costs of completed construction works are transferred to the appropriate categories of property, plant and equipment.

The cost of land use rights is amortised over the period of the rights using the straight line method. Depreciation is charged so as to write off the cost of other items of property, plant and equipment over their estimated useful lives, using the straight line method, at the following rates per annum:

Buildings	2%-5%
Plant and machinery	10%
Furniture and equipment	20%-25%
Motor vehicles	20%

The gain or loss arising from the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the consolidated income statement.

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes income statements items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Foreign currencies

Transactions in currencies other than Hong Kong dollars are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in such currencies are re-translated at the rates prevailing on the balance sheet date. Profits and losses arising on exchange are included in net profit or loss for the year.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Foreign currencies (Cont'd)

On consolidation, the assets and liabilities of the Group's operations in the People's Republic of China (the "PRC") are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Operating leases

Leases where substantially all the risks and rewards of ownership of asset remain with the lessor are accounted for as operating leases. Rentals payable under operating leases are charged to the income statement on a straight line basis over the term of the relevant lease.

Retirement benefit costs

Payments to state managed retirement benefit schemes and the Mandatory Provident Fund Scheme ("the "MPF Scheme") are charged as expenses when they fall due.

Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of those financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, tax balances, corporate and financing expenses.

4. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks: market price (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

(a) Credit risk

As at 31st December 2006, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to discharge an obligation by the counterparties and financial guarantees issued by the Group is arising from the amount of contingent liabilities disclosed in note 22(v).

In order to minimize the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regards, the directors of the Company consider that the Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a number of counterparties and customers.

(b) Liquidity risk

In the management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by the management to finance the Group's operations and mitigate the effects of fluctuation in cash flows. The management monitors the utilization of borrowings and ensures compliance with loan covenants.

The Group relies on borrowings as a significant source of liquidity. As at 31st December 2006, the Group has available unutilised overdrafts and short-term bank loan facilities of approximately of HK$Nil (2005: HK$Nil) and HK$2 million (2005: HK$5 million) respectively.

4. FINANCIAL RISK MANAGEMENT (Cont'd)

(c) Cash flow interest rate risk

The Group's cash flow interest rate risk relates primarily to variable-rate borrowings (see note 22 for details of these borrowings). It is the Group's policy to keep its borrowings at floating rate of interests so as to minimize the fair value interest rate risk.

(d) Foreign currency risk

Foreign currency risk is the risk that the value of assets will fluctuate due to changes in foreign exchange rates.

The Group has no significant currency risk because substantially all assets and liabilities are denominated in Hong Kong dollars, Renminbi or US dollars.

(e) Fair values

As at 31st December 2006, the carrying amount of cash and cash equivalents, prepayments, deposits and other receivables, accrued liabilities and other payables approximated their fair values due to the short term maturities of these assets and liabilities. The Group considers that these assets and liabilities are included in the balance sheet at amounts approximating to their fair values.

5. BUSINESS AND GEOGRAPHICAL SEGMENTS

In accordance with the Group's internal financial reporting, the Group has determined that geographical segments are its primary reporting format.

Business segment

The Group is solely engaged in the manufacture and sale of leather. All of the Group's turnover, contribution to operating profit and assets were attributable to this business segment.

5. BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont'd)

Geographical segments

The Group reports its primary segment information by geographical location of its customers who are principally located in the United States of America ("USA") and the PRC.

Segment information about these geographical markets is presented below:

2006

	USA	PRC	Other	Consolidated
	HK$'000	HK$'000	HK$'000	HK$'000
TURNOVER	**570,103**	**148,806**	**–**	**718,909**
RESULT				
Segment result	**1,833**	**(111,666)**	**4,016**	**(105,817)**
Finance charges				**(8,619)**
Loss before tax				**(114,436)**
Income tax income				**1,597**
Loss for the year				**(112,839)**

The following is an analysis of the carrying amount of segment assets and segment liabilities analysed by the geographical location of its customers:

2006

	USA	PRC	Other	Consolidated
	HK$'000	HK$'000	HK$'000	HK$'000
ASSETS				
Segment assets	**172,723**	**12,410**	**–**	**185,133**
Unallocated assets				**753,220**
Consolidated total assets				**938,353**
LIABILITIES				
Unallocated liabilities				**291,806**
OTHER INFORMATION				
Allowance for bad and doubtful receivables, net	**6,859**	**5,053**	**–**	**11,912**

5. BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont'd)

Geographical segments (Cont'd)

2005

	USA	PRC	Other	Consolidated
	HK$'000	HK$'000	HK$'000	HK$'000
TURNOVER	768,903	105,726	–	874,629
RESULT				
Segment result	19,755	2,004	152	21,911
Finance charges				(10,271)
Profit before tax				11,640
Income tax expenses				(3,414)
Profit for the year				8,226

The following is an analysis of the carrying amount of segment assets and segment liabilities analysed by the geographical location of its customers:

2005

	USA	PRC	Other	Consolidated
	HK$'000	HK$'000	HK$'000	HK$'000
ASSETS				
Segment assets	216,786	14,550	–	231,336
Unallocated assets				832,503
Consolidated total assets				1,063,839
LIABILITIES				
Unallocated liabilities				316,833
OTHER INFORMATION				
Allowance for bad and doubtful receivables, net	1,807	410	–	2,217

5. BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont'd)

Geographical segments (Cont'd)

In addition to the analysis by geographical location of its customers, the following is an analysis of the carrying amount of consolidated segment assets and capital expenditure, analysed by the geographical area in which the assets and liabilities are located:

	Carrying amount of segment assets		Capital expenditure	
	2006	2005	**2006**	2005
	HK$'000	HK$'000	**HK$'000**	HK$'000
Hong Kong	**5,384**	14,516	**–**	5
Elsewhere in the PRC	**905,409**	1,026,670	**626**	1,451
	910,793	1,041,186	**626**	1,456

6. IMPAIRMENT LOSSES ON PROPERTY, PLANT AND EQUIPMENT, INVENTORIES AND TRADE RECEIVABLES

On 10th August 2006, the Board announced that the Xian production plant ("Xian Hua Lien") would suspended operation pursuant to a notice issued by西安市人民政府 (Xian People's Government) which encouraged enterprises in the region where the Xian production plant was located to relocate to other new industrial and logistics zone in Xian to conform with the government's plan of town restructuring. At the balance sheet date, the Group was still negotiating with the relevant government authorities for the amount of compensation with respect to the relocation and is looking for another area in Xian for the construction of a new production plant. In consideration that the progress of negotiation is in a stalemate, it is difficult to foresee the time that will be taken from relocation to full production run of new production plant. The Board expects that it may take 2 to 3 years or more.

In view of future demolition of the buildings of Xian Hua Lien, the uncertainty of the time expected to be required for the negotiation and construction of the new production plant, the possible reduction in the scale of operation of Xian Hua Lien and the rapid change in market demand that creates uncertainity in the suitability and usability of inventories and plant and machinery in future production, the recoverable amount of the existing property, plant and equipment and the net realisable value of inventories are expected to be drastically reduced, therefore impairment losses on property, plant and equipment, and write down of inventories has been made. Furthermore, the suspension of the trade relationships of Xian Hua Lien with their customers had also affected the recoverability of the trade receivables , an appropriate impairment loss was, therefore, made for the possible non-recoverable amount.

6. IMPAIRMENT LOSSES ON PROPERTY, PLANT AND EQUIPMENT, INVENTORIES AND TRADE RECEIVABLES (Cont'd)

The following impairment losses have been provided:

	2006	2005
	HK$'000	HK$'000
Impairment loss on property, plant and equipment	**32,375**	–
Impairment loss on trade receivables	**30,435**	–
Write-down of inventories	**49,432**	–
	112,242	–

7. (LOSS) PROFIT FROM OPERATIONS

	2006	2005
	HK$'000	HK$'000
(Loss) profit from operations has been arrived at after charging:		
Directors' remunerations (note 8)	**1,913**	2,398
Retirement benefits scheme contributions	**562**	699
Other staff costs	**13,657**	14,329
Total staff costs	**16,132**	17,426
Depreciation for property, plant and equipment	**34,398**	40,694
Amortisation of prepaid lease payment on land use rights	**1,024**	966
Total depreciation and amortisation	**35,422**	41,660
Net foreign exchange (gains) losses	**(3,865)**	834
Auditors' remuneration:	**465**	423
Allowance for bad and doubtful receivables, net	**11,912**	2,217
Impairment loss on available-for-sale financial assets (included in administrative expenses)	**–**	233
Loss on disposal of property, plant and equipment	**136**	740
and after crediting:		
Write-back on allowance for obsolete and slow moving inventories	**847**	658
Interest income	**639**	466

8. DIRECTORS' REMUNERATIONS

Details of remuneration paid by the Group to directors during the year are as follows:

	2006	2005
	HK$'000	HK$'000
Directors' fees	**90**	228
Salaries and allowances of executive directors	**1,823**	2,170
Total directors' remunerations	**1,913**	2,398

Their aggregate emoluments of the directors were within the following bands:

	2006	2005
	HK$'000	HK$'000
HK$ nil to HK$1,000,000	**7**	6
HK$1,000,001 to HK$1,500,000	**–**	–

During the year, no emoluments were paid by the Group to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

8. DIRECTORS' REMUNERATIONS (Cont'd)

The emoluments paid or payable to each of the 7 (2005: 6) directors were as follows:

The Group	**Fees**	**Salaries, allowances, and other remuneration**	**Employer's contributions to retirement benefits schemes**	**2006 Total emoluments**	**2005 Total emoluments**
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Executive Directors					
Liaw Yuan Chian	–	840	–	840	923
Shih Chian Fang	–	533	–	533	527
Chaiteerath Boonchai	–	180	–	180	720
Chen Ling	–	270	–	270	–
Independent Non-executive Directors					
Fu Heng Yang	30	–	–	30	30
Yu Chi Jui	30	–	–	30	160
Li Xiao Wei	30	–	–	30	38
	90	1,823	–	1,913	2,398

9. EMPLOYEES' EMOLUMENTS

The aggregate emoluments of the five highest paid individuals included three (2005: three) executive directors of the Company, whose emoluments are included in note 8 above. The emoluments of the remaining two (2005: two) highest paid individuals are as follows:

	2006	2005
	HK$'000	HK$'000
Salaries and allowances	**745**	949
Retirement benefits scheme contributions	**12**	12
	757	961

The emoluments of each of the remaining two highest paid individuals did not exceed HK$1,000,000 in both years.

10. INCOME TAX (INCOME) EXPENSE

	2006	2005
	HK$'000	HK$'000
Current tax:		
Hong Kong profits tax calculated at 17.5% (2005: 17.5%) of the estimated assessable profit	**21**	26
PRC enterprise income tax	**2,112**	3,140
	2,133	3,166
Over provision of Hong Kong profit tax in prior years	**(1)**	–
Deferred tax (note 16):	**(3,729)**	248
	(1,597)	3,414

PRC enterprise income tax is calculated at the prevailing rates. Pursuant to the relevant laws and regulations in the PRC, certain of the Company's PRC subsidiaries are entitled to exemption from PRC enterprise income tax for the first two years commencing from their first profit-making year of operation and, thereafter, these PRC subsidiaries will be entitled to a 50% relief from PRC enterprise income tax for the following three years. The tax exemption and tax reduction period can be extended by the relevant tax authorities. The PRC enterprise income tax expense for both years has been provided for after taking these tax incentives into account.

A portion of the Group's profit is not subject to income tax in the jurisdiction in which it operates.

10. INCOME TAX (INCOME) EXPENSE (Cont'd)

The income tax (income) expense for the year can be reconciled to the (loss) profit per the consolidated income statement as follows:

	2006		2005	
	HK$'000	**%**	HK$'000	%
(Loss) profit before tax	(114,436)		11,640	
Tax at the income tax rate of 23% (2005: 23%) *(Note)*	(26,320)	(23.0)	2,677	23.0
Tax effect of expenses that are not deductible in determining taxable profit	26,887	23.5	1,966	16.9
Tax effect of income that is not taxable in determining taxable profit	(1,807)	(1.6)	(822)	(7.1)
Tax effect of income under tax reduction period	–	–	(493)	(4.2)
Effect of different tax rates of subsidiaries operating in different province of the PRC	(357)	(0.3)	86	0.7
Others	–	–	–	–
Income tax (income) expense and effective tax rate for the year	(1,597)	(1.4)	3,414	29.3

Note: The income tax rate represents the average of the tax rate in the province in which the PRC subsidiaries are operated.

11. DIVIDEND

The directors do not recommend the payment of a dividend in respect of the year ended 31st December, 2006 (2005: Nil).

12. (LOSS) EARNINGS PER SHARE

The calculation of the loss per share for the year is based on net loss for the year approximately HK$73,362,000 (2005: net profit of HK$3,585,000) and on 686,400,000 shares (2005: 686,400,000 shares) in issue during the year.

The Company has no dilutive potential ordinary shares in issue during the years ended 31st December 2006 and 2005.

13. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Plant and machinery	Furniture and equipment	Motor vehicles	Construction in progress	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
THE GROUP						
COST						
At 1st January 2005	215,242	354,578	31,152	7,766	8,706	617,444
Additions	72	–	5	–	1,379	1,456
Transfers	6,859	–	–	–	(6,859)	–
Disposals	(1,201)	–	–	(181)	–	(1,382)
At 31st December 2005	220,972	354,578	31,157	7,585	3,226	617,518
Exchange adjustments	13,258	21,842	1,816	443	194	37,553
Additions	–	42	14	–	570	626
Disposals	–	(97)	(217)	(855)	–	(1,169)
At 31st December 2006	234,230	376,365	32,770	7,173	3,990	654,528
DEPRECIATION AND AMORTISATION						
At 1st January 2005	54,650	214,203	31,146	6,903	–	306,902
Provided for the year	11,067	29,291	–	336	–	40,694
Eliminated on disposals	(477)	–	–	(163)	–	(640)
At 31st December 2005	65,240	243,494	31,146	7,076	–	346,956
Exchange adjustments	3,914	14,702	1,713	415	–	20,744
Provided for the year	10,614	23,363	–	421	–	34,398
Impairment loss recognised	26,037	6,338	–	–	–	32,375
Eliminated on disposals	–	(59)	(182)	(769)	–	(1,010)
At 31st December 2006	105,805	287,838	32,677	7,143	–	433,463
NET BOOK VALUES						
At 31st December 2006	128,425	88,527	93	30	3,990	221,065
At 31st December 2005	155,732	111,084	11	509	3,226	270,562

The land and buildings of the Group are situated in the PRC and held under medium-term land use rights.

14. PREPAID LEASE PAYMENTS ON LAND USE RIGHTS

	2006	2005
	HK$'000	HK$'000
Analysed for reporting purposes as:		
Non-current asset	**43,441**	41,948
Current asset	**1,024**	966
	44,465	42,914

The leasehold land is held under medium-term lease and situated in PRC.

15. INTERESTS IN SUBSIDIARIES

	THE COMPANY	
	2006	2005
	HK$'000	HK$'000
Unlisted shares, at cost	**476,175**	476,175
Amounts due from subsidiaries	**71,156**	71,087
	547,331	547,262

The carrying value of the unlisted shares is based on the book values of the underlying net assets of the subsidiaries attributable to the Group as at the date on which the Company became the holding company of the Group under the Group reorganisation in 2000.

Details of the Company's subsidiaries at 31st December 2006 are set out in note 30.

In the opinion of the directors, the amounts due from subsidiaries are unsecured, non-interest bearing and are unlikely to be repayable within one year from the balance sheet date and are therefore shown in the balance sheet as non-current.

16. DEFERRED TAX ASSETS

The following are the major deferred tax assets recognised by the Group:

	Accelerated accounting depreciation	Inventories	Trade receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000
At 1st January 2005	8,218	3,647	11,036	22,901
Credit to income	1,034	(1,823)	541	(248)
At 31st December 2005 and 1st January 2006	9,252	1,824	11,577	22,653
Exchange Adjustments	555	(72)	695	1,178
(Charge) credit to income (note 10)	873	(834)	3,690	3,729
At 31st December 2006	10,680	918	15,962	27,560

There was no significant unprovided deferred tax for the Group and the Company for the year or at the balance sheet date.

17. INVENTORIES

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Raw materials	**56,822**	33,269
Work in progress	**117,647**	194,872
Finished goods	**11,704**	17,487
	186,173	245,628

18. TRADE AND OTHER RECEIVABLES

The Group has a policy of allowing an average credit period of 90 days to its trade customers. Included in trade and other receivables are trade receivables of approximately HK$185,133,000 (2005: HK$231,336,000), the aged analysis of which at the balance sheet date is as follows:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Up to 30 days	**27,255**	62,166
31 – 60 days	**38,938**	77,000
61 – 90 days	**48,888**	46,906
91 – 180 days	**70,052**	45,264
181 days to 1 year	**–**	–
	185,133	231,336

The directors consider that the carrying amount of trade and other receivables approximately their fair value.

19. BANK BALANCES AND CASH

Bank balances carry interest at market rates which range from 1.5% to 3.5% (2005: 1% to 2.5%).

20. TRADE AND OTHER PAYABLES

Included in trade and other payables are trade payables of approximately HK$61,438,000 (2005: HK$61,353,000), the aged analysis of which at the balance sheet date is as follows:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Up to 30 days	**4,218**	14,651
31 – 60 days	**1,015**	14,677
61 – 90 days	**2,959**	13,430
91 – 180 days	**16,323**	12,676
181 days to 1 year	**28,192**	4,026
Over 1 year	**8,731**	1,893
	61,438	61,353

The directors consider that the carrying amount of trade and other payables approximates their fair value.

21. LOAN FROM A DIRECTOR

The loan from Mr. Liaw Yuan Chian is unsecured, interest-free and is repayable on demand.

22. BANK BORROWINGS

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Secured bank loans	**100,192**	119,486
Unsecured bank loans	**82,372**	80,539
Secured bank overdraft	**–**	4,947
	182,564	204,972
The bank borrowings are repayable as follows:		
Within one year or on demand	**182,564**	204,614
One to two years	**–**	358
Two to five years	**–**	–
	182,564	204,972
Less: Amount due within one year shown under current liabilities	**(182,564)**	(204,614)
Amount due after one year	**–**	358

The carrying amounts of the Group's borrowings approximate their fair value.

The Group's borrowings that are denominated in currencies other than the functional currencies of the relevant group companies are set out below:

	Denominated in HK$	**Denominated in US$**
As at 31st December 2006	–	9,800,000
As at 31st December 2005	14,074,000	9,800,000

The borrowings denominated in Hong Kong dollars granted by the banks to a Group company are guaranteed by Company. The interest rates for the loans are Hong Kong Inter-bank Offered Rate or Singapore Inter-bank Offered Rate plus a spread, thus exposing the Group to cash flow interest rate risk.

22. BANK BORROWINGS (Cont'd)

The effective borrowing rate of the Group ranged from 5.18% to 7.02% (2005: 3.49% to 7.18%).

During the year, the Group obtained new loans with aggregate amounts of approximately HK$75,500,000. The proceeds were used for working capital purpose.

The carrying amount of bank borrowings approximates their fair value as the weighted average interest rates approximate the respective market rates.

At 31st December 2006, the Group's banking facilities were secured by the following:

(i) Certain of the Group's prepaid lease payment on land use rights, property, plant and equipment with a carrying value as follows:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Prepaid Lease Payments on land use right and building	**85,218**	85,979
Plant and machinery	**51,849**	34,427
	137,067	120,406

(ii) Inventories of the Group of approximately HK$52 million (2005: HK$80 million);

(iii) Bank deposits of the Group of approximately HK$1.5 million (2005: HK$10 million);

(iv) Cross-guarantees between subsidiaries; and

(v) The Company's corporate guarantees (at the balance sheet date, the aggregate amounts of facilities utilised by subsidiaries, including bills payable, amounted to approximately HK$10 million (2005: HK$47 million)).

On 12th September 2006, Bank of China, Xian Branch which lent USD9.8 million to the Xian Hua Lien obtained a writ from 陝西省高級人民法院 (Shannxi Province Highest People's Court) that granted the bank the legal rights to freeze and sequestrate all the assets of the Xian Hua Lien including property, plant and equipment, inventories, trade receivables and bank balances. At balance sheet date, Bank of China, Xian Branch sequestrated the bank account, the property, plant and machinery and inventories of Xian Hua Lien as additional security. Due to the suspension of operation of Xian Hua Lien and full provision against the assets had been made, the sequestrated assets have no carrying value at the balance sheet date.

23. SHARE CAPITAL

	2006 and 2005 Authorised		2006 and 2005 Issued and fully paid	
	Number of shares	HK$'000	Number of shares	HK$'000
Ordinary shares of HK$0.10 each	1,500,000,000	150,000	686,400,000	68,640

24. RESERVES

	Contributed surplus (note i)	Accumulated profits (note ii)	Total
	HK$'000	HK$'000	HK$'000
THE COMPANY			
At 1st January 2005	468,576	8,629	477,205
Loss for the year	–	(849)	(849)
At 31st December 2005 and 1st January 2006	468,576	7,780	476,356
Loss for the year	–	(452)	(452)
At 31st December 2006	468,576	7,328	475,904

Notes:

(i) The contributed surplus of the Company represents the difference between the book value of the underlying net assets of the subsidiaries acquired by the Company under the group reorganisation in 2000 and the nominal value of the Company's shares issued for the acquisition.

(ii) At 31st December 2006, the Company's reserves available for distribution to shareholders of approximately HK$475,904,000 (2005: HK$476,356,000) comprised the contributed surplus of approximately HK$468,576,000 (2005: HK$468,576,000) and the accumulated profits of approximately HK$7,328,000 (2005: HK$7,780,000).

25. CONTINGENT LIABILITIES

The Group reached a settlement of legal claim with Bank of East Asia, Shenzhen Branch against Jiangmen Hua Lien for repayment of the principal of approximately Rmb11,241,000 (approximately equivalent to HK$11,241,000) and interest thereon through a mutually agreed repayment schedule dated on 23rd March 2007.

26. COMMITMENTS

(a) Operating lease commitments:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Minimum lease payments paid during the year under operating leases in respect of land and buildings and office premises	**757**	1,386

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Within one year	**245**	1,357
In the second to fifth year inclusive	**125**	4,621
Over five years	**–**	2,310
	370	8,288

Operating lease payments principally represent rentals payable by the Group for certain of its factory properties and office premises. Leases are negotiated for terms from 1 to 20 years and rentals are fixed throughout the lease terms.

The Company did not have any significant operating lease commitments at the balance sheet date.

26. COMMITMENTS (Cont'd)

(b) Capital commitments:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Capital expenditure contracted for but not provided in the financial statements in respect of the acquisition of property, plant and equipment	**–**	–

The Company did not have any significant capital commitments at the balance sheet date.

(c) Other commitments:

Under the terms of a cooperative joint venture agreement in respect of 江門市華聯製皮工業有限公司 Jiangmen Hua Lien Tannery Co., Ltd. ("Jiangmen Hua Lien", formerly known as 新會華聯製皮工業有限公司 Xin Hui Hua Lien Tannery Co., Ltd.), a subsidiary of the Company, Galloon International (Holding) Company, Limited ("Galloon International") is entitled to all of the net profit or loss of Jiangmen Hua Lien throughout the entire cooperative joint venture period after the payment of a pre-determined distribution by Jiangmen Hua Lien each year to the joint venture partner of Galloon International (the "Joint Venture Partner"). In the event that Jiangmen Hua Lien does not have sufficient distributable profit to make the required payments to the Joint Venture Partner, Galloon International is responsible for making such payments to the Joint Venture Partner as compensation. At 31st December 2006, the pre-determined distributions payable to the Joint Venture Partner over the entire cooperative joint venture period are as follows:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Amount payable:		
Within one year	**5,610**	5,239
One to two years	**5,610**	5,239
Two to five years	**14,725**	13,751
Over five years	**50,994**	52,861
	76,939	77,090

The Company did not have any significant other commitments at the balance sheet date.

27. SHARE OPTIONS SCHEME

The Company's share option scheme (the "Scheme") which was adopted pursuant to a resolution passed by shareholders on 4th January 2000 for the primary purpose of providing incentives to directors and eligible employees, will expire on 3rd January 2010. Under the Scheme, the Board of Directors of the Company may grant options to eligible employees, including directors of the Company and its subsidiaries, to subscribe for shares in the Company.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders.

Options granted must be taken up within 30 days of the date of offer, upon payment of HK$1 per grant. Options may be exercised at any time from the period commencing on the date falling 6 months after the date of grant of the share option to the 5th anniversary of the date of grant. The exercise price is determined by the directors of the Company, and will not be less than the higher of the closing price of the Company's shares on the date of grant, the average closing price of the shares for the five business days immediately preceding the date of grant and the nominal value of the shares.

No options have been granted or agreed to be granted under the Scheme since its adoption.

28. RETIREMENT BENEFITS SCHEMES

The Group operates the MPF Scheme established under the Mandatory Provident Fund Ordinance for its qualifying employees. The assets of the MPF Scheme are held separately from those of the Group, in funds under the control of trustees.

The PRC subsidiaries are required to contribute a certain percentage, ranging from 18% to 20%, of the payroll of their employees to the retirement benefits schemes to fund the benefits. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the respective schemes.

At the balance sheet date, there were no significant forfeited contributions available to reduce the contribution payable in the future years.

The total cost charged to the consolidated income statement of approximately HK$0.6 million (2005: HK$0.7 million) represents contributions payable to these schemes by the Group in respect of the current accounting period.

29. RELATED PARTY TRANSACTIONS AND BALANCES

During the year, the Group had certain transactions with related parties. Details of these transactions for the year and balances at 31st December 2006 with related parties are as follows:

(a) Transactions

A subsidiary entered into a lease agreement (the "Lease Agreement") with Xian People's Tannery Factory ("Xian People's Tannery"), the minority shareholder of a subsidiary, to lease the land use rights related to the site on which the factory building of the subsidiary is located at a monthly rental of RMB102,000 (approximately HK$102,000). During the year, the Group paid rental expense of approximately HK$525,000 (2005: HK$1,155,000) to Xian People's Tannery and the amount paid was in the ordinary course of business and in accordance with terms of the Lease Agreement. The lease was terminated in September 2006.

(b) Balances

Details of balances with the related parties at the balance sheet date is set out in the consolidated balance sheet and note 21.

(c) Others

Details of an arrangement with a joint venture partner of Galloon International in respect of the distribution of profits in Jiangmen Hua Lien are set out in note 26(c).

(d) The remuneration of directors and other members of key management during the year was as follows:

	2006	2005
	HK$'000	HK$'000
Directors' fee	**90**	228
Salaries, allowance and benefits in kind	**1,823**	2,170
Mandatory Provident Fund Contribution	**–**	–
	1,913	2,398

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends.

30. SUBSIDIARIES

Details of the Company's subsidiaries at 31st December 2006 are as follows:

Name of company	Place of incorporation/ operations	Nominal value of issued and fully paid share capital/ registered capital	Effective proportion of issued/ registered capital held by the Company	Principal activities
Galloon International (Holding) Company, Limited	British Virgin Islands/ Taiwan	Ordinary share US$1	100%	Sale and marketing of leather, raw materials sourcing and investment holding
嘉聯皮革(中國)有限公司 Galloon Leather (China) Co, Ltd. ("Galloon Leather") (formerly known as 新會嘉聯皮革工業有限公司 Xin Hui Galloon Tannery Co., Ltd.)	The PRC **	Registered capital US$21,700,000 *Note (iv)*	100%	Manufacture and sale of leather
Hua Lien Group (Holding) Company, Limited ("Hua Lien Group (Holding)")	British Virgin Islands/ Hong Kong	Ordinary shares US$19,193,996 *Note (i)*	100%	Investment holding
Hua Lien (Hong Kong) Company Limited ("Hua Lien Hong Kong")	Hong Kong	Ordinary shares HK$10,000 Non-voting deferred shares HK$15,000,000 *Note (ii)*	100%	Provision of management services
江門市華聯製皮工業有限公司 Jiangmen Hua Lien	The PRC *	Registered capital US$14,522,000	70.5% *Note (iii)*	Manufacture and sale of leather
Sawston International Limited	British Virgin Islands/ Taiwan	Ordinary shares US$1	100%	Sale and marketing of leather and raw material sourcing
西安華聯製皮工業股份有限公司 Xian Hua Lien Tannery Co., Ltd. ("Xian Hua Lien")	The PRC ***	Registered capital RMB65,600,000	51% *Note (v)*	Manufacture and sale of leather

* Company incorporated as limited liability cooperative joint venture enterprise in the PRC.

** Company incorporated as limited liability equity joint venture enterprise in the PRC.

*** Company as joint stocks limited liability in the PRC.

30. SUBSIDIARIES (Cont'd)

Notes:

(i) Hua Lien Group (Holding) is held by the Company directly. All other subsidiaries are held by the Company indirectly.

(ii) The deferred shares of Hua Lien Hong Kong, which are not held by the Group, practically carry no rights to dividends or to receive notice of or to attend or vote at any of its general meetings or to participate in any distribution on its winding up.

(iii) Jiangmen Hua Lien is a limited liability cooperative joint venture enterprise with a term of operation to 26th August 2022. Under the terms of the cooperative joint venture agreement, Galloon International holds 70.5% of the registered capital of Jiangmen Hua Lien, but it is entitled to all of the net profit or loss of Jiangmen Hua Lien throughout the entire cooperative joint venture period, after the payment of a pre-determined distribution by Jiangmen Hua Lien each year to the Joint Venture Partner, details of which are set out in note 26 (c).

At the end of the cooperative joint venture period, Galloon International is entitled to the distribution of all the remaining assets of Jiangmen Hua Lien according to its capital contribution ratio in Jiangmen Hua Lien.

(iv) As at the date of this report, the registered capital of Galloon Leather was paid up to the extent of US$14,000,000 (2005: US$14,000,000).

(v) In January 2003, Xian Hua Lien was approved to change from a limited liability sino-foreign equity joint venture enterprise for a term of operation of 20 years to a joint stock limited liability company with a registered capital of RMB65,600,000.

Since the establishment of Xian Hua Lien, the minority shareholders received 40% of the profit distribution made by Xian Hua Lien in respect of the period from the date of its establishment to 31st December 2006 (rather than in proportion to the 49% equity interest that it holds in Xian Hua Lien) and, pursuant to an agreement made with Galloon International, Hua Lien Hong Kong, Xian Hua Lien, the minority shareholders waived its remaining entitlement to such profit distribution in favour of the Group. The Group therefore effectively had a 60% attributable economic interest in Xian Hua Lien for the period from the date of establishment of Xian Hua Lien to 31st December 2006.

None of the subsidiaries had any debt securities outstanding at the end of the year, or at any time during the year.