



## **Operation and Financial Reviews**

### **Interim Results**

The Group's unaudited profit before tax and minority interests for the six months ended 30 June 2001 was HK\$4,432,000, compared to the unaudited loss of HK\$5,525,000 for the same period last year. Unaudited earnings per share were 0.96 Hong Kong cent. Unaudited turnover for the period amounted to HK\$363,855,000, an increase of 7% over the same period of the previous year.

No interim dividend is recommended by the Board of Directors for the six months ended 30 June 2001 (2000: Nil).

### **Group Restructuring**

The Group planned to restructure its leather business in northern China and will be achieved through the disengagement of its interest in the Qingdao Nanhai Tannery ridden by continuing losses, and its initiatives to refocus its business on the Xuzhou Nanhai Tannery. With a more focused application of resources, the Group is able to improve the overall operating efficiency and enhance further its competitive edge by bringing into full play its existing advantage.

Qingdao Nanhai Tannery is a Sino-foreign cooperative joint venture set up in 1998 by the Group. Due to high production costs and small scale of operation, Qingdao Nanhai Tannery has been unable to break-even since its establishment and suffered from continuing losses amounting to HK\$8,970,000 over the three operating years. Negotiations are currently underway between the Group and the joint venture partner on effective ways to resolve related issues of Qingdao Nanhai Tannery, including the problems of staff layoff and production delay. The Group is actively addressing these issues and intends to transfer the majority of the existing assets in Qingdao Nanhai Tannery to other tannery plants of the Group so as to comply with its overall strategies. Provisions will be made where appropriate in the light of the circumstances.

Nexus Concepts LLC. in the North America was put into voluntary winding up in May this year given its losses over a prolonged period.

The Group is committed to maximising its return on asset whenever suitable opportunities arise, and will focus its resources on expanding further its core tannery business.

### **Market**

#### **The Leather Business**

The leather market continued to face intense competition during the first half of 2001. A significant slowdown of exports by China's downstream enterprises was witnessed following the economic downturn in Europe and the United States. These unfavourable conditions



## **Operation and Financial Reviews** *(Cont'd)*

### **The Leather Business** *(Cont'd)*

provided limited room for the Group to increase the price level of its leather products despite an upsurge in raw material prices. The Group has adjusted its product mix since last year, with active development of the new generation of black nappa cow leather which continued to be well-received by the market. Average prices of leather products in general remained basically unchanged as compared to the previous year. However, competition is set to be intensified as there will see an increasing number of leather manufacturers in the market. The Group has been dedicated to expanding its customer base and developing new product lines. Its active efforts to increase the overall sales has led to a rise of its production to sales ratio to around 100% during the period. A satisfactory level of settlement of receivables was also recorded.

### **The Leather Ware Business**

The Group has shifted its marketing mode to franchise for its leather ware products in China since April 2001. An agreement was reached between the Group and an agent for the grant of the trademark franchise at a fee of HK\$2,000,000 per year. However, given the current market situations, the agent has unilaterally terminated the agreement for the sale of 25% interest in Chapel Hill Developments Limited which holds the trademark. Pursuant to the relevant agreement, the deposit paid by the agent in an amount of HK\$500,000 was forfeited by the Group in August 2001 as compensation.

The leather ware market in Hong Kong was primarily affected by the slowing economy and the sluggish retail market where no visible improvement has been shown. The market share of Saint Jack leather ware products was adversely affected due to the shrinking number of wholesale shops and traditional retail counters at department stores. To meet these challenges ahead, the Group has made active efforts to adjust its distribution network. Three Saint Jack specialty shops were planned to open in 2001, with two of which opened in Shatin and Yuen Long respectively in March and August this year.

### **Cost**

During the period under review, the Group reduced its leather production cost by 2% and the operating cost for leather ware products in Hong Kong by 4% primarily attributable to its more stringent measures on cost control. Fluctuations in raw material prices were seen during the first half of 2001, demonstrated by the fluctuating prices of raw leather which rose from US\$73 to US\$90 per sheet early this year and then dropped sharply to US\$56. Inevitably, the problem of price volatility has posed certain impact on the Group's production and operations. However, the impact was moderated as the Group has established a sourcing centre in Xuzhou for raw leather produced in China and continued to pursue its prudent sourcing policy. As a result, the Group's leather manufacturing business was able to maintain a gross margin of over 8%.

The Group's effective control over the operating costs of all of its companies has again proven its worth during the period. Cost of sales was reduced by 2% and revenue was recorded for the Group even in the face of a highly competitive market.



## Operation and Financial Reviews *(Cont'd)*

### Production

The Group's mass production strategy of high quality and low cost products has been firmly in place. A satisfactory growth in leather production was recorded during the period, with total sales amounting to HK\$211,511,000. Productions of cow hides and coated cow splits increased by 7% and 18% from the same period last year to 17,429,000 sq.ft. and 5,608,000 sq. ft. respectively.

The Group's leather ware business in Hong Kong reported a satisfactory level of gross margin. Total sales for the period reached HK\$15,205,000 (2000: HK\$15,850,000), with a total of 37,000 handbags (2000: 33,000 handbags) and 31,000 units of leather ware products (2000: 35,000 units) being sold.

### Financial Position

As at 30 June 2001, the Group had bank loans amounting to HK\$196,305,000 and cash and bank balance totalling HK\$80,890,000. After deduction of cash and bank balance, the Group's ratio of net bank loans to shareholders' equity was 28%. The Group's bank loans included Hong Kong dollar borrowings of HK\$32,195,000, United States dollar borrowings of HK\$116,083,000 and Renminbi borrowings of HK\$48,027,000.

Of the total bank loans as at 30 June 2001, HK\$128,780,000 (the "TOA Loan") would be repayable or refinanced on or before 31 December 2003 according to the Tannery Override Agreement (the "TOA") entered into by the Group on 22 December 2000. Part of the TOA Loan amounting to HK\$83,870,000 would be repayable in year 2001 and HK\$69,120,000 of which has been repaid by the Group during the first half year. The TOA Loan bear interest at either 3 month's HIBOR/LIBOR plus 2% per annum, whereas the remainder of the Group's total bank loans amounting to HK\$67,525,000 bear fixed interest rate ranging from 6% to 7% per annum.

Interest expense incurred for the Group was reduced by 19.8% from the same period last year. The Group will take active steps to rationalise its capital structure so that on-time repayment of its borrowings is ensured.

As at 30 June 2001, certain of the Group's leasehold land and buildings, investment properties and bank deposits with a total net book value of HK\$68,804,000 were pledged to secure general banking facilities granted to the Group.

The Group's capital expenditure during the period under review amounted to HK\$5,859,000. They were incurred mainly for the purchase of machinery and equipment to optimise the standard of the Group's production facilities.



## Operation and Financial Reviews *(Cont'd)*

### Litigation

1. The arbitration between the Group and 深圳市金利暉實業有限公司 (“金利暉”) in respect of the trademark of “D Collection” leather ware products owned by the Group was settled at the Beijing First Intermediate People’s Court (北京市第一中級人民法院) on 29 June 2001. 金利暉 has undertaken to refrain from using any trademark similar to “D Collection” and raising any objection and counter-argument against the “D Collection” trademark. It has also undertaken to withdraw the petition submitted to the Trademark Arbitration Committee of the State Administration for Industry and Commerce, P.R. China (中國工商行政管理局商標評審委員會) for the revocation of the alleged improper trademark registration of “D Collection”. In July 2001, a total of RMB400,000 has been paid to the Group by 金利暉 in respect of the arbitration.
2. In January 2001, Guangdong Enterprises (North America) Fur Holdings Limited (“GDNA”) and Harbour Hill International Limited (“HHL”), wholly owned subsidiaries of the Company, filed suit to the United States District Court in the Southern District of New York to recover approximately US\$2.25 million loaned to Hennessy International Group, Inc. (“HIGI”). HIGI is one-third held by GDNA and is an associate of the Group. GDNA and HHL also asserted claims against a corporate shareholder of HIGI and two individuals, who have interests in the corporate shareholder of HIGI (the “Defendants”), based on their guarantees of one-half of HIGI’s obligation.

In March 2001, the Defendants answered the complaint denying all liabilities and asserted a counterclaim of approximately US\$2 million against GDNA for alleged failure to continue financing HIGI. The parties involved are engaged in discovery with depositions scheduled to begin around 24 September 2001.

### Employees

The Company and its subsidiaries have 1,950 employees. Employees’ cost was HK\$16,987,000 for the period. The Group ensures that the pay levels of its employees are competitive and made with reference to the Group’s operating results and the employee’s performance. The Group adopted a share option scheme for the benefit of its directors and employees.

### Prospects

The consumer market in China continues to be buoyant in tandem with the solid growth of China’s economy. Following its overall initiatives to maximise its return on asset and consolidate its tannery business, the Group is well poised to benefit from this positive environment and will continue to grow on an even stronger foundation.