



Chairman's Statement

I am pleased to report that our ongoing programs of corporate restructuring and rationalizing the management structure since two years ago have delivered encouraging results. A direct management mechanism has been established, under which management of production, supply, distribution and finance are centralized at two production bases in Nanhai and Xuzhou. In the meantime, we have established a solid position as a significant and influential player in the PRC's leather market.

The outbreak of Severe Acute Respiratory Syndrome ("SARS") in China earlier the year had caused widespread worries and uncertainties. This had a negative impact on the Group as our daily process of business negotiations and trading was hindered, and orders from customers were postponed. Fortunately, our operations have returned to normal in the second half of 2003, with business activities resumed almost to the same level before the SARS outbreak. The key to the Group's resilience lies in our shrewd actions to open up new markets in the wake of the SARS epidemic, to strengthen our long-term solid relationship with customers, and to continue our ongoing drive for quality enhancement.

In December 2003, the Group disposed of its entire 100% interest in Nanhai Tannery & Leather Products Limited to a subsidiary of GDH Limited. It was a strategic move to minimize the impact of the "Nanhai Tannery Incident" on the Group. However, in February and March 2004, certain bank accounts of 南海市通遠皮革有限公司 (Nanhai City Tongyuan Tanning Company Limited) ("Tongyuan Tannery"), a subsidiary of the Group, were frozen by the Guangzhou Customs in the PRC. A written notification was later sent to Tongyuan Tannery by the Guangzhou Customs demanding payment of an amount of RMB36,989,441.92. Tongyuan Tannery will continue to follow up with the Guangzhou Customs to resolve the matter and will, if necessary, take all such steps as may be required to safeguard its rights and position. As the freezing of its bank accounts has severely affected its operations, Tongyuan Tannery has suspended all of its operations on 19 March 2004 and started to lay off its existing staff.

The Group strives to effectively resolve the problem of reduced production and sales volume triggered by the suspension of Tongyuan Tannery's operations, while taking proactive steps to address the environmental issues that have long been a major concern facing the leather industry. To offset part of the impacts from shrinking business following the suspension of Tongyuan Tannery's operations, we have embarked on a northward shift of operations, underpinned by the establishment of Xuzhou Tannery as a major production base. At the same time, a larger proportion of upstream processing will be outsourced so that the negative impact on the environment that may be caused by our expanded operations can be minimized.



Chairman's Statement *(Cont'd)*

Operating results of Xuzhou Nanhai Tannery & Leather Products Limited ("Xuzhou Nanhai Tannery") have improved markedly for the second consecutive year. This is primarily due to an effective reduction in production costs as competition is introduced into the sourcing process by way of open tender under the "Sunshine" program. In addition, a notable growth in production and sales volume has been recorded as the leather products manufactured in the PRC are well received by customers given their unique quality and design. We aim to double the annual capacity of Xuzhou Nanhai Tannery to 18,000,000 sq.ft., and initiatives have been made to expand its production equipment and auxiliary facilities. Xuzhou Nanhai Tannery is set to be a major source of profit contribution to the Group over the next few years, as it will become a production base for the Group's leather products made in the PRC. Plans are underway to restructure Xuzhou Gangwei Colour Packaging Limited, another company in Xuzhou, to include production, processing and distribution of leather products as a new core business. Its idle plant will be used for downstream processing of imported cow hides, with an annual production capacity of 15,000,000 sq.ft. We target to complete this restructuring program within this year, and new streams of revenue will be created for the Group following its completion.

After years of a general slowdown, the leather industry has turned the corner in the first quarter of 2004, showing positive signs of a steady recovery. The summer sales, previously commenced only when the summer season set in, have started to grow as early as in January this year, with selling prices also picking up. Given this favourable environment, I have confidence that the Group is well poised to benefit from the strong demand in the leather market in 2004.

2004 will continue to be a difficult year for the Group. However, we are steadfast in an aim to enhance further our competitiveness in the leather industry, and to achieve a higher market share. Active efforts will be made in different areas to accomplish our objectives as follows:

1. *To resolve completely the Tongyuan Tannery Incident*

We are determined to effectively resolve the problems associated with the suspension of Tongyuan Tannery's operations, such as lay-off of existing staff and collection of trade receivables. We will take all possible steps to avoid any further damages made to the Company.

In the meantime, negotiations with the Guangzhou Customs are actively underway in order that the "Tongyuan Tannery Incident" can be resolved as early as possible. We are studying the proposal to resume the operations of Tongyuan Tannery and establish it as a processing base for the two tanneries in Xuzhou. Proposals to lease or to dispose of Tongyuan Tannery are also being considered.



Chairman's Statement *(Cont'd)*

2. *To expedite the development of Xuzhou base, a step to facilitate the northward shift of operations*

During the year, as mentioned above, we target to complete the expansion and renovation project of the two tanneries in Xuzhou to provide a combined capacity of up to 36,000,000 sq.ft.

3. *To strengthen further the direct management mechanism*

The Group's management will closely monitor the Group's operations at the front line. A program to streamline the Hong Kong headquarters will be pursued so as to reduce the staff-related costs and other expenses.

Management of production, supply, distribution and finance will be further centralized. We will continue to carry out the "Sunhsine" program for sourcing activities, and implement the "Integrated Application" program to integrate market-oriented R&D results into our production process. With these programs firmly in place, the Group is in a more solid position to enhance its market competitiveness and to improve further its profit margin.

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

Zhang Chunting
Chairman

Hong Kong, 14 April 2004