GDH

Management Discussion and Analysis

Results

The Group's audited profit attributable to shareholders for the year ended 31 December 2004 was HK$4,668,000, compared with a loss of HK$101,294,000 for the same period last year.

The audited net asset value of the Group as at 31 December 2004 was HK$171,072,000, an increase of HK$912,000 and a drop of HK$1,779,000 as compared to 31 December 2003 and 30 June 2004 respectively.

No final dividend is recommended by the Board of Directors for the year ended 31 December 2004.

Operations Review

We achieved encouraging progress in production and operations based on our relentless efforts to strive for improvement over the past year. Manifestations include: (1) significant enhancement of operational efficiency and profitability at the production base in Xuzhou as we pursued the expansion initiatives and strengthened the management and operations in production, supply and distribution, as part of the measures to remedy the problems of shrinking business and climbing costs following the closure of Nanhai production base; (2) steady removal of supply related risks and barriers of distribution bottleneck by extending the supply channels and sales network, and (3) rapid growth in production volume, steady improvement in product quality, as well as higher competitiveness of the Group's products.

Consolidated turnover for the year was HK$281,951,000, a drop of 26.11% as compared to HK$381,601,000 for the same period last year. Turnover of Xuzhou Tannery for the year was HK$162,741,000 (2003: HK$158,485,000), an increase of 2.68% over the previous year. Turnover of cowhides decreased by 18.82% to HK$254,917,000 (2003: HK$314,003,000) whereas cow split, coated cow split and others dropped by 60% to HK$27,034,000 (2003: HK$67,598,000). The Group maintained a stable turnover in the face of the slowing market last year primarily because: (1) we has established a strong sales network following the marketing strategy of "focusing on targeted markets and customers"; (2) our pursuit of direct sales to leading manufacturers has delivered initial results; (3) we adopted an incentive mechanism under which remuneration was linked to sales results, and this helped arouse the initiative and creativity of sales personnel in market development and marketing.

On the front of product mix, we have developed and launched to the market dozens of new products in three leather series: bumpy, natural and embossed series, which were newly included in our product portfolio in addition to the existing series of the domestic nappa leather. All of the new products were well received by the market.

Sourcing cost for raw materials was effectively controlled as we continued to introduce competition into the sourcing process through the tender system under the “Sunshine” program, and we were responsive to market changes in terms of supply and demand. Total sourcing costs for the year decreased by 58.8% to HK$158,806,000 as we were focused on clearing the raw materials of Tongyuan Tannery in the first half of 2004.

The Group’s total leather production for the year was 17,553,000 sq.ft., declined by 13,595,000 sq.ft. from 31,148,000 sq.ft. in 2003. Production of cowhides dropped by 26.49% to 16,344,000 sq.ft. (2003: 22,234,000 sq.ft.) whereas cow split, coated cow split and others down by 86.43% to 1,209,000 sq.ft. (2003: 8,914,000 sq.ft.). Xuzhou Tannery produced a total of 13,209,000 sq.ft. in cowhides for the year, an increase of 5,133,000 sq.ft. or 63.56% over the same period in the previous year.

As at 31 December 2004, the Group’s consolidated inventories amounted to HK$141,089,000, reduced by HK$80,306,000 and HK$64,368,000 as compared to 31 December 2003 and 30 June 2004 respectively. The decrease was primarily attributable to the reduced sourcing volume of the Group, and our moves to liquidate the assets and inventories of Tongyuan Tannery following its suspended operations.

Balance of trade receivables as at 31 December 2004 was HK$29,382,000. After deducting the provisions for doubtful debts of HK$3,473,000, trade receivables amounted to HK$25,909,000, an increase of HK$8,747,000 and a drop of HK$8,614,000 as compared to 31 December 2003 and 30 June 2004 respectively. Trade receivables turnover was 13.1 times and average collection period was 27.88 days, an increase of 9.45 days as compared to 18.43 days in 2003. The trade receivables of Tongyuan Tannery upon its suspension of operations in March 2004 was RMB39,000,000. As at 31 December 2004, these trade receivables were reduced to RMB5,150,000 as we have made active attempts to recover the receivables.

Financial Review

As at 31 December 2004, the Group’s interest-bearing borrowings amounted to HK$100,626,000 (as at 31 December 2003: HK$133,648,000). Of the total interest-bearing borrowings, HK$10,350,000 was denominated in Hong Kong dollars, HK$35,676,000 in Renminbi and HK$54,600,000 in US dollars. In addition, all interest-bearing borrowings are charged at fixed rate.

As at 31 December 2004, the Group’s cash and bank balances amounted to HK$98,040,000 (as at 31 December 2003: HK$84,332,000), denominated in Hong Kong dollars (HK$1,333,000), Renminbi (equivalent to HK$74,677,000) and US dollars (equivalent to HK$22,030,000) respectively.

As at 31 December 2004, after deduction of cash and bank deposits, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 1.51% (as at 31 December 2003: 28.98%). Loan facilities bear interest at approximately 3% to 5% per annum. All borrowings are repayable on 30 June 2005. Subsequent to the balance sheet date, the repayment due date of the loans are extended to 30 June 2006. Interest expense incurred by the Group during the year was HK$5,734,000, a drop of 3.59% as compared to the same period last year.

Net cash inflow from operating activities for the year was HK$24,048,000 and net cash outflow from financing activities was HK$16,931,000. Net increase in cash and cash equivalents for the year amounted to HK$6,274,000.

Fixed assets as at 31 December 2004 were HK$111,296,000, a reduction of HK$7,110,000 as compared to 31 December 2003. The Group's capital expenditure during the year amounted to HK$2,186,000 (2003: HK$3,044,000). It was incurred mainly for the replacement of the leather manufacture machinery and equipment, a move to cope with the expansion of the Xuzhou Tannery.

As at 31 December 2004, certain of the Group's buildings, investment properties, bank deposits and plant and machinery with a total net book value of HK$20,969,000 (31 December 2003: HK$15,295,000) were pledged to secure general banking facilities granted to the Group.

Freezing of Tongyuan Tannery's Bank Accounts

In February and March 2004, certain bank accounts of Foshan City Nanhai Tong Yuan Tanning Co., Ltd ("Tongyuan Tannery") were frozen by the Guangzhou Customs in the PRC. A written notification was later sent to Tongyuan Tannery by the Guangzhou Customs demanding payment of an amount of RMB36,989,441.92. As the freezing of bank accounts has severely affected its business, Tongyuan Tannery has suspended all of its operations in March 2004, and more than 600 employees were laid off as at the end of December 2004, which represented the entire pool of staff other than certain rear-service personnel. Tongyuan Tannery will continue to follow up with the Guangzhou Customs to resolve the matter and will, if necessary, take all such measures as may be required to safeguard its rights and position. As at 31 December 2004, the aggregate amount of Tongyuan Tannery's bank deposits being frozen was RMB9,247,000.

Progress on winding up Qingdao Tannery

As regards the litigation between Qingdao Nanhai Tannery Co., Ltd. ("Qingdao Tannery") and its PRC joint venture partner, a ruling was made by the China International Economic and Trade Arbitration Commission in Shenzhen on 27 May 2004 confirming that: (i) the "Joint Venture Agreement in respect of Qingdao Nanhai Tannery Co., Ltd." ("Qingdao Joint Venture Agreement") was terminated on 23 August 2001; (ii) Qingdao Tannery is required to be wound up in compliance with all applicable laws and regulations of the People's Republic of China and the terms and conditions under the joint venture agreement; and (iii) proceeds from selling Qingdao Tannery's assets and the remaining assets not yet been realized must be included in the liquidation account. On 22 June 2004, the claims made by the PRC joint venture partner for loss of fixed return under the Qingdao Joint Venture Agreement and damages in an aggregate of RMB15,000,000 were also dismissed by the China International Economic and Trade Arbitration Commission in Beijing. The Company will proceed with the winding-up of Qingdao Tannery in compliance with the above rulings.

Major Customers and Suppliers

For the year ended 31 December 2004, the amount of purchases attributable to the Group's largest supplier represented 21.18% of the Group's total purchases; and the aggregate amount of purchases (not including the purchases of items which are of a capital nature) attributable to the Group's five largest suppliers represented 69.97% of the Group's total purchases. In addition, the amount of turnover attributable to the Group's largest customer represented 24.28% of the Group's total turnover; and the aggregate amount of the turnover attributable to the Group's five largest customers represented 69.16% of the Group's total turnover. None of the Directors of the Company or their associates holds or any shareholders (which, to the best knowledge of the Directors, owns more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest suppliers or customers.

Employees

As at 31 December 2004, a total of 448 employees (2003: 1,018 employees) were employed by the Group. The pay levels of employees are made with reference to the Group's operating results and the employee's performance. The Group offered social and medical insurance and provident fund to all employees in different areas. The Company has adopted a share option scheme ("Share Option Scheme") in May 2002, and the purpose of which is to provide incentives to participants to contribute to the Group, and to enable the Group to recruit and retain quality employees to serve the Group on a long-term basis. Details of the Share Option Scheme are set out in the Report of the Directors.

Auditors – Services provided other than audit

Messrs. Ernst & Young, the auditors of the Group, have provided services to the Group other than the statutory audit work including the review of interim results and charges of such services were HK$186,000.