

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.).

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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.

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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.