

# Report of the Directors

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The directors have pleasure in submitting the interim report together with the unaudited condensed consolidated financial statements of Arnhold Holdings Limited (the "Company") together with its subsidiaries (collectively the "Group") for the six months ended 30 June 2005 (the "Period").

## MANAGEMENT DISCUSSION AND ANALYSIS

### Review of Operations

The Group continued to be engaged principally in its core business of trading of building materials and engineering equipment and its financial performance remained correlated to the level of construction activities in Hong Kong. During the Period, the Group recorded a turnover of HK\$115 million with gross profit of HK\$24.4 million (2004: HK\$154 million and HK\$27.3 million respectively). The decline in turnover was mainly caused by our decision to cancel certain low margin engineering equipment orders at the end of last year. Demand for building products was also relatively weak because most sizable projects commence construction in the second half of the year. However, gross profit margin improved from 17.8% to 21.1% as a result of the Group's focus on higher value-added trading activities. The Group's continued efforts in cost control and process flow improvement also resulted in a reduction of 10.6% in operating costs. Accordingly, Group's loss attributable to shareholders for the Period was reduced to HK\$1.5 million (2004: HK\$2.1 million, as restated).

The Group continued to consolidate its market position in Hong Kong and successfully improved its coverage of the Mainland and Macau. As a result, the Group's outstanding orders on hand at Period end amounted to HK\$149 million, representing an increase of 46.8% over the end of last year (At December 2004: HK\$101 million).

### Segmental Information

Revenues from the building products business were HK\$99.1 million, representing a decrease of 18.7% compared with HK\$121.9 million in the last corresponding period. Turnover of plumbing fixtures and tiles was HK\$27.1 million lower. The decrease in sales revenue was partially offset by the HK\$4.1 million improvement in marble export operations. Despite the substantial decrease in turnover, operating results were reduced by only 6.2% to HK\$21.7 million because of the improved margin in nearly all areas.

Turnover of the engineering business was decreased by 48.8% to HK\$16.3 million because of our decision to cancel certain low margin orders at the end of last year. Consequently, operating results were decreased from HK\$4.2 million to HK\$2.7 million. In order to capture future growth opportunities, the Group has located several new air handling products from Europe and North Asia for launching towards the end of the year.

### Capital Commitment

The Group commenced the construction work of its new marble processing factory in Dongguan, PRC. Upon completion of the new factory by end of the year, we expect to triple our production capacity and shall be able to meet the increasing overseas demand for marble mosaic. We estimate that the total capital expenditure for the new plant will be around HK\$20.0 million, of which HK\$4.7 million was paid as at end of the Period. The Group expects to finance this project from internal resources and bank credit facilities.

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## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### Financial Hedging

The Group adopts hedging policies for managing its risk exposure to foreign currency fluctuations and forward exchange contracts have been arranged with the Group's principal bankers to mitigate exchange risks. Further information of the forward exchange contracts is disclosed in the notes to the interim financial information.

### Liquidity and Financial Resources

The Group maintained a healthy balance sheet with no bank borrowing and zero gearing as at Period end (At 31 December 2004: Nil). The Group remained conservative in working capital management and maintained a breakeven position in terms of operating cashflow. As at Period end, cash balances amounted to HK\$73.9 million (At 31 December 2004: HK\$84.4 million). The decline in cash balances was largely caused by the payment of HK\$9.9 million final dividend declared in 2004.

Most of the Group's cash balances are placed in time deposits with reputable financial institutions. The Group will continue its conservative cash flow management policy and expects to meet its future financial requirements through internal resources and bank credit facilities.

### Contingent Liabilities

Certain subsidiaries have given undertakings to the banks that they will perform certain contractual non-financial obligations to third parties. In return, the banks have provided performance bonds and letters of guarantee to third parties on behalf of these subsidiaries. As at 30 June 2005, the amount of guarantees outstanding was HK\$1.0 million (At 31 December 2004: HK\$2.5 million).

### Banking facilities with assets pledged

A property with net book value of HK\$53.0 million at Period end held by a subsidiary of the Group is pledged to a bank to obtain banking facilities.

### Employees

At the end of the Period, the Group had approximately 340 and 110 employees in the Mainland and Hong Kong respectively. The Group continues to provide remuneration packages and training programmes to employees with reference to prevailing market practices. The Group adopted a new share option scheme on 11 July 2002 under which the directors of the Company, subject to the compliance of the Rules Governing the Listing of Securities (the "Listing Rules") on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), were authorised to grant share options to eligible persons as incentives. Details of share options granted were disclosed in the section "Share Option Scheme" of this report.

### Outlook

Hong Kong is still in the initial stages of recovery following years of economic restructuring. Market conditions remain competitive and the Group will allocate more resources to explore growth opportunities in Macau, the Mainland and mosaic exports. Our aim is to strengthen our leading position in Hong Kong and gradually expand our customer base overseas. With a healthy financial foundation and a dedicated, professional team, the Group remains cautiously optimistic it can take full advantage of the economic recovery.

# Report of the Directors

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## DIRECTORS

The directors of the Company during the Period and up to the date of this report are:

### Executive directors:

Michael John Green  
Daniel George Green  
Lai Ka Tak, Patrick

### Non-executive directors:

Augustus Ralph Marshall  
Christopher John David Clarke

### Independent non-executive directors:

V-Nee Yeh  
Thaddeus Thomas Beczak  
Simon Murray

## SHARE OPTION SCHEME

A Share Option Scheme ("the Scheme") was approved and adopted by the shareholders at a special general meeting of the Company on 11 July 2002. The following information relating to the Scheme is made pursuant to the requirements as contained in Chapter 17 of the Listing Rules (reference is made to the circular of the Company dated 24 June 2002 (the "Circular"). Terms defined in the Circular have the same meanings when used in the following summary unless the context requires otherwise):

### i) Purpose of the Scheme

The purpose of the Scheme is to recognize and acknowledge the contribution that Eligible Persons have made or may make to the Company and to attract and retain and motivate talented staff.

### ii) Participants of the Scheme

The participants of the Scheme shall be such Eligible Persons as the Board in its absolute discretion determines.

### iii) Maximum number of Shares available for issue under the Scheme

The maximum number of Shares which may be issued upon exercise of all outstanding Options to subscribe for Shares granted and yet to be exercised under the Scheme and any other share option scheme shall not exceed 10% of the total number of Shares in issue of the Company as at the date of approval of the Scheme. As at 30 June 2005 and the date of this report, 15,049,600 Shares were available for issue under the Scheme representing 6.7% of the total issued share capital of the Company.

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## SHARE OPTION SCHEME *(continued)*

### iv) Maximum entitlement to any one participant

Under the Scheme, the maximum entitlement to Options of each Eligible Person shall be such that the total number of Shares issued and to be issued upon exercise of Options granted and to be granted to him/her in any 12-month period up to each Commencement Date must not exceed 1% of the issued share capital of the Company at the relevant Commencement Date.

### v) Period and payment on acceptance of Options

Under the Scheme, an Offer may be accepted by an Eligible Person in whole or in part in respect of all Shares for which it is offered to such Eligible Person when the duplicate letter comprising acceptance of the Offer duly signed by the Eligible Person together with a remittance in favour of the Company of HK\$1.00 by way of consideration for the grant thereof is received by the Company within forty days from the Offer Date.

### vi) The basis of determining the exercise price

The Subscription Price in respect of any Option shall be not less than the highest of (i) the closing price of a Share as stated in the Stock Exchange's daily quotations sheet on the relevant Commencement Date in respect of such Option, which must be a Business Day; (ii) an amount equivalent to the mean closing price of a Share as stated in the Stock Exchange's daily quotations sheets for the five Business Days immediately preceding the relevant Commencement Date in respect of such Option, which must be a Business Day, and (iii) the nominal value of a Share.

### vii) Remaining life of the Scheme

The Scheme is valid and effective for a period of 10 years commencing on the Adoption Date unless otherwise terminated under the terms of the Scheme.

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## SHARE OPTION SCHEME *(continued)*

Details of Options granted to directors and employees under the Scheme as at 30 June 2005 were as follows:

	<b>Date of Options granted</b>	<b>Outstanding Options as at 1 January 2005</b>	<b>Granted during the Period</b>	<b>Exercised/ lapsed/ cancelled during the Period</b>	<b>Outstanding Options as at 30 June 2005</b>	<b>Subscription price per Share <i>HK\$</i></b>
<b>Directors</b>						
Daniel George	18 September 2003	1,200,000	–	–	1,200,000	0.500
Green	19 November 2004	2,000,000	–	–	2,000,000	0.602
Lai Ka Tak, Patrick	18 September 2003	1,500,000	–	–	1,500,000	0.500
	19 November 2004	1,700,000	–	–	1,700,000	0.602
Employees	18 September 2003	1,000,000	–	–	1,000,000	0.500
		<b>7,400,000</b>	<b>–</b>	<b>–</b>	<b>7,400,000</b>	

At the dates before the Options were granted, being 17 September 2003 and 18 November 2004, the market values per Share were HK\$0.500 and HK\$0.600 respectively.

The Options granted on 18 September 2003 can be exercised in two instalments, 50% of which at any time between 1 September 2005 and 30 August 2010 and the remaining 50% at any time between 1 September 2006 and 30 August 2010.

The Options granted 19 November 2004 can be exercised in two instalments, 50% of which at any time between 1 November 2006 and 30 August 2010 and the remaining 50% at any time between 1 November 2007 and 30 August 2010.

Apart from the Scheme mentioned above, at no time during the Period was the Company or its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of acquisition of shares in, or debentures of, the Company or any other body corporate. None of the directors (including their spouse and children under 18 years of age) have been granted, or have exercised, any rights to subscribe for Shares.

# Report of the Directors

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30 June 2005, the interests and short positions of each directors in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register maintained by the Company under Section 352 of the SFO or as notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

### Ordinary shares of HK\$0.10 each

	Personal interests	Family interests	Corporate interests	Number of shares held Trusts and similar interests	Equity derivatives (Note iii)	Total interests	Percentage of issued share capital
<i>Executive directors:</i>							
Michael John Green	1,272,000	–	–	166,093,617 (Note i)	–	167,365,617	74.55%
Daniel George Green	–	–	–	166,093,617 (Note ii)	3,200,000	169,293,617	75.41%
Lai Ka Tak, Patrick	–	–	–	–	3,200,000	3,200,000	1.43%
<i>Non-executive directors:</i>							
Augustus Ralph Marshall	–	–	–	–	–	–	–
Christopher John David Clarke	200,000	–	–	–	–	200,000	0.09%
<i>Independent non-executive directors:</i>							
V-Nee Yeh	74,444	–	–	–	–	74,444	0.03%
Thaddeus Thomas Beczak	–	–	–	–	–	–	–
Simon Murray	343,487	–	–	–	–	343,487	0.15%

#### Notes:

- (i) Such shares were held through corporations on behalf of the Michael Green Family Trust.
- (ii) Such shares were held through corporations on behalf of the Michael Green Family Trust in which Mr Daniel George Green has a beneficial interest.
- (iii) These represent interests of share options granted to directors under the share option scheme to subscribe for shares of the Company, further details of which are set out in the section "Share Option Scheme" of this report.

# Report of the Directors

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES *(continued)*

All interests in the shares and underlying shares of equity derivatives of the Company are long positions. None of the directors held any short position in the shares, underlying shares of equity derivatives or debentures of the Company.

Save as disclosed above, as at 30 June 2005, none of the directors and chief executives of the Company and/or any of their respective associates had any interested and short position in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO).

## SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

The register of substantial shareholders maintained under Section 336 of the SFO shows that as at 30 June 2005, the Company had been notified of the following substantial shareholder's interests, being 5% or more of the Company's issued ordinary share capital. These interests are in addition to those disclosed above in respect of the directors and chief executives:

Name of shareholder	Ordinary shares held	Percentage of total issued shares
Pacific Investments (BVI) Limited	16,957,431	7.55%

Pacific Investments (BVI) Limited is a wholly-owned subsidiary of Usaha Tegas Sdn. Bhd.

Save as disclosed above, as at 30 June 2005, the directors are not aware of any other persons who have interests or short positions in the shares, underlying shares of equity derivatives or debentures of the Company or any associated corporations (within the meaning of Part XV of the SFO) which would be required to disclose to the Company pursuant to Part XV of the SFO.

## INTERIM DIVIDEND

The board of directors has resolved that no interim dividend be paid for the Period (2004: Nil).

## PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not redeemed any of its shares during the six months ended 30 June 2005. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the Period.

# Report of the Directors

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## CORPORATE GOVERNANCE

### *The Code on Corporate Governance Practices*

The Company is committed to maintaining high standards of corporate governance in fulfilling its responsibilities to shareholders.

The Stock Exchange has promulgated the Code on Corporate Governance Practices (the "CG Code") which came into effect in January 2005. Throughout the Period, the Group has complied itself with all the code provisions of the CG Code except that:

- non-executive directors are not appointed for a specific term and directors are not subject to retirement by rotation at least once every three years. The Bye-laws of the Company (the "Bye-laws") provided that save that the Board shall have the absolute discretion to determine whether or not the Chairman and/or the Managing Director of the Company shall be subject to retirement by rotation, each annual general meeting one-third of the directors for the time being (or, if their number is not a multiple of three (3), the number nearest but not less than one-third) shall retire from office by rotation. To ensure the smooth running and continuous adhering to the strategic view of the Company, the Board believes that it is more practical for the Chairman/Managing Director not subject to retirement by rotation. The Board also considers it not necessary to appoint non-executive directors for a specific term as the Bye-laws enable all directors, including those non-executives, to retire at least once every three years;
- the Company has not adopted the terms of reference of the Remuneration Committee as prescribed in the CG Code in full but has duly adopted its own terms of reference that better suits the practical situation of the Company. The Board considers that the key responsibilities of the Remuneration Committee shall focus on assessing the reasonableness of the remuneration of the directors and fixing the remuneration packages for all directors. The Board understands that the terms of reference adopted by the Remuneration Committee deviates from rules B.1.3(a)-(e) of the CG Code as its scope does not cover the senior management of the Company. However, the Board considers that it is not practical for the Remuneration Committee to adopt the full terms stipulated in the CG Code because the management structure of the Group is relatively simple and its scale of operations is modest. It is also noted that the executive directors have extensive experience in the industry and are fully qualified to determine the remuneration packages of employees of the Company including the senior management. It has always been the Company's practice to provide compensation with reference to the prevailing market conditions. The remuneration details, together with the financial statements of the Company, are also subject to review and approval by the Board annually. As a result, it is considered more practical not to delegate the responsibility to the Remuneration Committee to determine any specific remuneration packages of the senior management. The Board believes that such arrangement a) will maintain a formal and transparent procedure for setting policy on executive directors' remuneration and for fixing the remuneration packages for all directors; b) will not affect the Company in providing transparent information of the directors' remuneration to the public; c) will give adequate authority to the Remuneration Committee to protect the interest of the Company and the minority shareholders; d) will enable the Company to maintain a reasonable balance of cost and benefit.



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## CORPORATE GOVERNANCE *(continued)*

### *The Code for Securities Transactions by Directors*

The Company has adopted a code of conduct regarding directors' securities transactions on terms no less exacting than the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in the Listing Rules. The Company, having made specific enquiry, confirms that all directors of the Company complied throughout the Period with the required standard set out in the Model Code and the Company's code of conduct regarding directors' securities transactions.

## AUDIT COMMITTEE

The Audit Committee of the Company provides an important link between the Board and the Company's auditors in matters coming within the scope of the Group audit. It also reviews the effectiveness of the external audit and of internal controls and risk evaluation. The Committee comprises two independent non-executive directors, namely Messrs V-Nee Yeh and Thaddeus Thomas Beczak and a non-executive director, Mr Christopher John David Clarke.

The Audit Committee has reviewed the unaudited condensed consolidated financial statements for the Period.

On behalf of the Board  
**Michael John Green**  
*Chairman*

Hong Kong, 8 September 2005