

Management Discussion and Analysis

Results

The Group's audited consolidated profit attributable to shareholders for the year ended 31 December 2005 was HK\$5,403,000, a rise of 8% when compared with the profit (restated) for the same period last year.

The audited net asset value of the Group as at 31 December 2005 was HK\$172,434,000, an increase of HK\$13,287,000 and HK\$12,345,000 over the net asset value as at 31 December 2004 (restated) and 30 June 2005 respectively.

No final dividend is recommended by the Board of Directors (the "Board") for the year ended 31 December 2005.

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 would pay to other shareholders HK\$0.28 in cash consideration for each ordinary share of the Company held by them. The Proposal did not proceed as the resolution to approve the Scheme was not approved by Independent Shareholders at the Court Meeting held on 22 September 2005. Details of the results of the Court Meeting were set out in the Company's announcement dated 22 September 2005.

Operations Review

The opening of Xuzhou Gangwei Leather Co. Ltd. in March 2005 marked a solid achievement of the Group in the course of its strategic shift of operations to the north. In the meantime, the momentum of steady growth in turnover of the Xuzhou production base has continued. Over the past year, we were steadfast in enhancing the management of production, and accelerating efforts in quality control as well as product and technology development. On the back of these measures, breakthrough achievement was recorded in terms of marketing and distribution.

The Group's customer base has been further strengthened with the addition of certain valued customers – leading shoe manufacturers in China. It was contributed by our customer-oriented marketing strategy with sales personnel specifically assigned to focus on the needs of each of these customers. On the other hand, our new distribution strategy of "one agent for one product and one market" has proved its worth. It helped minimize any possible harmful impact on the Group due to direct competition among various agents, and represented a fundamental change to the Group's traditional passive approach to distribution.

Consolidated turnover for the year was HK\$258,543,000, a drop of HK\$23,408,000 or 8.3% from HK\$281,951,000 for the previous year. The decrease was primarily attributable to the suspended operations of Foshan City Nanhai Tong Yuan Tanning Co., Ltd in the first half of 2004, resulting in a drop of HK\$66,037,000 in turnover. However, this negative impact was largely offset by the increase in turnover of the Xuzhou production base as a result of the Group's strategic shift of operations to the

Management Discussion and Analysis

north. During the year, turnover of the Xuzhou production base was HK\$255,212,000, a rise of 20.05% over the previous year. Turnover of cowhides for the year decreased by 6.88% to HK\$237,370,000 (2004: HK\$254,917,000) whereas cow split, coated cow split and others dropped by 21.68% to HK\$21,173,000 (2004: HK\$27,034,000).

Total leather production of the Group declined by 3,342,000 sq.ft. to 14,211,000 sq.ft. for the year. Production of cowhides dropped by 17.95% to 13,411,000 sq.ft. (2004: 16,344,000 sq.ft.) whereas cow split, coated cow split and others down by 33.83% to 800,000 sq.ft. (2004: 1,209,000 sq.ft.).

As at 31 December 2005, the Group's consolidated inventories amounted to HK\$122,468,000, reduced by HK\$18,621,000 and HK\$9,197,000 as compared with 31 December 2004 and 30 June 2005 respectively. It was primarily a function of our active attempts to clear the inventories 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 less popular and unprofitable items. These measures have proved effective as our inventory level was reduced, and problems on recovering trade receivables were alleviated.

Balance of trade receivables as at 31 December 2005 was HK\$24,856,000. After deducting the provisions for doubtful debts of HK\$2,991,000, trade receivables amounted to HK\$21,865,000, a reduction of HK\$4,044,000 and HK\$13,279,000 as compared with 31 December 2004 and 30 June 2005 respectively. Trade receivables turnover was 10.8 times and average collection period was 34 days, an increase of 6 days as compared with 28 days in 2004.

Financial Review

As at 31 December 2005, the Group's interest-bearing borrowings amounted to HK\$84,176,000 (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\$19,226,000 in Renminbi and HK\$54,600,000 in US dollars. All of these interest-bearing borrowings are charged at fixed rate.

As at 31 December 2005, the Group's cash and bank balances amounted to HK\$69,832,000 (as at 31 December 2004: HK\$98,040,000), and denominated in Hong Kong dollars (HK\$2,731,000), Renminbi (equivalent to HK\$63,386,000) and US dollars (equivalent to HK\$3,715,000) respectively.

As at 31 December 2005, after deduction of cash and bank deposits, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 8.32% (as at 31 December 2004 (restated): 1.62%). Loan facilities bear interest at approximately 3.8% to 4.15% per annum. All of the Group's total borrowings are repayable within one year. Interest expense incurred by the Group during the year was HK\$3,734,000, a drop of 34.88% as compared with the same period last year.

Net cash outflow from operating activities for the year was HK\$17,540,000 and net cash outflow from financing was HK\$15,241,000. Net decrease in cash and cash equivalents for the year amounted to HK\$28,609,000.

As at 31 December 2005, net non-current assets including properties, plant and equipment, investment properties and prepaid land lease payments were HK\$86,325,000, a reduction of HK\$8,706,000 as compared with the restated figure as at 31 December 2004. The Group's capital expenditure for the year

Management Discussion and Analysis

amounted to HK\$987,000 (2004: HK\$2,186,000). It was incurred mainly for the replacement of the leather manufacture machinery and equipment, a move to cope with the production requirement of the Xuzhou production base.

As at 31 December 2005, certain of the Group's buildings, investment properties, bank deposits, bank notes, and machinery and equipment with a total net book value of HK\$40,220,000 (31 December 2004: HK\$20,969,000) were pledged to secure general banking facilities granted to the Group.

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 notes to the Financial Statements headed "Contingent Liabilities".

Major Customers and Suppliers

For the year ended 31 December 2005, the amount of purchases attributable to the Group's largest supplier represented 26.6% 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 84.6% of the Group's total purchases. In addition, the amount of turnover attributable to the Group's largest customer represented 25.5% of the Group's total turnover; and the aggregate amount of the turnover attributable to the Group's five largest customers represented 50.3% 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 2005, a total of 622 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.