

Results

The Group's consolidated profit attributable to shareholders for the year ended 31 December 2006 was HK\$20,657,000, representing an increase of HK\$15,254,000 or 282% when compared with the profit for the same period of last year. The increase in profit was mainly due to the continued improvement in the operating results of the production base in Xuzhou and a gain on disposal of subsidiaries.

The net asset value of the Group as at 31 December 2006 was HK\$199,721,000, representing an increase of HK\$27,287,000 and HK\$25,344,000 as compared to the net asset value as at 31 December 2005 and 30 June 2006 respectively.

The Board does not recommend the payment of final dividend for the year ended 31 December 2006.

Business Review

The business volume recovered rapidly with the production base in Xuzhou entering the early phase of large-scale operation in the wake of the successful shift of operations to the northern part of China. Since the outsourcing of upstream production processes has been completed and in place, the shortfall arising from the upstream production processes prior to outsourcing has been resolved, which effectively breaks through the bottleneck constraint in production and greatly releases the potential productivity of the production base in Xuzhou. The Group's leather production volume for the year was 23,047,000 sq. ft., an increase of 8,836,000 sq. ft. compared to 14,211,000 sq. ft. for the same period last year. The production of cowhides increased by 71.9% to 23,047,000 sq. ft. (2005: 13,411,000 sq. ft.) whereas the production of coated cow split and others decreased by 100% to zero sq. ft. (2005: 800,000 sq. ft.). The rise in production volume marks the successful completion of the Group's strategic shift of operations to the northern part of China.

Product development will continue to be one of our priority tasks. Through the introduction of technical staffs, technical support services from chemical suppliers, the Group's leather production technology has been further consolidated. Apart from our traditional bestseller such as nappa leather and natural-look nappa leather series, the breakthrough in the production technology of calf skin leather resulting in the improvement of the quality of calf skin leather, these products have become our new areas of profit growth. At the same time, we strive for products innovations and promotion campaigns. Of which, new products have been successfully developed such as wax resemble nappa leather series which are well-received by the market. The product mix has become broader, and thus, the Group's ability to face the risks of market changes has been strengthened and it also helps the Group in exploring a further breakthrough in marketing.

During the year, the Group took an initiative to push forward with the transformation from production oriented to sales and marketing oriented, to optimize our staff incentive mechanism and to improve the segregation of duties and responsibilities of each division. The Group initiated various sales and marketing activities such as hosting industry summit meetings, becoming members of the related industry associations, participating in leather exhibitions and providing customized services to key customers in key regions. This also helps building up our image of being a reputable and well-established enterprise with a modernized management team in the industry, thus reinforcing our sales. The Group's regional sales system has also been enhanced and improved, with the direct sales made to renowned footwear manufacturers seeing marked growth. Other than the significant growth in turnover, the Group has become much more capable in dealing with market risk and the recoverability risk of receivables.

Business Review (Continued)

During the year, the consolidated turnover of the Group was HK\$419,975,000, representing an increase of HK\$161,432,000, or 62.4% from HK\$258,543,000 of the same period of last year. The increase in turnover was mainly due to the effectiveness of the strategy of large-scale operation. In the midst of the surging prices of raw materials, the stringent environmental protection policies, the changes in the industrial policies of the State and the continuous international trading conflicts, a large number of small- to medium-sized tanneries were closed as a result. The Group had the foresight to implement the strategy of large-scale operation in order to secure the survival and development through economies of scale. In the face of the problems arising from the aging of equipments, insufficient production premises and lack of synergy between the upstream and downstream processing, the Group took the initiative to mobilize the resources and to go along with an appropriate operation strategy, by which the Group succeeded in beating out a path to operate the business at high efficiency.

During the year, the turnover of cowhides amounted to HK\$373,013,000 (2005: HK\$237,370,000), an increase of 57.1%; the turnover of coated cow split and other products amounted to HK\$46,962,000 (2005: HK\$21,173,000), an increase of 121.8%.

As at 31 December 2006, the Group's consolidated inventories amounted to HK\$210,076,000, an increase of HK\$87,608,000 and HK\$42,502,000 compared with 31 December 2005 and 30 June 2006 respectively. The increase in inventories was mainly due to the implementation of an extensive foresighted strategy in procurement of hides and imported chemicals on a large scale, which has secured the production and at the same time significantly reduced costs.

As at 31 December 2006, the trade receivables of the Group was HK\$25,453,000. After deducting the impairment of trade receivables of HK\$1,422,000, the balance net of impairment amounted to HK\$24,031,000, an increase of HK\$2,166,000 and a decrease of HK\$7,936,000 as compared with 31 December 2005 and 30 June 2006 respectively. Trade receivables turnover was 18 times, and the average collection period was 20 days, a decrease of 14 days compared with 34 days in 2005.

Financial Review

As at 31 December 2006, the Group's interest-bearing borrowings amounted to HK\$100,309,000 (as at 31 December 2005: HK\$84,176,000). Of which, interest-bearing borrowings in Hong Kong dollars amounted to HK\$10,350,000, interest-bearing borrowings in Renminbi amounted to HK\$19,908,000, and interest-bearing borrowings in US dollars amounted to HK\$70,051,000. All of these interest-bearing borrowings were charged at floating interest rate.

As at 31 December 2006, the Group's cash and bank balances amounted to HK\$54,424,000 (as at 31 December 2005: HK\$69,832,000), which were denominated in Hong Kong dollars (HK\$10,143,000), Renminbi (equivalent to HK\$43,575,000) and US dollars (equivalent to HK\$706,000).

As at 31 December 2006, after deduction of cash and bank balances, the ratio of the net value of our interest-bearing borrowings to shareholders' equity was 22.97% (as at 31 December 2005: 8.32%). The annual interest rate of the borrowings was approximately 4.15% to 6.5%. Of the Group's total borrowings, all are repayable within one year except for the amount due to immediate holding company amounted to HK\$30,258,000. During the year, the Group's interest expenses amounted to HK\$5,726,000, an increase of 53.3% from the same period of last year.

Financial Review (Continued)

During the year, net cash outflow from operating activities was HK\$27,578,000, which mainly represented our forward-looking purchase strategy on a mass scale of raw materials to ensure our production and minimize the effect of rise in prices of raw materials. Our net cash inflow from financing activities was HK\$18,248,000, and the cash and cash equivalents was decreased by HK\$17,335,000.

As at 31 December 2006, the net value of non-current assets including property, plant and equipment and investment property amounted to HK\$34,785,000, a decrease of HK\$51,540,000 over the net value as at 31 December 2005. The decrease was mainly due to the disposal of subsidiaries and provision for depreciation. The capital expenditure for the year amounted to HK\$6,525,000 (2005: HK\$987,000), which was mainly due to the renewal and purchase of leather manufacturing machines and equipments to cope with the production requirements of the production base in Xuzhou.

As at 31 December 2006, certain of the Group's bank deposits, machinery and equipments with a total net book value of HK\$16,568,000 (as at 31 December 2005: HK\$40,220,000) were pledged to secure general banking facilities granted to the Group.

Major Customers and Suppliers

For the year ended 31 December 2006, the amount of purchases attributable to the Group's largest supplier represented 25.1% of the Group's total purchases; and the aggregate amount of purchases (excluding the purchases of items of a capital nature) attributable to the Group's five largest suppliers represented 69.8% of the Group's total purchases. In addition, the amount of turnover attributable to the Group's largest customer represented 8.9% of the Group's total turnover; and the aggregate amount of the turnover attributable to the Group's five largest customers represented 29.0% of the Group's total turnover. None of the Directors of the Company or their associates, or any shareholders (which, to the best knowledge of the Directors of the Company, owns more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest suppliers or customers.

Risk of Exchange Rate

The assets, liabilities and transactions of the Group are basically denominated in Hong Kong dollars, US dollars or Renminbi. During the year, the exchange rates of Hong Kong dollars and US dollars were relatively stable without causing any material risk of exchange rate; as to the appreciation of Renminbi, since the sales of the Group are settled in Renminbi, whereas the purchases are made in Renminbi or US dollars, the Group does not have material exposure to foreign exchange.

Disposal of Subsidiaries

On 1 November 2006, the Group disposed its subsidiary, Sun Perfect Limited and its subsidiary, for a total consideration of HK\$8,500,000, which recorded a gain of HK\$14,119,000. Details of the disposal were set out in the announcement of the Company dated 1 November 2006 and in the notes 31 and 35(a)(vi) to the financial statements.

Employees

As at 31 December 2006, a total of 871 employees (2005: 622) were employed by the Group. The remuneration policy is based on 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.