

The directors (the “Directors”) of Guangdong Tannery Limited (the “Company”) herein present their report and the audited financial statements of the Company and its subsidiaries (the “Group”) for the year ended 31 December 2006.

Principal Activities

The Company acts as an investment holding company and provides corporate management services to its subsidiaries. The Group is principally engaged in the processing and sale of semi-finished and finished leather. The activities of the subsidiaries and associates are set out in notes 15 and 16 to the financial statements respectively. There were no significant changes in the nature of the Group's principal activities during the year.

Segment Information

An analysis of the Group's revenue and contribution to results by principal activity for the year ended 31 December 2006 is set out in note 4 to the financial statements.

Results and Dividends

The results of the Group for the year ended 31 December 2006 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 31 to 86.

No interim dividend was paid during the year and the Directors do not recommend the payment of a final dividend in respect of the year ended 31 December 2006.

Financial Summary

The following is a summary of the published results and assets and liabilities of the Group for the last five financial years, as extracted from the audited financial statements and reclassified as appropriate and adjusted to reflect the change in accounting policy. The summary does not form part of the audited financial statements.

Results

	2006 HK\$'000	Year ended 31 December			
		2005 HK\$'000	2004 HK\$'000 <i>(Restated)</i>	2003 HK\$'000 <i>(Restated)</i>	2002 HK\$'000 <i>(Restated)</i>
Revenue					
Continuing operations	419,975	258,543	281,951	381,601	503,088
Discontinued operations	—	—	—	—	25,967
	419,975	258,543	281,951	381,601	529,055
Profit/(Loss) from operating activities	31,146	8,604	11,941	(95,118)	(198,453)
Finance costs	(5,726)	(3,734)	(5,734)	(5,948)	(6,387)
Share of results of associates	—	—	—	—	—
Profit/(Loss) before tax	25,420	4,870	6,207	(101,066)	(204,464)
Continuing operations	25,420	4,870	6,207	(101,066)	(204,464)
Discontinued operations	—	—	—	—	(376)
	25,420	4,870	6,207	(101,066)	(204,840)
Tax	(4,763)	533	(1,203)	286	—
Continuing operations	(4,763)	533	(1,203)	286	—
Discontinued operations	—	—	—	—	—
	(4,763)	533	(1,203)	286	—
Profit/(Loss) before minority interests	20,657	5,403	5,004	(100,780)	(204,840)
Minority interests	—	—	—	—	177
Net Profit/(loss) from ordinary activities attributable to shareholders	20,657	5,403	5,004	(100,780)	(204,663)

Financial Summary (Continued)

Assets and liabilities

	2006 HK\$'000	As at 31 December			
		2005 HK\$'000	2004 HK\$'000 (Restated)	2003 HK\$'000 (Restated)	2002 HK\$'000 (Restated)
Assets					
Property, plant and equipment, investment property and prepaid land lease payments	34,785	86,325	95,031	100,228	152,831
Interest in an associate	1,219	4,336	—	—	—
Other long term assets	—	—	—	—	1,268
Current assets	345,858	291,636	301,883	361,503	301,479
Total assets	381,862	382,297	396,914	461,731	455,578
Liabilities					
Current liabilities	150,695	205,146	233,002	300,824	181,546
Long term liabilities	31,446	4,717	4,765	4,196	18,882
Total liabilities	182,141	209,863	237,767	305,020	200,428
Minority interests	—	—	—	—	—
Net assets	199,721	172,434	159,147	156,711	255,150

Property, Plant and Equipment and Investment Property

Details of movements in property, plant and equipment, and investment property of the Company and the Group during the year are set out in notes 12 and 13 to the financial statements.

Share Capital and Share Options

There were no movements in either the Company's authorized or issued share capital during the year. Details of the Company's movements in the share options during the year, together with the reasons therefore, are set out in note 29 to the financial statements.

Purchase, Redemption or Sale of Listed Securities of the Company

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 30 to the financial statements and in the consolidated statement of changes in equity respectively.

Distributable Reserves

At 31 December 2006, no reserves, calculated in accordance with the provisions of Section 79B of the Companies Ordinance, is available for cash distribution.

Charitable Contributions

The Group did not make any charitable contributions during the year (2005: Nil).

Share Options of the Company

In assessing the theoretical aggregate value of the share options granted during the year, the Binomial option pricing model (the "Model")[#] has been used.

Share options granted during the year ended 31 December 2006:

Date of Grant	:	3 April 2006
Vesting Period	:	3 April 2006–3 July 2006
Exercise Period	:	4 July 2006–3 July 2011
Exercise Price	:	HK\$0.196 per share

	Number of options at 3 April 2006	Options value at 3 April 2006 (Note (2)) HK\$	Number of options at 31 December 2006	Options value at 31 December 2006 (Note (3)) HK\$
Grantee:				
Employee	1,000,000	110,000	1,000,000	100,000
Total	1,000,000	110,000	1,000,000	100,000

Notes:

- (1) The closing price of the ordinary shares of the Company immediately before the date on which the options were granted was HK\$0.191.

Share Options of the Company (Continued)

Notes: (Continued)

- (2) According to the Model, the theoretical aggregate value of the options was estimated at HK\$110,000 as at 3 April 2006 (when the options were granted) with the following variables and assumptions:

Risk Free Rate	:	4.4298%, being the approximate yield of the 5-year Exchange Fund Note traded on 3 April 2006
Expected Volatility	:	61.73%, being the annualised volatility of the closing price of the ordinary shares of the Company from 4 April 2005 to 3 April 2006
Expected Dividend Yield	:	Nil
Expected Life of the Options	:	5.25 years
Assumptions	:	There is no material difference between the expected volatility over the whole life of the options and the historical volatility of the ordinary shares of the Company over the period from 4 April 2005 to 3 April 2006.

- (3) According to the Model, the theoretical aggregate value of the outstanding options was estimated at HK\$100,000 as at 31 December 2006 with the following variables and assumptions:

Risk Free Rate	:	3.715%, being the approximate yield of the 5-year Exchange Fund Note traded on 31 December 2006
Expected Volatility	:	57.45%, being the annualised volatility of the closing price of the ordinary shares of the Company from 1 January 2006 to 31 December 2006
Expected Dividend Yield	:	Nil
Expected Life of the Options	:	4.5 years
Assumptions	:	There is no material difference between the expected volatility over the whole life of the options and the historical volatility of the ordinary shares of the Company over the period from 1 January 2006 to 31 December 2006.

- (4) Options forfeited, if any, before the expiry of the options will be treated as lapsed options which will be added back to the number of ordinary shares available to be issued under the relevant share option scheme.

The Model is developed to estimate the fair value of publicly traded options that have no vesting restriction and are fully transferable. The Model is only one of the commonly used models to estimate the fair value of an option. The value of an option varies with different variables of certain subjective assumptions. Any change in the variables so adopted may materially affect the estimation of the fair value of an option.

Directors

The Directors during the year and up to the date of this report were:

Zhang Chunting	<i>(Chairman)</i>
Deng Rongjun	<i>(Managing Director)</i>
Zhang Yaping	<i>(appointed on 9 January 2007)</i>
Xiong Guangyang	
Fung Lak*	
Choi Kam Fai Thomas*	
Chan Cheong Tat*	<i>(appointed on 22 March 2006)</i>
Ho Lam Lai Ping Theresa	

* Independent Non-Executive Director

Mr. Zhang Yaping, who was appointed a Director of the Company after the last annual general meeting of the Company is due to retire pursuant to Article 77 of the Company's Articles of Association at the forthcoming annual general meeting of the Company. Being eligible, he offers himself for re-election.

Mr. Zhang Chunting and Mr. Fung Lak are due to retire by rotation from the board of Directors in accordance with Article 82 of the Company's Articles of Association at the forthcoming annual general meeting of the Company. Being eligible, they offer themselves for re-election.

Directors' Service Contracts

No Directors proposed for re-election at the forthcoming annual general meeting has a service contract with the Group which is not determinable within one year without payment of compensation, other than statutory compensation.

Directors' Interests in Contracts of Significance

No contracts of significance to which the Company, its subsidiaries, its holding companies or any of its fellow subsidiaries was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Directors' Interests and Short Positions in Securities

As at 31 December 2006, the Directors and chief executives of the Company and their respective associates had the following interests and short positions in the shares, underlying shares or 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 pursuant to Section 352 of the SFO; or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"):

(1) Interests and short positions in the Company

(a) Interests in ordinary shares

Name of Director	Capacity/ nature of interests	Number of ordinary shares interested ⁽¹⁾	Long/short position	Approximate percentage of holding
Zhang Chunting	Personal	4,500,000	Long position	0.86%
Deng Rongjun	Personal	1,500,000	Long position	0.29%
Xiong Guangyang	Personal	5,200,000	Long position	0.99%

Notes:

- (1) All relevant shares were in fact only allotted on 9 January 2007. However, as the options relating to those shares were exercised during the year, for disclosure purposes, the number of ordinary shares interested set out above include also all the relevant shares.
- (2) The number of ordinary shares of the Company actually in issue as at 31 December 2006 was 524,154,000 and therefore without including therein also any of the relevant shares referred to in Note (1) above.

Directors' Interests and Short Positions in Securities (Continued)

(1) Interests and short positions in the Company (Continued)

(b) Interests in options relating to ordinary shares

Name of Director	Number of options held as at 1 January 2006	Options granted during the year ended 31 December 2006 Date (dd/mm/yyyy)	Number	Exercisable period (dd/mm/yyyy) (Note)	Total consideration paid for options (HK\$)	Price per ordinary share payable on exercise of options (HK\$)	Number of options exercised during the year ended 31 December 2006	Number of options held as at 31 December 2006	Long/Short Position
Zhang Chunting	2,500,000	—	—	10/09/2003 – 09/09/2008	1.00	0.220	2,500,000	—	Long position
	2,000,000	—	—	12/05/2004 – 11/05/2009	1.00	0.246	2,000,000	—	Long position
Deng Rongjun	1,500,000	—	—	12/05/2004 – 11/05/2009	1.00	0.246	1,500,000	—	Long position
Xiong Guangyang	3,000,000	—	—	10/09/2003 – 09/09/2008	1.00	0.220	3,000,000	—	Long position
	2,200,000	—	—	12/05/2004 – 11/05/2009	1.00	0.246	2,200,000	—	Long position
Fung Lak	300,000	—	—	10/09/2003 – 09/09/2008	1.00	0.220	—	300,000	Long position
	300,000	—	—	12/05/2004 – 11/05/2009	1.00	0.246	—	300,000	Long position

Note: If the last day of any of the option period is not a business day in Hong Kong, the option period shall end at the close of business on the business day preceding that day.

(2) Interests and short positions in Guangdong Investment Limited ("GDI")

(a) Interests in ordinary shares of GDI

Name of Director	Capacity/nature of interests	Number of ordinary shares held	Long/short position	Approximate percentage of holding
Ho Lam Lai Ping Theresa	Personal	3,000,000	Long position	0.05%

Note: The number of ordinary shares of GDI in issue as at 31 December 2006 was 6,090,948,071.

(b) Interests in options relating to ordinary shares of GDI

Name of Director	Number of options held as at 1 January 2006	Options granted during the year ended 31 December 2006 Date (dd/mm/yyyy)	Number	Exercisable period (dd/mm/yyyy) (Note)	Total consideration paid for options (HK\$)	Price per ordinary share payable on exercise of options (HK\$)	Number of options exercised during the year ended 31 December 2006	Number of options held as at 31 December 2006	Long/Short Position
Ho Lam Lai Ping Theresa	900,000	—	—	05/03/2003–04/03/2008	1.00	0.96	900,000	—	Long position
	1,500,000	—	—	08/08/2003–07/08/2008	1.00	1.22	1,500,000	—	Long position
	1,500,000	—	—	07/05/2004–06/05/2009	1.00	1.59	—	1,500,000	Long position
	1,000,000	—	—	25/08/2004–24/08/2009	1.00	1.25	—	1,000,000	Long position

Note: If the last day of any of the option period is not a business day in Hong Kong, the option period shall end at the close of business on the business day preceding that day.

Directors' Interests and Short Positions in Securities (Continued)

(3) Interests and short positions in Kingway Brewery Holdings Limited ("Kingway")

Name of Director	Capacity/ nature of interests	Number of ordinary shares held	Long/short position	Approximate percentage of holding
Ho Lam Lai Ping Theresa	Personal	80,000	Long position	0.0057%

Note: The number of ordinary shares of Kingway in issue as at 31 December 2006 was 1,396,368,000.

Save as disclosed above, as at 31 December 2006, to the knowledge of the Company, none of the Directors or chief executives of the Company or their respective associates had any interests and short positions in the shares, underlying shares or debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO; or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

Substantial Shareholders' Interests

As at 31 December 2006, so far as is known to any Director or chief executive of the Company, the following persons (other than a Director or chief executive of the Company) had interests in five per cent. or more of the issued share capital of the Company as recorded in the register to be kept by the Company under Section 336 of the SFO. Details of the interests in the shares or underlying shares of the Company as notified to the Company are set out below:

Name of Shareholders	Capacity/nature of interests	Number of ordinary shares held	Long/short position	Approximate percentage of the Company's issued ordinary share capital
廣東粵港投資控股有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) (<i>Note</i>)	Beneficial owner/ interest of controlled corporation	375,100,000	Long position	71.56%
GDH Limited	Beneficial owner/ interest of controlled corporation	375,100,000	Long position	71.56%

Note: The attributable interest which 廣東粵港投資控股有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) has in the Company is held through its 100 per cent. direct interest in GDH Limited.

Substantial Shareholders' Interests (Continued)

Save as disclosed above, no other persons (other than a Director or chief executive of the Company) known to any Director or chief executive of the Company as at 31 December 2006 had an interest or short position in the shares or underlying shares of the Company as recorded in the register required to be kept by the Company under Section 336 of the SFO.

Arrangements to Acquire Shares or Debentures

Save as disclosed in the sections headed "Directors' Interests and Short Positions in Securities" of this report, and in note 29 to the financial statements, at no time during the year was the Company, any subsidiaries or holding company of the Company or any subsidiaries of the Company's holding company, a party to any arrangements to enable the Directors or their spouse or children under 18 years of age to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Connected Transaction

Details of the connected transaction are disclosed in note 35(a)(vi).

Subsequent Event

Details of the significant subsequent event of the Group are set out in note 38 to the financial statements.

Public Float

As at the date of this report, the Company has maintained the prescribed public float under the Listing Rules based on the information that is publicly available to the Company and within the knowledge of the Directors.

Auditors

A resolution will be proposed at the forthcoming annual general meeting for the re-appointment of Messrs. Ernst & Young as the auditors of the Company.

By order of the Board
Zhang Chunting
Chairman

Hong Kong, 30 March 2007