粵海制革有限公司

GUANGDONG TANNERY LIMITED

(Incorporated in Hong Kong with limited liability)

(Stock code: 1058)

INTERIM RESULTS FOR 2005

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.).

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.

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.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

		Six months ended 30 June	
		2005	2004
	Notes	***HK$'000***	*HK$'000*
		(Unaudited)	*(Unaudited)*
			(Restated)
TURNOVER	2	**95,077**	162,836
Cost of sales		**(82,922)**	(146,094)
Gross profit		**12,155**	16,742
Other income and gains		**2,208**	1,640
Selling and distribution costs		**(776)**	(842)
Administrative expenses		**(12,143)**	(11,952)
Other operating profit/(expenses), net		**(116)**	291
Finance costs		**(1,788)**	(3,104)
PROFIT/(LOSS) BEFORE TAX		**(460)**	2,775
Tax	4	**(55)**	—
PROFIT/(LOSS) FOR THE PERIOD		**(515)**	2,775
EARNINGS/(LOSS) PER SHARE	5		
— Basic		**HK(0.10) cent**	HK0.53 cent
— Diluted		**N/A**	N/A

CONDENSED CONSOLIDATED BALANCE SHEET

	30 June 2005 HK$'000 (Unaudited)	31 December 2004 HK$'000 (Audited) (Restated)
NON-CURRENT ASSETS		
Fixed assets	**89,951**	91,296
Land lease payments	**3,781**	3,828
Total non-current assets	**93,732**	95,124
CURRENT ASSETS		
Inventories	**131,665**	141,089
Receivables, prepayments and deposits	**79,541**	54,698
Tax recoverable	**7,038**	7,040
Loan to an officer	**898**	923
Pledged and frozen bank balances	**12,195**	14,794
Cash and bank balances	**44,595**	83,246
Total current assets	**275,932**	301,790
CURRENT LIABILITIES		
Trade and bills payables	**19,838**	38,864
Accruals and other liabilities	**26,928**	19,781
Due to a PRC joint venture partner	**1,131**	1,131
Loans from the immediate holding company	**29,128**	46,026
Loan from a fellow subsidiary	**54,600**	54,600
Provisions	**72,600**	72,600
Total current liabilities	**204,225**	233,002
NET CURRENT ASSETS	**71,707**	68,788
TOTAL ASSETS LESS CURRENT LIABILITIES	**165,439**	163,912
NON-CURRENT LIABILITIES		
Deferred tax liabilities	**(5,350)**	(4,765)
	160,089	159,147
CAPITAL AND RESERVES		
Issued capital	**52,415**	52,415
Reserves	**107,674**	106,732
	160,089	159,147

Notes:

(1) ACCOUNTING POLICIES

The unaudited condensed consolidated interim financial statements are prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting". The accounting policies and basis of preparation adopted in the preparation of the unaudited condensed consolidated interim financial statements are the same as those used in the preparation of the Group's audited annual financial statements for the year ended 31 December 2004, except in relation to the following new and revised Hong Kong Financial Reporting Standards ("HKFRSs", which also include HKASs and interpretations) that affect the Group and are adopted for the first time for the current period's financial statements:

- HKAS 1 Presentation of Financial Statements
- HKAS 2 Inventories
- HKAS 7 Cash Flow Statements
- HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- HKAS 10 Events after the Balance Sheet Date
- HKAS 12 Income Taxes
- HKAS 16 Property, Plant and Equipment
- HKAS 17 Leases
- HKAS 18 Revenue
- HKAS 19 Employee Benefits
- HKAS 21 The Effects of Changes in Foreign Exchange Rates
- HKAS 23 Borrowing Costs
- HKAS 24 Related Party Disclosures
- HKAS 27 Consolidated and Separate Financial Statements
- HKAS 28 Investment in Associates
- HKAS 32 Financial Instruments: Disclosure and Presentation
- HKAS 33 Earnings per Share
- HKAS 36 Impairment of Assets
- HKAS 37 Provisions, Contingent Liabilities and Contingent Assets
- HKAS 38 Intangible Assets
- HKAS 39 Financial Instruments: Recognition and Measurement
- HKAS 40 Investment Property
- HKFRS 2 Share-based Payment
- HKFRS 3 Business Combinations
- HK(SIC)-Int 21 Income Taxes — Recovery of Revalued Non-depreciable Assets
- HK-Int 4 Leases — Determination of the Length of Lease Term in respect of Hong Kong Land Leases

The adoption of HKASs 1, 2, 7, 8, 10, 12, 16, 18, 19, 21, 23, 24, 27, 28, 32, 33, 37, 39, HK(SIC)-Int 21 and HK-Int 4 has had no material impact on the accounting policies of the Group and the methods of computation in the Group's unaudited condensed consolidated interim financial statements. The impact of adopting the other HKFRSs is summarised as follows:

(a) HKAS 17 — Leases

In prior periods, leasehold land and buildings held for own use were stated at valuation less accumulated depreciation.

Upon adoption of HKAS 17, the Group's leasehold interests in land and buildings is separated into leasehold land and leasehold buildings. The Group's leasehold land is classified as an operating lease, because the title of the land is not expected to pass to the Group by the end of the lease term, and is reclassified from fixed assets to land lease payments, while leasehold buildings continue to be classified as part of fixed assets. Land lease payments under operating leases are initially stated at cost and subsequently amortised on the straight-line basis over the lease term. When the lease payments cannot be allocated reliably between the land and building elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in fixed assets.

This change in accounting policy has had effects on the unaudited condensed consolidated financial statements as follows:

	31 December 2004 *HK$'000* *(Unaudited)*	1 January 2004 *HK$'000* *(Unaudited)*
Effect of new policy on equity:		
Decrease in property revaluation reserve	16,020	17,208
Decrease in accumulated losses	(4,095)	(3,759)
Total	11,925	13,449

	Six months ended 30 June	
	2005	2004
	HK$'000	*HK$'000*
	(Unaudited)	*(Unaudited)*
Effect of new policy on profit/(loss):		
Decrease in cost of sales	**168**	168
Decrease in loss/increase in profit for the period	**168**	168
Decrease in basic loss/increase in basic earnings per share	**HK0.03 cent**	HK0.03 cent

(b) HKAS 40 — Investment Properties

In prior periods, changes in the fair values of investment properties were dealt with as movements in the property revaluation reserve. If the total of this reserve was insufficient to cover a deficit, on a portfolio basis, the excess of the deficit was charged to the profit and loss account. Any subsequent revaluation surplus was credited to the profit and loss account to the extent of the deficit previously charged.

Upon the adoption of HKAS 40, gains or losses arising from changes in the fair values of investment properties are included in the profit and loss account in the year in which they arise. Any gains or losses on the retirement or disposal of an investment property are recognised in the profit and loss account in the year of the retirement or disposal.

The adoption of HKAS 40 has had no effect on these unaudited condensed consolidated interim financial statements because the Group's investment properties had a net revaluation deficit position as at 30 June 2005 and 2004 and 1 January 2005 and 2004 and the changes in valuation thereof had been dealt with in the profit and loss account.

(c) HKFRS 2 — Share-based Payment

In prior periods, no recognition and measurement of share-based transactions in which employees (including directors) were granted share options over shares in the Company was required until such options were exercised by employees, at which time the share capital and share premium were credited with the proceeds received.

Upon the adoption of HKFRS 2, when employees (including directors) render services as consideration for equity instruments ("equity-settled transactions"), the cost of the equity-settled transactions with employees is measured by reference to the fair value at the date at which the instruments are granted. The fair value is determined by an external valuer using a binominal model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company, if applicable.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (the "vesting date"). The cumulative expense recognised for equity-settled transactions at each balance sheet date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the profit and loss account for a period represents the movement in cumulative expense recognised as the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

The Group has taken advantage of the transitional provision of HKFRS 2 in respect of equity-settled awards and has applied HKFRS 2 only to share options granted after 7 November 2002 that had not vested on or before 1 January 2005. The adoption of this new HKFRS has no impact to the unaudited condensed consolidated interim financial statements of the Group as the Group has neither share options granted after 7 November 2002 and not vested before 1 January 2005 nor liabilities settled based on shares or other rights over shares.

(d) HKFRS 3 — Business Combinations, HKAS 36 — Impairment of Assets, and HKAS 38 — Intangible Assets

In prior periods, goodwill arising on acquisitions prior to 1 January 2001 was eliminated against consolidated capital reserve in the year of acquisition and was not recognised in the profit and loss account until disposal or impairment of the acquired business.

Goodwill arising on acquisitions on or after 1 January 2001 was capitalised and amortised on the straight-line basis over its estimated useful life and was subject to impairment testing when there was any indication of impairment.

Upon the adoption of HKFRS 3 and HKAS 36, goodwill arising on acquisitions is no longer amortised but subject to an annual impairment review (or more frequently if events or changes in circumstances indicate that the carrying value may be impaired). Any impairment loss recognised for goodwill is not reversed in a subsequent period.

The transitional provisions of HKFRS 3 have required the Group to eliminate at 1 January 2005 the carrying amounts of accumulated amortisation with a corresponding entry to the cost of goodwill and to derecognise the carrying amounts of negative goodwill (including that remaining in consolidated capital reserve) against retained earnings. Goodwill previously eliminated against consolidated capital reserve remains eliminated against consolidated capital reserve and is not recognised in the profit and loss account when all or part of the business to which the goodwill relates is disposed of or when a cash-generating unit to which the goodwill relates become impaired.

The change in accounting policy has had no effect on these unaudited condensed consolidated interim financial statements.

(2) SEGMENT INFORMATION

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments.

(a) Business segments

The following table presents revenue, profit/(loss) and other information for the Group's business segments.

	Leather processing Six months ended 30 June		**Property investment Six months ended 30 June**		**Corporate and other Six months ended 30 June**		**Consolidated Six months ended 30 June**	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
	(Unaudited)	*(Unaudited)*	***(Unaudited)***	*(Unaudited)*	***(Unaudited)***	*(Unaudited)*	***(Unaudited)***	*(Unaudited)*
		(Restated)						*(Restated)*
Segment revenue:								
Sales to external customers	**95,077**	162,836	**—**	—	**—**	—	**95,077**	162,836
Other revenue (excluding exchange gains/ (losses), net)	**1,359**	596	**345**	471	**—**	31	**1,704**	1,098
Exchange gains/(losses), net	**(32)**	1,526	**—**	—	**(111)**	87	**(143)**	1,613
Total	**96,404**	164,958	**345**	471	**(111)**	118	**96,638**	165,547
Segment results	**7,198**	9,528	**74**	396	**(6,448)**	(4,587)	**824**	5,337
Interest income							**504**	542
Finance costs							**(1,788)**	(3,104)
Profit/(loss) before tax							**(460)**	2,775
Tax							**(55)**	—
Profit/(loss) for the period							**(515)**	2,775
Other segment information:								
Capital expenditure	**545**	1,279	**—**	—	**33**	20	**578**	1,299
Depreciation	**3,663**	5,504	**—**	—	**9**	18	**3,672**	5,522
Amortisation of land lease payments	**47**	44	**—**	—	**—**	—	**47**	44
Deficit arising on revaluation of leasehold buildings	**25**	—	**—**	—	**—**	—	**25**	—
Other non-cash expenses	**52**	39	**—**	—	**—**	72	**52**	111

(b) Geographical segments

The following table presents revenue for the Group's geographical segments.

	Mainland China Six months ended 30 June		**Hong Kong Six months ended 30 June**		**Consolidated Six months ended 30 June**	
	2005	2004	**2005**	2004	**2005**	2004
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
	(Unaudited)	*(Unaudited)*	***(Unaudited)***	*(Unaudited)*	***(Unaudited)***	*(Unaudited)*
Segment revenue:						
Sales to external customers	**95,077**	162,836	**—**	—	**95,077**	162,836
Other revenue (excluding exchange gains/(losses), net)	**1,704**	1,037	**—**	61	**1,704**	1,098
Exchange gains/(losses), net	**(20)**	1,488	**(123)**	125	**(143)**	1,613
Total	**96,761**	165,361	**(123)**	186	**96,638**	165,547

(3) PROFIT/(LOSS) BEFORE TAX

Profit/(loss) before tax is arrived at after charging/(crediting):

	Six months ended 30 June	
	2005	2004
	HK$'000	*HK$'000*
	(Unaudited)	*(Unaudited)*
Depreciation	**3,672**	5,522
Amortisation of land lease payments	**47**	44
Redundancy payments	**—**	1,211

(4) TAX

No provision for Hong Kong profits tax has been made as the Group had no assessable profits arising in Hong Kong during the period (2004: Nil). No provision for Mainland China and overseas profits tax has been made (2004: Nil) as there were no assessable profits arising from certain subsidiaries of the Company operating in Mainland China and overseas during the period and certain subsidiaries of the Company operating in Mainland China and overseas had tax losses brought forward from prior years to offset the assessable profit during the period.

	Six months ended 30 June	
	2005	2004
	HK$'000	*HK$'000*
	(Unaudited)	*(Unaudited)*
Group:		
Current — Hong Kong		
Charge for the period	**—**	—
Deferred	**55**	—
Total tax charage for the period	**55**	—

Certain subsidiaries of the Company established in the PRC were exempt from PRC corporate income tax for two years starting from their first profit-making year of operations, and are eligible for a 50% relief from PRC corporate income tax for the following three years under the PRC tax laws. The standard PRC corporate income tax rate applicable to those PRC subsidiaries ranged from 24% to 33% for the six months ended 30 June 2005.

(5) EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share is based on the loss for the period of HK$515,000 (2004: profit of HK$2,775,000 (as restated)) and 524,154,000 (2004: 524,154,000) ordinary shares in issue during the period.

Diluted earnings/(loss) per share amounts for the six months ended 30 June 2005 and 2004 have not been disclosed as the share options outstanding during these periods had an anti-dilutive effect on the basic earnings/(loss) per share for these periods, respectively.

(6) CONTINGENT LIABILITIES

Following the change in senior management of the Company in June 2002, it was discovered that certain former executives (the "Former Executives") of Nanhai Tannery & Leather Products Co., Ltd. ("Nanhai Tannery") (one of whom was also a former director of the Company) had been involved in certain irregularities. Nanhai Tannery was until 31 December 2003 a wholly-owned subsidiary of the Company established in Nanhai, the PRC.

Upon discovery of the irregularities, an internal audit team of the Company's holding companies, working with the new management, conducted a preliminary investigation of the irregularities. The investigation revealed that the Former Executives apparently operated a business in parallel to the operations of Nanhai Tannery (the "Parallel Operation") for their own personal gain.

The incident was reported by the Company to the relevant PRC authorities who have detained the Former Executives and seized documents related to the Parallel Operation for investigation. The Company also instructed its auditors and the PRC lawyers to carry out special investigations with a view to ascertaining the effects of the Parallel Operation on the business of Nanhai Tannery and to advise management of the Group's possible recourse against the Former Executives.

Based on the findings of the special investigations and having regard to the professional advice received, the directors of the Company were of the opinion that the Parallel Operation should not be (and it had not been) incorporated in the financial statements of the Group and that the Parallel Operation appeared to have involved various irregularities in its transactions under the applicable PRC laws and regulations.

Pursuant to a business restructuring plan implemented by the Group, Tongyuan Tannery was established to operate the Group's tannery operations and businesses in the Guangdong province in January 2003. Tongyuan Tannery is a wholly-owned subsidiary of the Company which owns and operates a factory and distribution operations in Nanhai, the PRC. Tongyuan Tannery had purchased from Nanhai Tannery most of its fixed assets and inventories in 2003.

On 31 December 2003, the Company entered into a conditional sale and purchase agreement with Yong Sheng Limited, a former subsidiary of GDH and a former fellow subsidiary of the Company, for the disposal of the Company's entire 100% interest in Nanhai Tannery. The transaction was completed on 31 December 2003 and Nanhai Tannery became a wholly-owned subsidiary of Yong Sheng Limited and ceased to be a subsidiary of the Company.

In February and March 2004, certain bank accounts of Tongyuan Tannery in the PRC containing in total approximately RMB7 million were frozen by the Guangzhou Customs. Subsequently, additional bank balance of RMB2 million were frozen by the Guangzhou Customs. Accordingly, bank balances of RMB9 million (equivalent to approximately HK$8.7 million) were frozen as at 30 June 2005 (note 10).

The directors and management of the Company are satisfied that all the business and operations of Tongyuan Tannery have been conducted strictly in accordance with all the applicable PRC laws and regulations since its establishment, and that there has been no wrongdoing on the part of Tongyuan Tannery or any of its management or staff.

On 22 March 2004, the Guangzhou Customs issued a demand letter to Tongyuan Tannery and Nanhai Tannery (i) claiming tax of RMB36,989,000 (equivalent to approximately HK$34,800,000) payable within 30 days from the date of the demand letter in relation to the tax evaded by Nanhai Tannery during the period from 2000 to 2002; and (ii) asserting that Tongyuan Tannery and Nanhai Tannery failed to notify the Guangzhou Customs of the change from Nanhai Tannery to Tongyuan Tannery.

Although the Group had disposed of its entire interest in Nanhai Tannery to Yong Sheng Limited and the tax evasion was related to the Parallel Operation of Nanhai Tannery, the PRC legal advice obtained by the Company in April 2004 indicated that if, which is denied by the Company, Tongyuan Tannery and Nanhai Tannery are considered to be one and the same entity, then it may be possible for the Guangzhou Customs to impose Nanhai Tannery's liability of approximately HK$34,800,000 (the "Potential Tax Liability") on Tongyuan Tannery. Accordingly, the Company made a provision of RMB36,989,000 (equivalent to approximately HK$34,800,000) for the Potential Tax Liability in its annual results for the year ended 31 December 2003 (note 15(a)). The same provision was carried in the Company's annual results for the year ended 31 December 2004.

In addition, the PRC legal advice indicated that, under the existing PRC laws and regulations, the relevant PRC authorities may also impose a tax penalty on Tongyuan Tannery of an amount equal to 1 to 5 times the Potential Tax Liability, i.e. RMB36,989,000 to RMB184,945,000 (equivalent to approximately HK$34,800,000 to HK$174,000,000) (the "Potential Liability"). In light of the PRC legal advice, the directors of the Company considered it appropriate to make a provision of RMB36,989,000 (equivalent to approximately HK$34,800,000) for the Potential Penalty in the Company's annual results for the year ended 31 December 2003 (note 15(a)). The same provision was carried in the Company's annual results for the year ended 31 December 2004.

In April 2005, a prosecution was initiated in the Guangzhou Intermediate People's Court (the "Guangzhou Court") against, amongst others, Nanhai Tannery, in relation to alleged tax evasion activities on the part of Nanhai Tannery and others between January 2000 and May 2002 (the "Guangzhou Proceedings"). Although Tongyuan Tannery was not made a party to the Guangzhou Proceedings, allegations were made in these proceedings that Tongyuan Tannery was set up as a vehicle to take over the assets of Nanhai Tannery, and to place obstacles on the Guangzhou Custom's attempt to recover the evaded tax. Tongyuan Tannery filed its objections to these allegations with the Guangzhou Court in June 2005 to explain that (i) Tongyuan Tannery and Nanhai Tannery were separate legal entities; (ii) the acquisition of Nanhai Tannery's assets (including factory premises, machinery and raw materials) by Tongyuan Tannery were legitimate and genuine transactions at fair market prices; and (iii) the balances in the bank accounts of Tongyuan Tannery which were frozen by Guangzhou Customs were the proceeds of the normal operations of Tongyuan Tannery, and were not related to the operations of Nanhai Tannery.

Judgment in the Guangzhou Proceedings (the "Judgment") was rendered, subsequent to the balance sheet date, on 2 September 2005. Nanhai Tannery, amongst others, is found liable for tax evasion and it was ordered that all illegal gains from the tax evasion activities be recovered and confiscated by the State (such order is to be executed by the Guangzhou Customs). Further, a fine of RMB8,000,000 is imposed on Nanhai Tannery.

On 9 September 2005, the Company obtained PRC legal advice on the potential effects of the Judgment on Tongyuan Tannery. The PRC legal advice indicated that the parties have 10 days within which to lodge an appeal. The Judgment does not take effect before the expiry of this period. The PRC legal advice analysed the potential effects of the Judgment on Tongyuan Tannery in three alternative scenarios:

(1) If no appeal is lodged within the 10-day period, the Judgment will take effect. The PRC legal advice indicated that:

    (i) The Judgment made no finding to the effect that Tongyuan Tannery is in fact the same entity as Nanhai Tannery. Therefore, Tongyuan Tannery has not been held liable for any of the peralties which is imposed on Nanhai Tannery;

    (ii) The Judgment made no finding to the effect that the balances in the bank accounts of Tongyuan Tannery which were frozen by Guangzhou Customs are the proceeds of Nanhai Tannery's illegal activities. This gives Tongyuan Tannery grounds to seek to apply to Guangzhou Customs for such bank accounts to be unfrozen; and

    (iii) The Judgment made no finding to the effect that the acquisition of Nanhai Tannery's assets by Tongyuan Tannery was an attempt to dispose of Nanhai Tannery's assets in order to place obstacles on the Guangzhou Customs' attempt to recover evaded tax. It is arguable that Guangzhou Customs should not therefore seek to recover Nanhai Tannery's illegal gains from its illegal activities from Tongyuan Tannery.

    The PRC legal advice noted that as it was ordered that all "illegal gains" obtained by Nanhai Tannery from the tax evasion activities be recovered and confiscated by the State, the amount of such "illegal gains" will exceed the amount of tax evaded by Nanhai Tannery to include all gains obtained by Nanhai Tannery as a result of the tax evasion activities. Also according to the PRC legal advice, the possibility that, notwithstanding the apparent absence in the Judgment of any findings directly incriminating Tongyuan Tannery, the Guangzhou Customs may nevertheless still seek to apply the balances in Tongyuan Tannery's bank accounts towards (or otherwise resort to the other assets of Tongyuan Tannery for) discharging Nanhai Tannery's liabilities cannot be excluded.

(2) If Nanhai Tannery (or other defendants to the Guangzhou Proceedings) lodges an appeal and the Guangzhou Prosecution Office does not lodge an appeal, the Judgment will not take effect pending the resolution of the appeal by the Guangdong High Court. The PRC legal advice indicated that there are three possible outcomes in this scenario:

    (i) If the Guangdong High Court confirms the Guangzhou Court's findings of facts and findings of law and also the penalties imposed by the Guangzhou Court, the appeal will be dismissed and the Judgment will take effect;

    (ii) If the Guangdong High Court confirms the Guangzhou Court's findings of facts but find that the Guangzhou Court made errors of law or that the penalties imposed are not appropriate, the Guangdong High Court may vary the Judgment;

    (iii) If the Guangdong High Court finds that the Guangzhou Court made incorrect findings of facts, the High Court may vary the Judgment or order a re-trial by the Guangzhou Court.

    The PRC legal advice further indicated that under the relevant PRC legislation, in the event that an appeal is lodged by Nanhai Tannery (or other defendants to the Guangzhou Proceedings) but no appeal is lodged by the Guangzhou Prosecution Office and the Guangdong High Court decides in the appeal that the Judgment should be varied, it cannot impose penalties which are heavier than those imposed pursuant to the Judgment. However, the effect of any decision of the Guangdong High Court upon Tongyuan Tannery will be dependent upon the actual content of the Guangdong High Court's decision.

(3) If the Guangzhou Prosecution Office lodges an appeal against the Judgment, it is possible that:

   (i) The Guangdong High Court may impose on Nanhai Tannery penalties which are heavier than those imposed pursuant to the Judgment; and

   (ii) The Guangdong High Court may make findings which are different from those made by the Guangzhou Court on a number of issues including the relationship between Nanhai Tannery and Tongyuan Tannery, and whether the balances in the bank accounts of Tongyuan Tannery which are currently frozen by Guangzhou Customs are proceeds of Nanhai Tannery's illegal activities.

   The PRC legal advice indicated that the Guangzhou Prosecution Office may decide to lodge an appeal against the Judgment on the bases that: (i) the RMB8 million penalty imposed is lower than that prescribed by the relevant PRC legislation; (ii) the Judgment made no finding to the effect that Nanhai Tannery and Tongyuan Tannery are the same entity, nor was there any finding that balances in the bank accounts of Tongyuan Tannery which are currently frozen by Guangzhou Customs are proceeds of Nanhai Tannery's illegal activities.

The Company is not currently aware of the parties' intention as to appeal. Although the Judgment has been rendered, it remains uncertain what the impact of the Judgment, or the ruling in any appeal against the Judgment, on Tongyuan Tannery is going to be. If an appeal is lodged against the Judgment, the effect of any decision of the Guangdong High Court upon Tongyuan Tannery will be dependent upon the actual content of the Guangdong High Court's decision. Even if no appeal is lodged against the Judgment, in light of the PRC legal advice as detailed above, it remains unclear whether the PRC authorities will seek to enforce the Judgment against Tongyuan Tannery, and if so, what the amount of penalty which may finally be imposed against it is going to be, and the other possible consequential actions that may be taken by the PRC authorities for the apparent breaches of certain PRC laws and regulations, or the existence or otherwise of any other penalties and claims so arising as a result of the aforesaid irregularities. Accordingly, the directors are of the opinion that the provision for Potential Tax Liability and Potential Liability made in the Company's annual results for the year ended 31 December 2003 and carried in the Company's annual results for the year ended 31 December 2004 should continue to be carried in the condensed consolidated financial statements. Should additional penalties in excess of the amount of the provision be imposed against Tongyuan Tannery, the directors are of the opinion that the Group would have adequate net assets and resources to continue its operations.

SUMMARY OF INDEPENDENT AUDITORS' REVIEW REPORT

An extract from the independent auditors' review report of the Company for the six months ended 30 June 2005 is as follows:

Fundamental uncertainty — Contingent liabilities

In arriving at our review conclusion, we have considered the adequacy of the disclosures made in note 19 to the condensed consolidated financial statements concerning the irregularities involving certain former executives of a former subsidiary of the Company in a previous year and the related provision of RMB73,978,000 (equivalent to approximately HK$69,600,000) for the tax claim and tax penalty made by the Group as detailed in note 15(a) to the condensed consolidated financial statements. As more fully explained in note 19 to the condensed consolidated financial statements, although judgment for the proceeding in the Guangzhou Intermediate People's Court (the "Judgment") has been rendered on 2 September 2005, the impacts of the Judgment or the ruling in any appeal against the Judgment, including the other possible consequential actions that may be taken by the PRC authorities for the apparent breaches of certain PRC laws and regulations, and the existence or otherwise of any other penalties and claims so arising as a result of the aforesaid irregularities, remain uncertain. As of the date of this report, no further provision other than that disclosed in notes 15(a) and 19 to the condensed consolidated financial statements has been made in the interim financial report for such contingencies. We consider that appropriate disclosures and estimates have been made in the interim financial report and our review conclusion is therefore not modified in this respect.

Review conclusion

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 June 2005.

CORPORATE GOVERNANCE AND OTHER INFORMATION

Code on Corporate Governance Practices

The Company has applied the principles and complied with the code provisions of the Code on Corporate Governance Practices ("Code on CG Practices") as set out in Appendix 14 of the Listing Rules throughout the six months ended 30 June 2005.

Audit Committee

The Company established an audit committee ("Audit Committee") in September 1998. The terms of reference of the Audit Committee adopted by the board of directors of the Company are in line with the Code on CG Practices. The existing Audit Committee comprises the three independent non-executive directors, Mr. Cheng Hok Lai James, Mr. Choi Kam Fai Thomas and Mr. Fung Lak as members. The principal duties of the Audit Committee include the review of the effectiveness of the completeness, accuracy and fairness of the Company's financial reports and internal control systems.

Remuneration Committee

The Company has also established a remuneration committee ("Remuneration Committee") in accordance with the Listing Rules. The terms of reference of the Remuneration Committee adopted by the board of directors of the Company are in line with the Code on CG Practices. The existing Remuneration Committee comprises Mr. Zhang Chunting, Mr. Cheng Hok Lai James, Mr. Choi Kam Fai Thomas and Mr. Fung Lak as members. The principal duties of the Remuneration Committee include the review of the remuneration policy and compensation of the directors and senior management of the Company.

Nomination Committee

The Company has also established a nomination committee ("Nomination Committee") in accordance with the Listing Rules. The terms of reference of the Nomination Committee adopted by the board of directors of the Company are in line with the Code on CG Practices. The existing Nomination Committee comprises Mr. Zhang Chunting, Mr. Cheng Hok Lai James, Mr. Choi Kam Fai Thomas and Mr. Fung Lak as members. The principal duties of the Nomination Committee include the process of nominating and recommending candidates to fill vacancies on the Board of Directors.

Model Code for Securities Transactions by Directors

The Company has adopted the Model Code set out in Appendix 10 of the Listing Rules as the code of conduct regarding Directors' securities transactions. All directors have confirmed, following specific enquiry by the Company, that they have complied with the required standard set out in the Model Code throughout the six months ended 30 June 2005.

Review of Interim Results

The Group's interim financial report for the six months ended 30 June 2005 has not been audited, but has been reviewed by the Audit Committee and the Company's auditors Messrs. Ernst & Young.

Purchase, Sale and Redemption of listed securities

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the six months ended 30 June 2005.

By Order of the Board
Zhang Chunting
Chairman

Hong Kong, 9 September 2005

As at the date of this announcement, the Company's Board comprises Zhang Chunting, Xiong Guangyang, Hui Wai Man Lawrence, Ho Lam Lai Ping Theresa, and three independent non-executive directors, namely, Cheng Hok Lai James, Fung Lak and Choi Kam Fai Thomas.

Please also refer to the published version of this announcement in ***(China Daily)***