粵海制革有限公司
GUANGDONG TANNERY LIMITED

(Incorporated in Hong Kong with limited liability)

SUMMARISED 2003 INTERIM RESULTS

MANAGEMENT DISCUSSION AND ANALYSIS

Interim Results

The Group's unaudited loss attributable to shareholders for the six months ended 30 June 2003 was HK$2,382,000, decreased by HK$179,949,000 against the loss of HK$182,331,000 for the same period in 2002. The loss for the period was reduced by HK$35,543,000, as compared to HK$37,925,000 for the same period last year after deducting the provisions for impairment of goodwill of Nanhai Tannery & Leather Products Co., Ltd. ("Nanhai Tannery") and provision for obsolete stock of Qingdao Nanhai Tannery Co., Ltd. ("Qingdao Tannery") totalling to HK$144,406,000. Loss per share for the period was 0.45 HK cent (2002: 34.79 HK cents).

The unaudited net asset value of the Group as at 30 June 2003 was HK$264,163,000, down by HK$35,459,000 and HK$11,480,000 as compared to 30 June 2002 and 31 December 2002, respectively.

No interim dividend is recommended by the Board of Directors for the six months ended 30 June 2003.

Operations

The Group has disengaged its interests in certain non-core operations and focused its resources mainly on the core leather business following the corporate restructuring program initiated two years ago. In the early 2003, the Group's effort to rationalise its distribution network, supplier channels, production mix and product positioning has proven its worth, enabling the leather business to get back on track to a steady and positive development. However, the Group's production and operations were indirectly affected from April to June this year due to reduced orders from shoes manufacturers, the Group's major customers, in the face of a slowing consumer market amid the outbreak of Severe Acute Respiratory Syndrome ("SARS") in Mainland China and Hong Kong.

To expand further its market coverage, the Group has adjusted its distribution strategy, shifting the focus from a few distributors to direct sales customers and new regional distributors. During the period, the sales contributed by the Group's top five customers dropped to 52% from 76% for the same period last year. The Group's nationwide direct sales distribution network spans a number of major provinces and cities in Mainland China, including Guangdong, Shandong, Jiangsu, Shanghai, Zhejiang, Chongqing and Sichuan.

On the product front, the Group is actively strengthening its research and development effort to develop techniques that turn defective leather into innovative products with higher market acceptance, such as "imitation reindeer leather" and "Kaibianzhu". With such product developments, the Group reduced its inventory level by clearing up the defective leather inventories at a higher return.

The Group has further optimised its assets during the period. A total of approximately HK$20,101,000 was realised from the disposal of certain of its properties, including the Company's former office in Tsim Sha Tsui, Hong Kong; an office unit at Huanghua Road, Guangzhou; as well as an industrial premise in Hong Kong.

Turnover

Turnover for the period was HK$142,380,000, decreased by HK$171,788,000 or 55% from HK$314,168,000 for the same period last year.

The decrease in turnover was primarily caused by a number of factors including: a drop of HK$25,090,000 as a result of discontinuation of the paper box packaging business and disengagement of the Group's interests in the leather ware business; a reduction of HK$10,250,000 arising from the production of double face leather; a decrease of HK$89,838,000 in turnover for leather ware trading; and a decline of HK$46,610,000 in turnover for the leather business hit by the fallout from the SARS outbreak. Turnover of the leather business (by product) in the first half of 2002 and 2003 are as follows:

Product	Turnover		
	2003	2002	+/(-)
	(HK$'000)	*(HK$'000)*	*(%)*
Cow hides	**116,712**	156,494	(25)
Cow split, coated cow split & others	**25,668**	42,746	(40)
Total	**142,380**	199,240	(29)

Turnover of the Group is expected to improve in the second half year, as a revitalised leather market in Mainland China is anticipated given the subsiding repercussions of the SARS outbreak.

Costs

Leather sourcing cost, which accounts for approximately 79% of total sourcing costs, was reduced markedly following the expansion of supplier network, introduction of competition into the sourcing process, and enhanced efforts in market research and price negotiation. During the period under review, average sourcing prices per sq. ft. of domestic large, medium and small cow hides dropped approximately by 2%, 10% and 5% respectively against the same period last year. Sourcing of chemicals and metals was carried out through open tender in order to lower the overall production costs.

Production

The Group's total leather production for the period was 15,269,000 sq. ft., declined by 6,879,000 sq. ft. from 22,148,000 sq. ft. for the same period last year. Production volume of the leather business (by product) in the first half of 2002 and 2003 are as follows:

Product	Production Volume		
	2003	2002	+/(-)
	('000 sq. ft.)	*('000 sq. ft.)*	*(%)*
Cow hides	**11,142**	14,470	(23)
Cow split, coated cow split and others	**4,127**	7,678	(46)
Total	**15,269**	22,148	(31)

Inventories

As at 30 June 2003, the Group's consolidated inventories amounted to HK$229,197,000, reduced by HK$5,701,000 against the same period last year. The inventories actually surged by HK$1,115,000 after deduction of the inventories from those discontinued operations amounting to HK$6,816,000. A rise of HK$37,008,000 was recorded when compared to the inventories as at 31 December 2002. The increase was primarily triggered by weakened sales following the SARS outbreak in the first half year.

Trade Receivables

Balance of trade receivables at the end of the period was HK$75,031,000. After deducting the provisions for doubtful debts of HK$35,507,000, trade receivables amounted to HK$39,524,000, an increase of HK$4,703,000 and HK$18,052,000 as compared to 30 June 2002 and 31 December 2002, respectively. The increase was mainly attributable to an expanded customer base, a higher level of credit limit to customers, and slower payments from customers who were adversely affected by the SARS outbreak.

Financial Position

As at 30 June 2003, the Group's interest-bearing borrowings and cash and bank balances are analysed as follows together with their comparative figures as at 31 December 2002:

	30 June 2003 ***(HK$'000)***	31 December 2002 *(HK$'000)*
Interest-bearing borrowings		
Currencies:		
Hong Kong dollar	**24,400**	24,400
Renminbi	**71,506**	69,694
United States dollar	**19,402**	28,548
	115,308	122,642
Interest rates:		
At fixed rate	**71,506**	69,694
At floating rate	**43,802**	52,948
	115,308	122,642
Cash and bank balances		
Currencies:		
Hong Kong dollar	**3,694**	666
Renminbi	**13,811**	43,094
United States dollar	**10,193**	21,066
	27,698	64,826

At 30 June 2003, after deduction of cash and bank balances, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 33% (31 December 2002: 21%). Loan facilities bear interest at approximately 3% to 6% per annum. On 2 September 2003, the repayment date of certain loans to the Group of HK$46,163,000 was extended to 30 September 2004, therefore, of the Group's total borrowings, HK$60,812,000 is repayable within one year. Interest expense incurred by the Group during the period was HK$2,589,000, a drop of 23% as compared to the same period last year.

Net cash outflow from operating activities for the period was HK$47,928,000 and net cash outflow from financing was HK$7,352,000. Net cash outflow for the period amounted to HK$27,263,000.

Fixed assets as at 30 June 2003 were HK$143,159,000, a reduction of HK37,835,000 as compared to 31 December 2002. The Group's capital expenditure during the period amounted to HK$2,046,000 (2002: HK$12,496,000). It was incurred mainly for the replacement of the leather manufacture machinery and equipment, a move to cope with the operations and development of the leather business.

As at 30 June 2003, certain of the Group's leasehold land and buildings, receivables and bank balances with a total net book value of HK$32,726,000 (31 December 2002: HK$48,972,000) were pledged to secure general banking facilities granted to the Group.

Litigations

In September 2002, the Company submitted a claim to China International Economic and Trade Arbitration Commission (the "Arbitration Commission") in Shenzhen, Mainland China, against a PRC joint venture partner of Qingdao Tannery seeking, amongst others, termination of the joint venture agreement of Qingdao Tannery (the "Qingdao Joint Venture Agreement") and compensation of losses and damages of approximately RMB24,000,000. However, the PRC joint venture partner also applied to the Arbitration Commission in Beijing against the Company claiming for loss of fixed return under the Qingdao Joint Venture Agreement and damages in an aggregate amount of RMB15,000,000. The two arbitration proceedings are still in progress.

Employees

The Company and its subsidiaries have 1,028 employees (2002: 1,607 employees). Employees' cost for the period was HK$11,264,000 (2002: HK$20,209,000). In June 2003, certain directors and employees were granted options to subscribe for a total of 9,650,000 shares of the Company. The purpose of the Company's share option scheme 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.

Auditors — Services provided other than audit

No other service was provided by Messrs. Ernst & Young, the auditors of the Group, other than the interim review during the period.

Prospects

The Group is poised to benefit from China's sustained robust economic growth, given the closer economic partnership between Hong Kong and Mainland China, and the accelerated implementation of various economic and trading policies following China's admission to the World Trade Organisation. To venture into new markets and develop innovative products under strict cost control will continue to be the thrust of our expansion philosophy. We are confident that the Group is set to improve its operational efficiency steadily, and strive to achieve profitability in the year of 2003.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Notes	**For the six months ended 30 June** **2003** ***HK$'000*** **(Unaudited)**	2002 *HK$'000* (Unaudited)
TURNOVER	*2*		
Continuing operations		**142,380**	289,078
Discontinued operations		**—**	25,090
		142,380	314,168
Cost of sales		**(132,169)**	(286,890)
Gross profit		**10,211**	27,278
Other revenue and gains	*2*	**1,707**	2,872
Selling and distribution costs		**(1,195)**	(9,040)
Administrative expenses		**(11,461)**	(20,327)
Other operating income/(expenses), net		**659**	(179,286)
Staff compensation payments in respect of a discontinued operation		**—**	(552)
LOSS FROM OPERATING ACTIVITIES	*2, 3*	**(79)**	(179,055)
Finance costs	*4*	**(2,589)**	(3,353)
LOSS BEFORE TAX			
Continuing operations		**(2,668)**	(182,323)
Discontinued operations		**—**	(85)
		(2,668)	(182,408)
Tax — Continuing operations	*5*	**286**	—
LOSS BEFORE MINORITY INTERESTS		**(2,382)**	(182,408)
Minority interests		**—**	77
NET LOSS FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		**(2,382)**	(182,331)
LOSS PER SHARE	*6*		
— Basic		**(0.45 cents)**	(34.79 cents)
— Diluted		**N/A**	N/A

Notes:

(1) Impact of Revised Statements of Standard Accounting Practice ("SSAP")

Due to the adoption of SSAP 12 (Revised) in the current period, prior period adjustments were made to recognise the deferred tax liabilities in respect of the revaluation of the Group's leasehold land and buildings, which was not required in the prior periods. The principal effects of the adjustments on these condensed consolidated financial statements are as follows:

(a) A decrease in the Group's property revaluation reserve as at 1 January 2003 by HK$9,793,000 (as at 1 January 2002: HK$9,549,000) which represents the deferred tax liabilities recognised in respect of the net revaluation surplus on the Group's leasehold land and buildings recorded in the reserves at that date; and

(b) An increase in the deferred tax liabilities of HK$651,000 as at 30 June 2002 by a reduction of revaluation surplus on the Group's leasehold land and buildings of the same amount credited to the property revaluation reserve for the six months then ended.

(2) Segment Information

Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

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 other business segments. Summary details of the business segments are as follows:

Continuing operations

(a) the leather processing segment processes raw leather to finished leather for use in the leather ware products manufacturing industry mainly in Mainland China;

(b) the merchandise trading segment purchases commodities from overseas and sells to customers in Mainland China;

(c) the property investment segment invests in residential and commercial properties in Hong Kong and Mainland China for rental income purpose; and

(d) the corporate and other segment mainly comprises the Group's corporate income and expense items.

Discontinued operations

(a) the leather ware products manufacture and distribution segment produced leather ware products in Mainland China and sold them mainly in Hong Kong. This segment was discontinued following the Group's disposal of its entire 60% interest in Alpha Universal Limited in July 2002; and

(b) the packaging materials manufacture and distribution segment produced and distributed packaging materials in Mainland China. This segment was discontinued following the Group's discontinuation of the operation of Xuzhou Gangwei Colour Packaging Co., Ltd. in June 2002.

In determining the Group's geographical segments, revenues and results are attributed to the segments based on the location of the customers. There were no intersegment sales and transfers during the periods.

(a) Business segments

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

	Leather processing (Continuing) For the six months ended 30 June		Merchandise trading (Continuing) For the six months ended 30 June		Property investment (Continuing) For the six months ended 30 June		Corporate and other (Continuing) For the six months ended 30 June		Leather ware products manufacture and distribution (Discontinued) For the six months ended 30 June		Packaging materials manufacture and distribution (Discontinued) For the six months ended 30 June		Consolidated For the six months ended 30 June	
	2003	2002	**2003**	2002	**2003**	2002	**2003**	2002	**2003**	2002	**2003**	2002	**2003**	2002
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
	(Unaudited)	(Unaudited)	**(Unaudited)**	(Unaudited)	**(Unaudited)**	(Unaudited)	**(Unaudited)**	(Unaudited)	**(Unaudited)**	(Unaudited)	**(Unaudited)**	(Unaudited)	**(Unaudited)**	(Unaudited)
Segment revenue:														
Sales to external customers	**142,380**	199,240	**—**	89,838	**—**	—	**—**	—	**—**	16,766	**—**	8,324	**142,380**	314,168
Other revenue (excluding exchange gains/(losses), net)	**575**	548	**—**	47	**991**	980	**47**	113	**—**	579	**—**	8	**1,613**	2,275
Exchange gains/(losses), net	**54**	(9)	**—**	(28)	**—**	—	**(4)**	—	**—**	(42)	**—**	—	**50**	(79)
Total	**143,009**	199,779	**—**	89,857	**991**	980	**43**	113	**—**	17,303	**—**	8,332	**144,043**	316,364
Segment results	**2,107**	(147,901)*	**—**	(28,677)	**1,990**	344	**(4,270)**	(3,185)	**—**	(144)	**—**	(89)	**(173)**	(179,652)
Interest income													**94**	597
Loss from operating activities													**(79)**	(179,055)
Finance costs													**(2,589)**	(3,353)
Loss before tax													**(2,668)**	(182,408)
Tax													**286**	—
Minority interests													**—**	77
Net loss from ordinary activities attributable to shareholders													**(2,382)**	(182,331)

* *The balance includes an impairment of goodwill amounting to HK$133,349,000 in respect of the Group's acquisition of Nanhai Tannery & Leather Products Co., Ltd.*

(b) Geographical segments

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

	Mainland China For the six months ended 30 June		Hong Kong For the six months ended 30 June		Elsewhere For the six months ended 30 June		Consolidated For the six months ended 30 June	
	2003	2002	**2003**	2002	**2003**	2002	**2003**	2002
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
	(Unaudited)	(Unaudited)	**(Unaudited)**	(Unaudited)	**(Unaudited)**	(Unaudited)	**(Unaudited)**	(Unaudited)
Segment revenue:								
Sales to external customers	**142,380**	288,265	**—**	15,370	**—**	10,533	**142,380**	314,168
Other revenue (excluding exchange gains/(losses), net)	**1,168**	847	**445**	1,428	**—**	—	**1,613**	2,275
Exchange gains/(losses), net	**54**	(36)	**(4)**	(43)	**—**	—	**50**	(79)
Total	**143,602**	289,076	**441**	16,755	**—**	10,533	**144,043**	316,364

(3) Loss from Operating Activities

The Group's loss from operating activities is arrived at after charging:

	For the six months ended 30 June	
	2003	2002
	HK$'000	*HK$'000*
	(Unaudited)	(Unaudited)
Cost of inventories sold	**132,169**	286,890
Depreciation	**8,025**	8,222
Amortisation of trademarks*	**—**	700
Staff costs (including Directors' remuneration)		
Wages and salaries	**10,602**	19,464
Pension scheme contributions	**662**	745
Less: Forfeited contributions	**—**	—
Net pension scheme contributions	**662**	745
	11,264	20,209
Operating leases expenses in respect of land and buildings:		
Minimum lease payments	**182**	3,854
Contingent rent payments	**—**	1,512
	182	5,366
Annual fee paid to a PRC joint venture partner	**—**	404
Exchange (gains)/losses, net	**(50)**	79
Expenses included in other operating (income)/expenses, net:		
(Gain)/loss on disposal of fixed assets, net	**(380)**	949
Surplus arising on revaluation of investment properties	**(1,300)**	(12)
Deficit/(surplus) arising on revaluation of leasehold land and buildings	**23**	(60)
Loss on disposal of a subsidiary	**15**	—
Write-off of fixed assets	**983**	26
Provision for doubtful debts	**—**	32,574
Provision against inventories	**—**	11,057
Provision for impairment of fixed assets	**—**	1,403
Impairment of goodwill arising from acquisition of subsidiaries	**—**	133,349
and after crediting:		
Gross rental income from investment properties	**850**	980
Add: Sublease income	**—**	82
Total rental income in respect of minimum lease receivables	**850**	1,062
Less: Outgoings from investment properties	**(231)**	(12)
Net rental income	**619**	1,050
Other rental income	**154**	—
Royalty income	**—**	500
Interest income	**94**	597

* *The amortisation for the period is included in "Administrative expenses" on the face of the condensed consolidated profit and loss account.*

(4) Finance Costs

This represented interest on bank borrowings and loans from the Company's former immediate holding company, Guangdong Investment Limited, the Company's current immediate holding company, GDH Limited, and fellow subsidiaries during the period.

These bank and other borrowings are wholly repayable within five years.

(5) 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 (2002: Nil). The tax credit for the period represented the reversal of overprovision of Hong Kong profits tax in the prior periods.

The Group did not have any assessable profits in respect of subsidiaries of the Company in Mainland China and overseas during the period (2002: Nil).

(6) Loss Per Share

The calculation of basic loss per share is based on the unaudited net loss attributable to shareholders for the period of HK$2,382,000 (2002: HK$182,331,000) and the weighted average number of 524,154,000 ordinary shares in issue during the period.

No diluted loss per share amount is presented for the six months ended 30 June 2003 as the options outstanding during the period had an anti-dilutive effect on the basic loss per share for the period.

No diluted loss per share amount is presented for the six months ended 30 June 2002 as no diluting events existed during that period.

(7) Contingent Liabilities

At the balance sheet date, the Group had the following significant contingent liabilities:

(a) 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 is a wholly owned subsidiary of the Company in Nanhai, Mainland China.

Upon discovery of the irregularities, an internal audit team of the Company’s then holding companies, working with the then 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 detained the Former Executives and seized documents related to the Parallel Operation for investigations. 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 are of the opinion that the Parallel Operation should not be 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 law and regulations.

As the investigations of the PRC authorities are still ongoing, it is not possible to ascertain with any degree of reasonable certainty of the consequential actions that may be taken by the PRC authorities for the aforesaid irregularities and the existence or otherwise of any penalties and claims. As of the date of this report, no action has been taken against the Group and there have been no indications that any adverse actions against it are pending. Accordingly, based on currently available information, no provision has been made in the financial statements for such contingencies.

(b) In September 2002, the Company submitted a claim to China International Economic and Trade Arbitration Commission (the “Arbitration Commission”) in Shenzhen, Mainland China against a PRC joint venture partner of a subsidiary in Qingdao seeking, among others, termination of the relevant joint venture agreement and compensation of losses and damages of approximately RMB24,000,000. However, the PRC joint venture partner also applied to the Arbitration Commission in Beijing against the Company claiming for loss of fixed return under the aforesaid joint venture agreement and damages in an aggregate of RMB15,000,000. The two arbitration proceedings are still in progress.

In the opinion of the Directors, based on legal advice, it is too premature to conclude the likely outcome of the two arbitration proceedings. Accordingly, no provision has been made in the condensed consolidated financial statements as at 30 June 2003.

SUMMARY OF INDEPENDENT AUDITORS' REVIEW REPORT

An extract from the independent auditors' review report of the Company for the six months ended 30 June 2003 is as follows:

Fundamental uncertainty — Contingent liabilities

In arriving at our review conclusion, we have considered the adequacy of the disclosures made in the interim financial report concerning the investigations of the authorities of the People's Republic of China (the "PRC") in respect of the irregularities involving certain former executives of a subsidiary of the Company. As the investigations of the PRC authorities are still ongoing, it is not possible to ascertain with any degree of reasonable certainty of the 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 penalties and claims as a result of the aforesaid irregularities. As of the date of this report, no provision has been made in the financial statements for such contingencies. We consider that appropriate disclosures and estimates have been made 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 2003.

OTHER INFORMATION

Corporate Governance

Regular meetings have been held by the Audit Committee since its establishment and it shall meet at least twice each year to review and supervise the Group's financial reporting process and internal controls.

None of the Directors is aware of information that would reasonably indicate that the Company is not, or was not for any part of the accounting period covered by this interim report, in compliance with Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

The Group's interim financial report for the six months ended 30 June 2003 has not been audited, but has been reviewed by the Company's auditor Messrs. Ernst & Young.

Purchase, Sale or Redemption of Shares

The Company has not redeemed any of its shares during the six months ended 30 June 2003. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the period.

Publication of Unaudited Interim Results on the Website of the Stock Exchange of Hong Kong Limited

A detailed unaudited interim results announcement for the six months ended 30 June 2003 containing all the information required by paragraphs 46(1) to 46(6) of Appendix 16 to the Rules Governing the

Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") will be published on the website of the Stock Exchange in due course.

By Order of the Board
Xiong Guangyang
Chairman

Hong Kong, 5 September 2003

(The above results announcement may be downloaded from the Company's website at www.gdtann.com.)

Please also refer to the published version of this announcement in The Standard.