粵海制革有限公司
GUANGDONG TANNERY LIMITED

(Incorporated in Hong Kong with limited liability)

(Stock Code: 1058)

2004 ANNUAL RESULTS ANNOUNCEMENT

CHAIRMAN'S STATEMENT

I am pleased to report that the Group's audited consolidated profit attributable to shareholders for the year ended 31 December 2004 was HK$4,668,000. It was a reflection of our success in achieving profitability and ending the protracted loss since 1998.

We have adjusted our operations and management strategies in quick response to the freezing of bank accounts of Tongyuan Tannery in early 2004. In tandem with the strategic move to shift the operations from Nanhai to Xuzhou, we have put in place various measures to establish Xuzhou as a primary production base of the Group. These measures include expanding the production capacity, adding new product series with good competitiveness, and extending the supply and distribution network. With all these strategies and new measures, the Group is currently provided with a stronger platform for future growth.

Xuzhou Gangwei Colour Package Co., Ltd. has changed its name to Xuzhou Gangwei Leather Co. Ltd., and has commenced mass production in March 2005 after the production plant was restructured. Gangwei Tannery, primarily a downstream production line for imported cowhides, was established to fill the production vacuum of imported cowhides due to the suspended operations of Tongyuan Tannery. Following our moves to expand and restructure the two tanneries in Xuzhou, Xuzhou Nanhai Tannery is currently focusing on the processing of domestic cowhides, and the combined production capacity of the two tanneries will reach 36,000,000 sq.ft. per year.

To completely resolve the development bottleneck associated with environmental protection, we have outsourced the upstream processing to remote areas, and have increased the proportion of outsourcing and franchising. Currently part of our upstream processing is outsourced to a tannery in Shandong. We plan to seek one or two additional outsourcing partners, and are considering possible investments in upstream processing plants in the adjacent coastal areas where suitable conditions arise. These initiatives well illustrate our intact commitment to removing any environmental related barriers arising from the Group's expansion.

We have continued to follow up with the Guangzhou Customs to resolve the matter in relation to the freezing of Tongyuan Tannery's bank accounts and will, if necessary, take such measures as may be required to safeguard the rights and position of Tongyuan Tannery. Given that Tongyuan Tannery has suspended all of its operations in March 2004, we are taking steps to liquidate its assets such as production plant and equipment, and will utilize the fund for future development of the two tanneries in Xuzhou.

The Group has more than ten years of experience in the leather industry. Leveraging on this extensive experience, coupled with our efforts to strengthen the market research, work with new suppliers with good reliability and integrity, and introduce competition into the sourcing process, we have been placed in a favourable position to acquire raw materials at reasonable prices. On the front of distribution, our active efforts initiated since last year to open up the direct sales market have delivered solid results. Looking ahead, direct sales to shoes manufacturers will be a major focus of the Group in distribution, and this approach will enable the Group to thrive on a leading position in China's highly competitive leather market.

I take this opportunity to thank our customers, suppliers and shareholders for their continued support, and our staff for their hard work and dedication.

Zhang Chunting
Chairman

Hong Kong, 8 April 2005

MANAGEMENT DISCUSSION AND ANALYSIS

Results

The Group's audited profit attributable to shareholders for the year ended 31 December 2004 was HK$4,668,000, compared with a loss of HK$101,294,000 for the same period last year.

The audited net asset value of the Group as at 31 December 2004 was HK$171,072,000, an increase of HK$912,000 and a drop of HK$1,779,000 as compared to 31 December 2003 and 30 June 2004 respectively.

No final dividend is recommended by the Board of Directors for the year ended 31 December 2004.

Operations Review

We achieved encouraging progress in production and operations based on our relentless efforts to strive for improvement over the past year. Manifestations include: (1) significant enhancement of operational efficiency and profitability at the production base in Xuzhou as we pursued the expansion initiatives and strengthened the management and operations in production, supply and distribution, as part of the measures to remedy the problems of shrinking business and climbing costs following the closure of Nanhai production base; (2) steady removal of supply related risks and barriers of distribution bottleneck by extending the supply channels and sales network, and (3) rapid growth in production volume, steady improvement in product quality, as well as higher competitiveness of the Group's products.

Consolidated turnover for the year was HK$281,951,000, a drop of 26.11% as compared to HK$381,601,000 for the same period last year. Turnover of Xuzhou Tannery for the year was HK$162,741,000 (2003: HK$158,485,000), an increase of 2.68% over the previous year. Turnover of cowhides decreased by 18.82% to HK$254,917,000 (2003: HK$314,003,000) whereas cow split, coated cow split and others dropped by 60% to HK$27,034,000 (2003: HK$67,598,000). The Group maintained a stable turnover in the face of the slowing market last year primarily because: (1) we has established a strong sales network following the marketing strategy of "focusing on targeted markets and customers"; (2) our pursuit of direct sales to leading manufacturers has delivered initial results; (3) we adopted an incentive mechanism under which remuneration was linked to sales results, and this helped arouse the initiative and creativity of sales personnel in market development and marketing.

On the front of product mix, we have developed and launched to the market dozens of new products in three leather series: bumpy, natural and embossed series, which were newly included in our product portfolio in addition to the existing series of the domestic nappa leather. All of the new products were well received by the market.

Sourcing cost for raw materials was effectively controlled as we continued to introduce competition into the sourcing process through the tender system under the "Sunshine" program, and we were responsive to market changes in terms of supply and demand. Total sourcing costs for the year decreased by 58.8% to HK$158,806,000 as we were focused on clearing the raw materials of Tongyuan Tannery in the first half of 2004.

The Group's total leather production for the year was 17,553,000 sq. ft., declined by 13,595,000 sq.ft. from 31,148,000 sq. ft. in 2003. Production of cowhides dropped by 26.49% to 16,344,000 sq. ft. (2003: 22,234,000 sq. ft.) whereas cow split, coated cow split and others down by 86.43% to 1,209,000 sq. ft. (2003: 8,914,000 sq. ft.). Xuzhou Tannery produced a total of 13,209,000 sq. ft. in cowhides for the year, an increase of 5,133,000 sq. ft. or 63.56% over the same period in the previous year.

As at 31 December 2004, the Group's consolidated inventories amounted to HK$141,089,000, reduced by HK$80,306,000 and HK$64,368,000 as compared to 31 December 2003 and 30 June 2004 respectively. The decrease was primarily attributable to the reduced sourcing volume of the Group, and our moves to liquidate the assets and inventories of Tongyuan Tannery following its suspended operations.

Balance of trade receivables as at 31 December 2004 was HK$29,382,000. After deducting the provisions for doubtful debts of HK$3,473,000, trade receivables amounted to HK$25,909,000, an increase of HK$8,747,000 and a drop of HK$8,614,000 as compared to 31 December 2003 and 30 June 2004 respectively. Trade receivables turnover was 13.1 times and average collection period was 27.88 days, an increase of 9.45 days as compared to 18.43 days in 2003. The trade receivables of Tongyuan Tannery upon its suspension of operations in March 2004 was RMB39,000,000. As at 31 December 2004, these trade receivables were reduced to RMB5,150,000 as we have made active attempts to recover the receivables.

Financial Review

As at 31 December 2004, the Group's interest-bearing borrowings amounted to HK$100,626,000 (as at 31 December 2003: HK$133,648,000). Of the total interest-bearing borrowings, HK$10,350,000 was denominated in Hong Kong dollars, HK$35,676,000 in Renminbi and HK$54,600,000 in US dollars. In addition, all interest-bearing borrowings are charged at fixed rate.

As at 31 December 2004, the Group's cash and bank balances amounted to HK$98,040,000 (as at 31 December 2003: HK$84,332,000), denominated in Hong Kong dollars (HK$1,333,000), Renminbi (equivalent to HK$74,677,000) and US dollars (equivalent to HK$22,030,000) respectively.

As at 31 December 2004, after deduction of cash and bank deposits, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 1.51% (as at 31 December 2003: 28.98%). Loan facilities bear interest at approximately 3% to 5% per annum. All borrowings are repayable on 30 June 2005. Subsequent to the balance sheet date, the repayment due date of the loans are extended to 30 June 2006. Interest expense incurred by the Group during the year was HK$5,734,000, a drop of 3.59% as compared to the same period last year.

Net cash inflow from operating activities for the year was HK$24,048,000 and net cash outflow from financing activities was HK$16,931,000. Net increase in cash and cash equivalents for the year amounted to HK$6,274,000.

Fixed assets as at 31 December 2004 were HK$111,296,000, a reduction of HK$7,110,000 as compared to 31 December 2003. The Group's capital expenditure during the year amounted to HK$2,186,000 (2003: HK$3,044,000). It was incurred mainly for the replacement of the leather manufacture machinery and equipment, a move to cope with the expansion of the Xuzhou Tannery.

As at 31 December 2004, certain of the Group's buildings, investment properties, bank deposits and plant and machinery with a total net book value of HK$20,969,000 (31 December 2003: HK$15,295,000) were pledged to secure general banking facilities granted to the Group.

Freezing of Tongyuan Tannery's Bank Accounts

In February and March 2004, certain bank accounts of Foshan City Nanhai Tong Yuan Tanning Co., Ltd ("Tongyuan Tannery") were frozen by the Guangzhou Customs in the PRC. A written notification was later sent to Tongyuan Tannery by the Guangzhou Customs demanding payment of an amount of RMB36,989,441.92. As the freezing of bank accounts has severely affected its business, Tongyuan Tannery has suspended all of its operations in March 2004, and more than 600 employees were laid off as at the end of December 2004, which represented the entire pool of staff other than certain rear-service personnel. Tongyuan Tannery will continue to follow up with the Guangzhou Customs to resolve the matter and will, if necessary, take all such measures as may be required to safeguard its rights and position. As at 31 December 2004, the aggregate amount of Tongyuan Tannery's bank deposits being frozen was RMB9,247,000.

Progress on winding up Qingdao Tannery

As regards the litigation between Qingdao Nanhai Tannery Co., Ltd. ("Qingdao Tannery") and its PRC joint venture partner, a ruling was made by the China International Economic and Trade Arbitration Commission in Shenzhen on 27 May 2004 confirming that: (i) the "Joint Venture Agreement in respect of Qingdao Nanhai Tannery Co., Ltd." ("Qingdao Joint Venture Agreement") was terminated on 23 August 2001; (ii) Qingdao Tannery is required to be wound up in compliance with all applicable laws and regulations of the People's Republic of China and the terms and conditions under the joint venture agreement; and (iii) proceeds from selling Qingdao Tannery's assets and the remaining assets not yet been realized must be included in the liquidation account. On 22 June 2004, the claims made by the PRC joint venture partner for loss of fixed return under the Qingdao Joint Venture Agreement and damages in an aggregate of RMB15,000,000 were also dismissed by the China International Economic and Trade Arbitration Commission in Beijing. The Company will proceed with the winding-up of Qingdao Tannery in compliance with the above rulings.

Major Customers and Suppliers

For the year ended 31 December 2004, the amount of purchases attributable to the Group's largest supplier represented 21.18% of the Group's total purchases; and the aggregate amount of purchases (not including the purchases of items which are of a capital nature) attributable to the Group's five largest suppliers represented 69.97% of the Group's total purchases. In addition, the amount of turnover attributable to the Group's largest customer represented 24.28% of the Group's total turnover; and the aggregate amount of the turnover attributable to the Group's five largest customers represented 69.16% of the Group's total turnover. None of the Directors of the Company or their associates holds or any shareholders (which, to the best knowledge of the Directors, owns more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest suppliers or customers.

Employees

As at 31 December 2004, a total of 448 employees (2003: 1,018 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 ("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. Details of the Share Option Scheme are set out in the Report of the Directors.

Auditors – Services provided other than audit

Messrs. Ernst & Young, the auditors of the Group, have provided services to the Group other than the statutory audit work including the review of interim results and charges of such services were HK$186,000.

The Directors of Guangdong Tannery Limited (the "Company") announce the audited consolidated results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2004 together with the comparative figures for 2003 as follows:

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Notes	**2004** *HK$'000*	2003 *HK$'000*
TURNOVER	*2*	**281,951**	381,601
Cost of sales		**(255,849)**	(376,238)
Gross profit		**26,102**	5,363
Other revenue and gains		**2,922**	19,663
Selling and distribution costs		**(1,630)**	(2,941)
Administrative expenses		**(20,015)**	(28,963)
Other operating profit/(expenses), net		**4,226**	(88,754)
PROFIT/(LOSS) FROM OPERATING ACTIVITIES	*3*	**11,605**	(95,632)
Finance costs	*4*	**(5,734)**	(5,948)
PROFIT/(LOSS) BEFORE TAX		**5,871**	(101,580)
Tax	*5*	**(1,203)**	286
NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		**4,668**	(101,294)
EARNING/(LOSS) PER SHARE	*6*		
– Basic		**0.89 cents**	(19.33 cents)
– Diluted		**N/A**	N/A

CONSOLIDATED BALANCE SHEET

	31 December 2004 *HK$'000*	31 December 2003 *HK$'000*
NON-CURRENT ASSETS		
Fixed assets	**111,296**	118,406
CURRENT ASSETS		
Inventories	**141,089**	221,395
Receivables, prepayments and deposits	**54,698**	47,683
Tax recoverable	**7,040**	7,031
Loan to an officer	**923**	970
Pledged and frozen deposits	**14,794**	7,355
Cash and cash equivalents	**83,246**	76,977
	301,790	361,411
CURRENT LIABILITIES		
Trade and bills payables	**(38,864)**	(67,725)
Accruals and other liabilities	**(19,781)**	(25,720)
Due to a PRC joint venture partner	**(1,131)**	(1,131)
Loans from the immediate holding company	**(46,026)**	(45,957)
Loan from a fellow subsidiary	**(54,600)**	(54,600)
Interest bearing bank borrowings	–	(33,091)
Provisions	**(72,600)**	(72,600)
	(233,002)	(300,824)
NET CURRENT ASSETS	**68,788**	60,587
TOTAL ASSETS LESS CURRENT LIABILITIES	**180,084**	178,993

NON-CURRENT LIABILITIES		
Deferred tax liabilities	**(9,012)**	(8,833)
	171,072	170,160
CAPITAL AND RESERVES		
Issued capital	**52,415**	52,415
Reserves	**118,657**	117,745
	171,072	170,160

Notes:

(1) BASIS OF PREPARATION AND IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs") AND INTERPRETATIONS

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the Companies Ordinance. They have been prepared under the historical cost convention, except for the periodic remeasurement of investment properties and leasehold land and buildings.

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and interpretations, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005.

The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

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

(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 property investment segment invests in residential and commercial properties in Mainland China for rental income purpose; and

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

In determining the Group's geographical segments, revenues and results are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets. Intersegment transactions mainly represented management services provided and charged by the Company to its subsidiaries at the bases determined by the Group.

(a) Business segments

The following tables present revenue, profit/(loss) and expenditure information for the Group's business segments.

Group - 2004

	Leather processing *HK$'000*	**Property investment** *HK$'000*	**Corporate and other** *HK$'000*	**Eliminations** *HK$'000*	**Consolidated** *HK$'000*
Segment revenue:					
Sales to external customers	281,951	–	–	–	281,951
Intersegment sales	–	–	480	(480)	–
Other revenue (excluding exchange gains/(losses), net)	1,408	1,066	31	–	2,505
Exchange gains/ (losses), net	491	–	22	–	513
Total	283,850	1,066	533	(480)	284,969
Segment results	18,379	342	(7,533)	–	11,188
Interest income					417
Profit/(loss) from operating activities					11,605
Finance costs					(5,734)
Profit/(loss) before tax					5,871
Tax					(1,203)
Net profit/(loss) from ordinary activities attributable to shareholders					4,668

Other segment information:					
Capital expenditure	2,165	–	21	–	2,186
Depreciation	8,956	–	452	–	9,408
Reversal of impairment of fixed assets	(5,162)	–	–	–	(5,162)
Impairment of fixed assets	–	–	–	–	–
Revaluation deficit/(surplus) of investment properties	–	234	–	–	234
Revaluation surplus of leasehold land and buildings	(138)	–	–	–	(138)
Other non-cash expenses	25	–	71	–	96
Provisions for tax claim and tax penalty by the PRC authorities	–	–	–	–	–

The following tables present revenue, profit/(loss) and expenditure information for the Group's business segments.

Group – 2003

	Leather processing *HK$'000*	Property investment *HK$'000*	Corporate and other *HK$'000*	Eliminations *HK$'000*	Consolidated *HK$'000*
Segment revenue:					
Sales to external customers	381,601	–	–	–	381,601
Intersegment sales	–	–	480	(480)	–
Other revenue (excluding exchange gains/(losses), net)	941	1,825	16,703	–	19,469
Exchange gains/ (losses), net	(1,171)	–	(160)	–	(1,331)
Total	381,371	1,825	17,023	(480)	399,739
Segment results	(106,898)	2,075	8,997	–	(95,826)
Interest income					194
Profit/(loss) from operating activities					(95,632)
Finance costs					(5,948)
Profit/(loss) before tax					(101,580)
Tax					286
Net profit/(loss) from ordinary activities attributable to shareholders					(101,294)
Other segment information:					
Capital expenditure	2,985	–	59	–	3,044
Depreciation	15,531	–	784	–	16,315
Reversal of impairment of fixed assets	–	–	–	–	–
Impairment of fixed assets	10,320	–	–	–	10,320
Revaluation deficit/(surplus) of investment properties	–	(662)	–	–	(662)
Revaluation surplus of leasehold land and buildings	(42)	–	–	–	(42)
Other non-cash expenses	8,098	(681)	790	–	8,207
Provisions for tax claim and tax penalty by the PRC authorities	69,600	–	–	–	69,600

(b) Geographical segments

The following tables present revenue information for the Group's geographical segments.

Group

	Mainland China		Hong Kong		Eliminations		Consolidated	
	2004 **HK$'000**	2003 *HK$'000*	**2004** **HK$'000**	2003 *HK$'000*	**2004** **HK$'000**	2003 *HK$'000*	**2004** **HK$'000**	2003 *HK$'000*
Segment revenue:								
Sales to external customers	**281,951**	381,601	**–**	–	**–**	–	**281,951**	381,601
Other revenue (excluding exchange gains/(losses), net)	**2,505**	18,843	**–**	626	**–**	–	**2,505**	19,469
Exchange gains/(losses), net	**675**	(1,171)	**(162)**	(160)	**–**	–	**513**	(1,331)
Total	**285,131**	399,273	**(162)**	466	**–**	–	**284,969**	399,739

(3) PROFIT/(LOSS) FROM OPERATING ACTIVITIES

The Group's profit/(loss) from operating activities is arrived at after charging/(crediting):

	2004	2003
	HK$'000	*HK$'000*
Cost of inventories sold	**255,849**	376,238
Auditors' remuneration	**720**	799
Depreciation	**9,408**	16,315
Staff costs (excluding directors' remuneration)		
Wages and salaries	**9,912**	20,741
Redundancy payments (included in other operating profit/(expenses),net below)	**1,257**	–
Pension scheme contributions (defined contributions scheme)*	**714**	1,153
	11,883	21,894
Minimum lease payments under operating leases in respect of land and buildings	**251**	359
Other rental income	**(449)**	(384)
Gross rental income from investment properties	**(855)**	(1,684)
Less: Outgoings from investment properties	**158**	320
Net rental income	**(697)**	(1,364)
Expenses/(income) included in other operating profit/(expenses), net:		
Deficit/(surplus) arising on revaluation of investment properties	**234**	(662)
Surplus arising on revaluation of leasehold land and buildings	**(138)**	(42)
Provision for doubtful debts	**–**	816
Write off of fixed assets	**83**	8,021
Loss/(gain) on disposal of fixed assets, net	**13**	(630)
Reversal of Impairment of fixed assets	**(5,162)**	–
Impairment of fixed assets	**–**	10,320
Exchange losses/(gains), net	**(513)**	1,331
Redundancy payments	**1,257**	–
Provisions for tax claim and tax penalty by the PRC authorities	**–**	69,600
	(4,226)	88,754

* The amount of forfeited pension scheme contributions available at the current and prior year ends to reduce contributions in future years is not material.

(4) FINANCE COSTS

		Group
	2004	2003
	HK$'000	*HK$'000*
Interest on:		
Bank loans	**1,847**	3,585
Loans from the former immediate holding company	**–**	434
Loans from the immediate holding company	**1,778**	1,343
Loans from a fellow subsidiary	**2,109**	586
	5,734	5,948

(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 year (2003: Nil). No provision for Mainland China and overseas profits tax has been made (2003: Nil) as there were no assessable profits arising from certain subsidiaries of the Company operating in Mainland China and overseas during the year and certain subsidiaries of the Company operating in Mainland China and overseas had tax losses brought forward from prior years to offset the assessable profits during the year.

	2004	2003
	HK$'000	*HK$'000*
Group:		
Current – Hong Kong		
Charge for the year	**–**	–
Overprovision in prior years	**–**	(286)
Deferred	**1,203**	–
Total tax charge/(credit) for the year	**1,203**	(286)

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 year ended 31 December 2004.

(6) EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of HK$4,668,000 (2003: net loss of HK$101,294,000) and the 524,154,000 (2003: 524,154,000) ordinary shares in issue during the year.

Diluted earnings/(loss) per share amounts for the years ended 31 December 2004 and 2003 have not been disclosed, as the share options outstanding during these years had an anti-dilutive effect on the basic earnings/(loss) per share for these years.

(7) PROVISIONS

Group

	Tax claim and tax penalty by the PRC authorities *HK$'000*	**Early termination of a joint venture agreement** *HK$'000*	**Total** *HK$'000*
At beginning of year and 31 December 2004	69,600	3,000	72,600

(a) Tax claim by the PRC authorities

With respect to the tax claim of RMB36,989,000 (equivalent to approximately HK$34,800,000) made by the Anti-Smuggling Bureau of Guangzhou Customs (廣州海關緝私局) (the "Guangzhou Customs") to Foshan City Nanhai Tong Yuan Tanning Co., Ltd. (formerly known as Nanhai City Tongyuan Tanning Company Limited) ("Tongyuan Tannery"), a wholly-owned subsidiary of the Company established in Mainland China, provisions of HK$69,600,000 was made as at 31 December 2003 for (a) the tax claim of HK$34,800,000 made by the Guangzhou Customs; and (b) the tax penalty of HK$34,800,000 that may be imposed by the relevant PRC authorities, which were provided for by the directors with reference to a PRC legal opinion obtained by them.

(b) Provisions for termination of a joint venture agreement

With respect to the Group's decision in August 2001 to curtail the operations of Qingdao Nanhai Tannery Co., Ltd. ("Qingdao Tannery") due to its continuous losses, provisions of HK$3,000,000 was made as at 31 December 2001 for (a) staff redundancy payments of HK$2,000,000; and (b) compensation of HK$1,000,000 to the PRC joint venture partner for early termination of the joint venture agreement of Qingdao Tannery. These provisions were determined based on the relevant employment contracts and the terms of the joint venture agreement.

During the year, the arbitration proceedings undertaken by the Group and the PRC joint venture partner were concluded by the China International Economic and Trade Arbitration Commissions in Shenzhen and Beijing determined that (i) the joint venture agreement of Qingdao Tannery was terminated with effect from 23 August 2001; (ii) Qingdao Tannery should be liquidated in accordance with the joint venture agreement and with the relevant laws and regulations in the PRC; and (iii) the PRC joint venture partner's claim against the Company for an economic loss of RMB15 million due to the termination of the joint venture agreement.

As the liquidation of Qingdao Tannery has not been completed, no payment for the provisions was made during the year. Accordingly, there was no movement in the provisions during the year.

(8) 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 a former 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 are of the opinion that the Parallel Operation should not be incorporated in the financial statements of the Group and that the Parallel Operation appears 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 subsidiary of GDH and a 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 GDH and a fellow 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 balances of RMB 2 million were frozen by the Guangzhou Customs. Accordingly, bank balances of RMB9 million (equivalent to approximately HK$8.7 million) were frozen as at 31 December 2004.

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, 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 a 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 has disposed of its entire interest in Nanhai Tannery to GDH and the tax evasion was related to the Parallel Operation of Nanhai Tannery, it cannot be precluded that the Guangzhou Customs may still claim the tax evaded by Nanhai Tannery against Tongyuan Tannery on the ground that Nanhai Tannery had transferred most of its fixed assets and inventories to Tongyuan Tannery after the commencement of the investigations undertaken by the Guangzhou Customs. The directors have sought PRC legal advice on such matters and consider that Tongyuan Tannery will be liable for the above-mentioned tax claim of HK$34,800,000 by the Guangzhou Customs if the Guangzhou Customs considers that Tongyuan Tannery and Nanhai Tannery are one and the same entity. Accordingly, the Group made a provision of HK$34,800,000.

In addition, based on a PRC legal opinion, 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 tax evaded by the Parallel Operation of Nanhai Tannery, ie. HK$34,800,000 to HK$174,000,000. The directors have sought legal advice on such matters and consider that a provision of HK$34,800,000 for the tax penalty is appropriate.

As the actions taken by the PRC authorities have not yet been concluded, it is not possible to determine with any degree of reasonable certainty the amount of tax penalty which may finally be imposed by the PRC authorities against Tongyuan Tannery, which may be within the range of HK$34,800,000 to HK$174,000,000, other 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 as a result of the aforesaid irregularities. Should additional tax penalty in excess of the amount provided of HK$34,800,000 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.

As of the date of this report, no further action has been taken by the Guangzhou Customs or any other PRC authorities against Tongyuan Tannery and there have been no further claims made against Tongyuan Tannery. Accordingly, based on the current available information, no further provision for the tax penalty and other claims or liabilities has been made in the financial statements.

SUMMARY OF REPORT OF THE AUDITORS

An extract from the report of the auditors to the Company for the year ended 31 December 2004 is as follows:

Fundamental uncertainty - Contingent liabilities

In arriving at our audit opinion, we have considered the adequacy of the disclosures made in the 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 HK$69,600,000 for the tax claim and tax penalty made by the Group as detailed in the financial statements. As the actions taken by the authorities of the People's Republic of China (the "PRC") have not yet been concluded, it is not possible to ascertain with any degree of reasonable certainty the amount of any tax penalty which may finally be imposed by the PRC authorities and the other 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 arising as a result of the aforesaid irregularities. As of the date of this report, no further provision other than that disclosed in the financial statements has been made in the financial statements for such contingencies. We consider that appropriate disclosures and estimates have been made in the financial statements and our audit opinion is therefore not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2004 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

DIVIDENDS

The Directors do not recommend the payment of a final dividend (2003: Nil).

CODE OF BEST PRACTICE

The Company has compiled throughout the year ended 31 December 2004 with the Code of Best Practices, as set out in Appendix 14 of the Listing Rules of The Stock Exchange of Hong Kong Limited of which is effective before 31 December 2004.

The Company has adopted the Model Code set out in Appendix 10 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited as the code of conduct regarding Director's 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 Codel during the year.

AUDIT COMMITTEE

The Company has established an Audit Committee comprising all of the Independent Non-Executive Directors of the Company in accordance with the Code of Corporate Governance Practice as set out in Appendix 14 to the Listing Rules (the "Code"). The principal duties of the Audit Committee include the review of the completeness, accuracy and fairness of the Company's financial reports and the effectiveness of the Company's internal control system. The results of the Group for the year ended 31 December 2004 has been reviewed by the Audit Committee.

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.

PUBLICATION OF ANNUAL RESULTS ON THE WEBSITE OF THE STOCK EXCHANGE OF HONG KONG LIMITED

A detailed results announcement containing all the information required by paragraphs 45(1) to 45(3) 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
Zhang Chunting
Chairman

Hong Kong, 8 April 2005

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

Please also refer to the published version of this announcement in China Daily.