粵海制革有限公司

GUANGDONG TANNERY LIMITED

(Incorporated in Hong Kong with limited liability)

(Stock Code: 1058)

INTERIM RESULTS FOR 2006

BUSINESS AND FINANCIAL REVIEWS

Results

The unaudited profit attributable to shareholders for the six months ended 30 June 2006 of Guangdong Tannery Limited (the "Company") and its subsidiaries (the "Group") was HK$924,000 compared with the loss of HK$515,000 for the same period last year.

The unaudited net asset value of the Group as at 30 June 2006 was HK$174,377,000, an increase of HK$14,288,000 and HK$1,943,000 as compared to the net asset value as at 30 June 2005 and 31 December 2005 respectively.

The board of directors (the "Board") of the Company resolved not to declare the payment of interim dividend for the six months ended 30 June 2006 (2005: Nil).

Operations Review

With the successful realization of the Group's strategic shift of operation to the northern part of China in 2005, the turnover of the Group rapidly recovered and our production base in Xuzhou began to benefit from economies of scales. Since the outsourcing of upstream production processes, our productivity of downstream production processes was released, the productivity of Xuzhou Gangwei Leather Co. Ltd. ("Xuzhou Gangwei Tannery") can be utilized more efficiently, and thus the overall production of Xuzhou production base has increased significantly as compared with the same period last year. During the period under review, total leather production of the Group amounted to 9,504,000 sq.ft. which increased by 4,072,000 sq.ft. as compared to 5,432,000 sq.ft for the same period last year. Production of cowhides increased by 94% to 9,504,000 sq.ft. (2005: 4,897,000 sq.ft.), whereas the production of cow split, coated cow split and other products decreased by 100% to zero sq.ft. (2005: 535,000 sq.ft.). The increase of production indicated that the Group's strategic shift of operations to the northern part of China has been successfully realized.

Product development will continuously be as one of our priority tasks. Apart from enhancing our production and marketing of nappa series which has been our main products, we further strived for product innovation and promotion. A range of innovative products such as wax-resemble nappa leather series had been successfully introduced into the market with a favourable market response. All these efforts hugely enriched the product mix and forged strong capability of the Group to adjust to ever-changing market demands.

Consolidated turnover for the period under review was HK$160,015,000, which increased by 68.30% as compared to HK$95,077,000 for the same period of 2005. Turnover of cowhides for the first half this year increased by 66.59% to HK$142,817,000 (2005: HK$85,730,000). Meanwhile, turnover of cow split, coated cow split and other products increased by 83.99% to HK$17,198,000 (2005: HK$9,347,000). Due to the increase in sales of the first half of 2006, the consolidated inventories of the Group increased correspondingly. As at 30 June 2006, consolidated inventories amounted to HK$167,574,000, which increased by HK$35,909,000 and HK$45,106,000 as compared with 30 June 2005 and 31 December 2005 respectively.

Balance of trade receivables as at 30 June 2006 was HK$34,972,000. After deducting the provisions for doubtful debts of HK$3,005,000, trade receivables amounted to HK$31,967,000, a decrease of HK$3,177,000 as compared to 30 June 2005 and an increase of HK$10,102,000 as compared to 31 December 2005 respectively. Trade receivables turnover was 11.9 times and average collection period was 31 days, a decrease of 28 days as compared to 59 days for the same period in 2005.

Financial Review

As at 30 June 2006, the Group's interest-bearing borrowings amounted to HK$84,378,000 (as at 31 December 2005: HK$84,176,000). Of the total interest-bearing borrowings, HK$10,350,000 was denominated in Hong Kong dollars, HK$19,428,000 in Renminbi and HK$54,600,000 in US dollars. All of these interest-bearing borrowings are charged at fixed rates.

As at 30 June 2006, the Group's cash and bank balances amounted to HK$58,063,000 (as at 31 December 2005: HK$69,832,000), which are denominated in Hong Kong dollars (HK$2,280,000), Renminbi (equivalent to HK$54,884,000) and US dollars (equivalent to HK$899,000) respectively.

As at 30 June 2006, after deduction of cash and bank deposits, the Group's ratio of net interest-bearing borrowings to shareholders' equity was 15.09% (as at 31 December 2005: 8.32%). Loan facilities bear interest at approximately 3% to 6% 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$1,933,000, representing an increase of 8.1% as compared with the same period last year.

During the period, net cash outflow from operating activities was HK$20,366,000 and net cash inflow from financing was HK$3,117,000. Net decrease in cash and cash equivalents amounted to HK$16,990,000.

As at 30 June 2006, net non-current assets including properties, plant and equipment, investment properties and prepaid land lease payments were HK$74,031,000, a reduction of HK$12,294,000 as compared with the figure as at 31 December 2005. During the period, the Group's capital expenditure amounted to HK$983,000 (2005: HK$578,000). 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 2006, certain of the Group's buildings, bank deposits and machinery and equipment with a total net book value of HK$21,225,000 (31 December 2005: HK$40,220,000) 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 ("Tongyuan Tannery") by the Guangzhou Customs in the PRC were set out in the note 20 to the unaudited condensed consolidated interim financial statements.

EMPLOYEES

As at 30 June 2006, a total of 731 employees (31 December 2005: 622 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 will face a difficult operating environment in coming years; such as the increasing of costs of raw materials, fuels consumption and salaries combined with keen competition. To strive against such harsh environment, the Group will continue its efforts to face the challenges ahead by consolidating the foundation of Group's production, supply, sales, marketing as well as operation efficiency. In addition, it is the Group's intention to operate the merchandise trading business as well as actively explore effective ways to deal with the idle assets of Tongyuan Tannery.

CONDENSED CONSOLIDATED INCOME STATEMENT

		Six months ended 30 June	
		2006	2005
	Notes	***HK$'000***	*HK$'000*
		(Unaudited)	(Unaudited)
REVENUE			
Processing and sale of leather	*2*	**160,015**	95,077
Cost of sales		**(144,142)**	(82,922)
Gross profit		**15,873**	12,155
Other income and gains		**2,670**	2,208
Selling and distribution costs		**(520)**	(776)
Administrative expenses		**(10,892)**	(12,143)
Other operating expenses, net		**(2,060)**	(116)
Finance costs		**(1,933)**	(1,788)
PROFIT/(LOSS) BEFORE TAX	*3*	**3,138**	(460)
Tax	*4*	**(2,214)**	(55)
PROFIT/(LOSS) FOR THE PERIOD		**924**	(515)
EARNINGS/(LOSS) PER SHARE	*5*		
– Basic		**HK0.18 cent**	HK(0.10)cent
– Diluted		**HK0.18 cent**	N/A

CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	30 June 2006 HK$'000 (Unaudited)	31 December 2005 HK$'000 (Audited)
NON-CURRENT ASSETS			
Property, plant and equipment		**68,122**	80,313
Investment properties		**2,185**	2,280
Prepaid land lease payments		**3,724**	3,732
Interest in an associate		**1,219**	4,336
Total non-current assets		**75,250**	90,661
CURRENT ASSETS			
Inventories		**167,574**	122,468
Receivables, prepayments and deposits	*6*	**81,274**	91,257
Tax recoverable		**7,282**	7,206
Loan to an officer		**–**	873
Pledged and frozen bank balances		**18,694**	13,918
Cash and cash equivalents		**39,369**	55,914
Total current assets		**314,193**	291,636
CURRENT LIABILITIES			
Trade and bills payables	*7*	**(31,152)**	(26,123)
Other payables and accruals		**(18,646)**	(19,601)
Tax payable		**(1,040)**	–
Due to a PRC joint venture partner		**(1,131)**	(1,131)
Loans from the immediate holding company		**–**	(29,576)
Loan from a fellow subsidiary		**–**	(54,600)
Provisions		**(74,862)**	(74,115)
Total current liabilities		**(126,831)**	(205,146)
NET CURRENT ASSETS		**187,362**	86,490
TOTAL ASSETS LESS CURRENT LIABILITIES		**262,612**	177,151
NON-CURRENT LIABILITIES			
Deferred tax liabilities		**(3,857)**	(4,717)
Loans from the immediate holding company		**(29,778)**	–
Loan from a fellow subsidiary		**(54,600)**	–
Total non-current liabilities		**(88,235)**	(4,717)
Net assets		**174,377**	172,434
EQUITY			
Issued capital		**52,415**	52,415
Reserves		**121,962**	120,019
Total equity		**174,377**	172,434

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 these unaudited condensed consolidated interim financial statements are the same as those used in the annual financial statements for the year ended 31 December 2005.

The Hong Kong Institute of Certified Public Accountants has issued a number of new Hong Kong Financial Reporting Standards ("HKFRSs") (which also included HKASs and Interpretations), which are generally effective for accounting periods beginning on or after 1 January 2006. The Group has adopted the following HKFRS issued up to 30 June 2006 which is pertinent to its operations and relevant to these unaudited condensed consolidated interim financial statements.

HK(IRFIC)-Int 4	Determining whether an Arrangement contains a Lease

The Group considered that the adoption of the above accounting standard has had no material impact on the Group's unaudited condensed consolidated interim financial statements.

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these unaudited condensed consolidated interim financial statements:

HKAS 1 Amendment	Capital Disclosure
HKFRS 7	Financial Instruments: Disclosures

HKAS 1 Amendment will affect the disclosures about qualitative information about the Group's objective, policies and processes for managing capital, quantitative data about what the Group regards as capital; and compliance with any capital requirements and consequences of any non-compliance.

HKFRS 7 will replace HKAS 32 and has modified the disclosure requirements of HKAS 32 relating to financial instruments.

These HKFRSs are effective for annual periods beginning on or after 1 January 2007. The Group expects that the adoption of the other pronouncements will not have any significant impact on the Group's financial statements in the period of initial application.

(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.

The following table presents revenue and results for the Group's primary 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	
	2006	2005	**2006**	2005	**2006**	2005	**2006**	2005
	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	**160,015**	95,077	**–**	–	**–**	–	**160,015**	95,077
Other income and gains	**2,109**	1,359	**168**	345	**–**	–	**2,277**	1,704
Total	**162,124**	96,436	**168**	345	**–**	–	**162,292**	96,781
Segment results	**8,762**	7,198	**121**	74	**(4,205)**	(6,448)	**4,678**	824
Unallocated interest income							**393**	504
Finance costs							**(1,933)**	(1,788)
Profit/(loss) before tax							**3,138**	(460)
Tax							**(2,214)**	(55)
Profit/(loss) for the period							**924**	(515)

(3) PROFIT/(LOSS) BEFORE TAX

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

	Six months ended 30 June	
	2006	2005
	HK$'000	*HK$'000*
	(Unaudited)	(Unaudited)
Depreciation	**4,197**	3,672
Recognition of prepaid land lease payments	**47**	47
Impairment of items of property, plant and equipment	**2,123**	–

(4) TAX

No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits arising in Hong Kong during the period (2005: Nil). Taxes on profits assessable in Mainland China have been calculated at the rates of tax prevailing in Mainland China in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

	Six months ended 30 June	
	2006	2005
	HK$'000	*HK$'000*
	(Unaudited)	(Unaudited)
Group:		
Current – PRC corporate income tax	**2,264**	–
Deferred	**(50)**	55
Total tax charge for the period	**2,214**	55

Certain subsidiaries of the Company established in the People's Republic of China (the "PRC") were exempt from PRC corporate income tax for two years commencing 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 and 2006.

A subsidiary of the Company established in the PRC was exempt from PRC corporate income tax for two years starting from its first profit-making year of operations, i.e. years ended 31 December 2004 and 2005, and is entitled to a 50%-relief from the PRC corporate income tax for the following three years ended 31 December 2006, 2007 and 2008. Accordingly, a provision for the PRC corporate income tax has been made on the estimated assessable profit of the subsidiary at the above preferential PRC corporate income tax rate for the six months ended 30 June 2006.

In the six months ended 30 June 2005, no provision for Mainland China and overseas profits tax has been made as there were either no assessable profits arising from certain subsidiaries of the Company operating in Mainland China and overseas during that period or certain subsidiaries of the Company operating in Mainland China and overseas with available tax losses brought forward from prior years to offset the assessable profit during that period.

(5) EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share for the period is based on the profit for the period of HK$924,000 (2005: loss of HK$515,000), and the weighted average number of 524,154,000 (2005: 524,154,000) ordinary shares in issue during the period.

The calculation of diluted earnings per share for the period is based on the profit for the period of HK$924,000. The weighted average number of ordinary shares used in the calculation is 524,154,000 ordinary shares in issue during the period, as used in the basic earnings per share calculation and the weighted average number of 45,281 ordinary shares assumed to have been issued at no consideration on the deemed exercise or conversion of all dilutive potential ordinary shares into ordinary shares during the period.

A diluted loss per share amount for the six months ended 30 June 2005 has not been disclosed as the share options outstanding during that period had an anti-dilutive effect on the basic loss per share for that period.

(6) RECEIVABLES, PREPAYMENTS AND DEPOSITS

As at 30 June 2006, included in the Group's receivables, prepayments and deposits are trade and bills receivables with a net balance of HK$68,622,000 (31 December 2005: HK$86,414,000) due from the Group's customers.

The Group's trading terms with customers are mainly on credit, except for new customers, where payment in advance is normally required. Invoices are normally payable within 30 days of issuance, except for certain well-established customers, where the terms are extended for two to three months. Each customer has a maximum credit limit. The Group seeks to maintain tight control over its outstanding receivables in order to minimise credit risk. Overdue balances are reviewed regularly by senior management. In view of the aforementioned and the fact that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. Trade receivables are non-interest-bearing.

As at 30 June 2006, the aged analysis of the Group's trade and bills receivables, based on the payment due date, is as follows:

	30 June 2006 *HK$'000* **(Unaudited)**	31 December 2005 *HK$'000* (Audited)
Current to 1 month	**63,462**	82,376
1 to 3 months	**2,053**	2,486
3 to 6 months	**1,246**	170
Over 6 months	**4,866**	4,373
	71,627	89,405
Provisions for doubtful debts	**(3,005)**	(2,991)
	68,622	86,414

A provision is made when there is objective evidence that the Group will not be able to collect the amounts due according to the original terms of the receivables.

At 31 December 2005, bills receivables of approximately HK$22,485,000 were pledged to secure the general banking facilities granted to the Group.

(7) TRADE AND BILLS PAYABLES

As at 30 June 2006, the aged analysis of the Group's trade and bills payables, based on the payment due date, is as follows:

	30 June 2006 *HK$'000* **(Unaudited)**	31 December 2005 *HK$'000* (Audited)
Within 3 months	**23,671**	21,130
3 to 6 months	**3,038**	1,229
6 to 12 months	**511**	292
Over 12 months	**3,932**	3,472
	31,152	26,123

(8) DIVIDEND

At a meeting of the Board held on 8 September 2006, the directors resolved not to declare an interim dividend to shareholders (2005: Nil).

(9) 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 items of property, plant and equipment 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 Limited and a former fellow subsidiary of the Company, for the disposal of the Company's entire 100% equity 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 2004, certain bank accounts of Tongyuan Tannery in the PRC containing in total of approximately RMB9 million (equivalent to approximately HK$8.7 million) were frozen by the Guangzhou Customs as at 31 December 2004. Taking into account the bank interest earned from the frozen bank balances and exchange realignment of HK$0.5 million in aggregate up to 30 June 2006 (31 December 2005: HK$0.3 million), the aggregate frozen bank balances amounted to approximately HK$9.2 million as at 30 June 2006 (31 December 2005: HK$9 million).

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 (the "Potential Tax Claim") 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 due to the transfer of most of Nanhai Tannery's items of property, plant and equipment and inventories to Tongyuan Tannery, then it may be possible for the Guangzhou Customs to impose the Potential Tax Claim on Tongyuan Tannery. Accordingly, the Group carried a provision of RMB36,989,000 (equivalent to approximately HK$35,884,000 as at 30 June 2006 (31 December 2005: HK$35,526,000)) for the Potential Tax Claim which was made during the year ended 31 December 2003.

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 Claim, i.e. RMB36,989,000 to RMB184,945,000 (equivalent to approximately HK$35,884,000 to HK$179,420,000 as at 30 June 2006 (31 December 2005: HK$35,526,000 to HK$177,630,000)) (the "Potential Penalty"). In light of the PRC legal advice, the directors of the Company considered it appropriate to carry a provision of RMB36,989,000 (equivalent to approximately HK$35,884,000 as at 30 June 2006 (31 December 2005: HK$35,526,000)) for the Potential Penalty which was made during the year ended 31 December 2003.

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 Customs' 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.

Judgement in the Guangzhou Proceedings (the "Judgement") was rendered on 2 September 2005. Nanhai Tannery, amongst others, was 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 was imposed on Nanhai Tannery.

On 30 August 2006, the Company obtained a PRC legal advice on the potential effects of the Judgement on Tongyuan Tannery. As there is no appeal lodged within the required appeal period, i.e. 10 days after the Judgement, the Judgement took effect and the PRC legal advice indicated that:

(i) The Judgement 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 penalties which is imposed on Nanhai Tannery;

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

(iii) The Judgement 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 the evaded tax. It is arguable that the Guangzhou Customs should not therefore seek to recover Nanhai Tannery's illegal gains from its illegal activities from Tongyuan Tannery; and

(iv) The possibility that, notwithstanding the apparent absence in the Judgement 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.

In light of the PRC legal advice as detailed above, it remains unclear whether the Guangzhou Customs will seek to enforce the Judgement 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 provisions for the Potential Tax Claim and Potential Penalty made during the year ended 31 December 2003 should continue to be carried in the Group's unaudited condensed consolidated interim balance sheet as at 30 June 2006. 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.

(10) PLEDGE OF ASSETS

As at 30 June 2006, assets of the Group pledged to banks to secure general banking facilities granted to the Group were as follows:

	30 June 2006 *HK$'000* **(Unaudited)**	31 December 2005 *HK$'000* (Audited)
Buildings	**7,240**	7,590
Plant and machinery	**4,469**	5,245
Bills receivables	**–**	22,485
Bank balances	**9,516**	4,900
	21,225	40,220

SUMMARY OF INDEPENDENT AUDITORS' REVIEW REPORT

An extract from the independent auditors' review report of the Company for the six months ended 30 June 2006 is as follows:

Fundamental uncertainty – Contingent liabilities

In arriving at our review conclusion, we have considered the adequacy of the disclosures made in note 20 to the condensed consolidated interim financial statements concerning the irregularities involving certain former executives of a former subsidiary of the Company in a previous year and the related provisions of RMB73,978,000 (equivalent to approximately HK$71,768,000) for the tax claim and tax penalty made by the Group as detailed in note 16(a) to the condensed consolidated interim 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 notes 16(a) and 20 to the condensed consolidated interim financial statements has been made in the interim financial report for such contingencies. We consider that appropriate disclosures 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 2006.

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 Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules") throughout the six months ended 30 June 2006.

Audit Committee

The Company established an audit committee ("Audit Committee") in September 1998 and its terms of reference are in line with the Code on CG Practices. The Audit Committee comprises the three independent non-executive directors, Mr. Fung Lak, Mr. Choi Kam Fai Thomas and Mr. Chan Cheong Tat. Mr. Fung Lak is Chairman of the Audit Committee. The principal duties of the Audit Committee include the review of the completeness, accuracy and fairness of the Company's financial reports and the Group's internal control systems.

Remuneration Committee

The Company established a remuneration committee ("Remuneration Committee") in June 2005 and its terms of reference are in line with the Code on CG Practices. The Remuneration Committee comprises one executive director, Mr. Zhang Chunting, and three independent non-executive directors, Mr. Fung Lak, Mr. Choi Kam Fai Thomas and Mr. Chan Cheong Tat. Mr. Zhang Chunting is Chairman of the Remuneration Committee. The principal duties of the Remuneration Committee include, inter alia, making recommendations to the Board relating to the Company's policy for directors' and senior management's remuneration, determining the executive directors' and senior management's remuneration packages, reviewing and approving their performance-based remuneration and compensation payable for their loss of offices.

Nomination Committee

The Company established a nomination committee ("Nomination Committee") in June 2005 and its terms of reference are in line with the Code on CG Practices. The Nomination Committee comprises one executive director, Mr. Zhang Chunting, and three independent non-executive directors, Mr. Fung Lak, Mr. Choi Kam Fai Thomas and Mr. Chan Cheong Tat. Mr. Zhang Chunting is Chairman of the Nomination Committee. The principal duties of the Nomination Committee include, inter alia, nominating and recommending candidates to fill vacancies on the Board.

Model Code for Securities Transactions by Directors

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 of the Listing Rules as the code of conduct regarding directors' securities transactions. All directors of the Company 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 2006.

Review of Interim Results

The Group's interim financial report for the six months ended 30 June 2006 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 the Company's 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 2006.

By Order of the Board
Zhang Chunting
Chairman

Hong Kong, 8 September 2006

As at the date of this announcement, the Company's Board comprises two executive directors, Zhang Chunting, Deng Rongjun; two non-executive directors, Xiong Guangyang, Ho Lam Lai Ping Theresa; and three independent non-executive directors, Fung Lak, Choi Kam Fai Thomas and Chan Cheong Tat.

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