



## HUA LIEN INTERNATIONAL (HOLDING) COMPANY LIMITED

(Incorporated in the Cayman Islands with limited liability)  
(Stock Code: 00969)



Annual Report 2006

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# Corporate Information

## EXECUTIVE DIRECTORS

Mr. SHIH Chian Fang (*Chairman*)  
Mr. LIAW Yuan Chian (*Managing Director*)  
Ms. CHEN Ling

## INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. FU Heng Yang  
Mr. YU Chi Jui  
Ms. LI Xiao Wei

## AUDITORS

HLM & Co.  
*Certified Public Accountants*

## COMPANY SECRETARY

Mr. WAN Hok Shing, ACS, ACIS

## REGISTERED OFFICE

P.O. Box 309  
Ugland House  
South Church Street  
George Town  
Grand Cayman  
Cayman Islands  
British West Indies

## HEAD OFFICE

Yaxi Industrial Development Zone,  
Yamen, Xinhui District  
Jiangmen City  
Guangdong  
The People's Republic of China

## PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Unit 2513A, 25th Floor  
113 Argyle Street  
Mongkok  
Kowloon  
Hong Kong

## PRINCIPAL BANKERS

The Hongkong and Shanghai Banking  
Corporation Limited

## CAYMAN ISLANDS PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

The Harbour Trust Co. Ltd  
One Capital Place  
P.O. Box 1787  
Grand Cayman  
Cayman Islands  
British West Indies

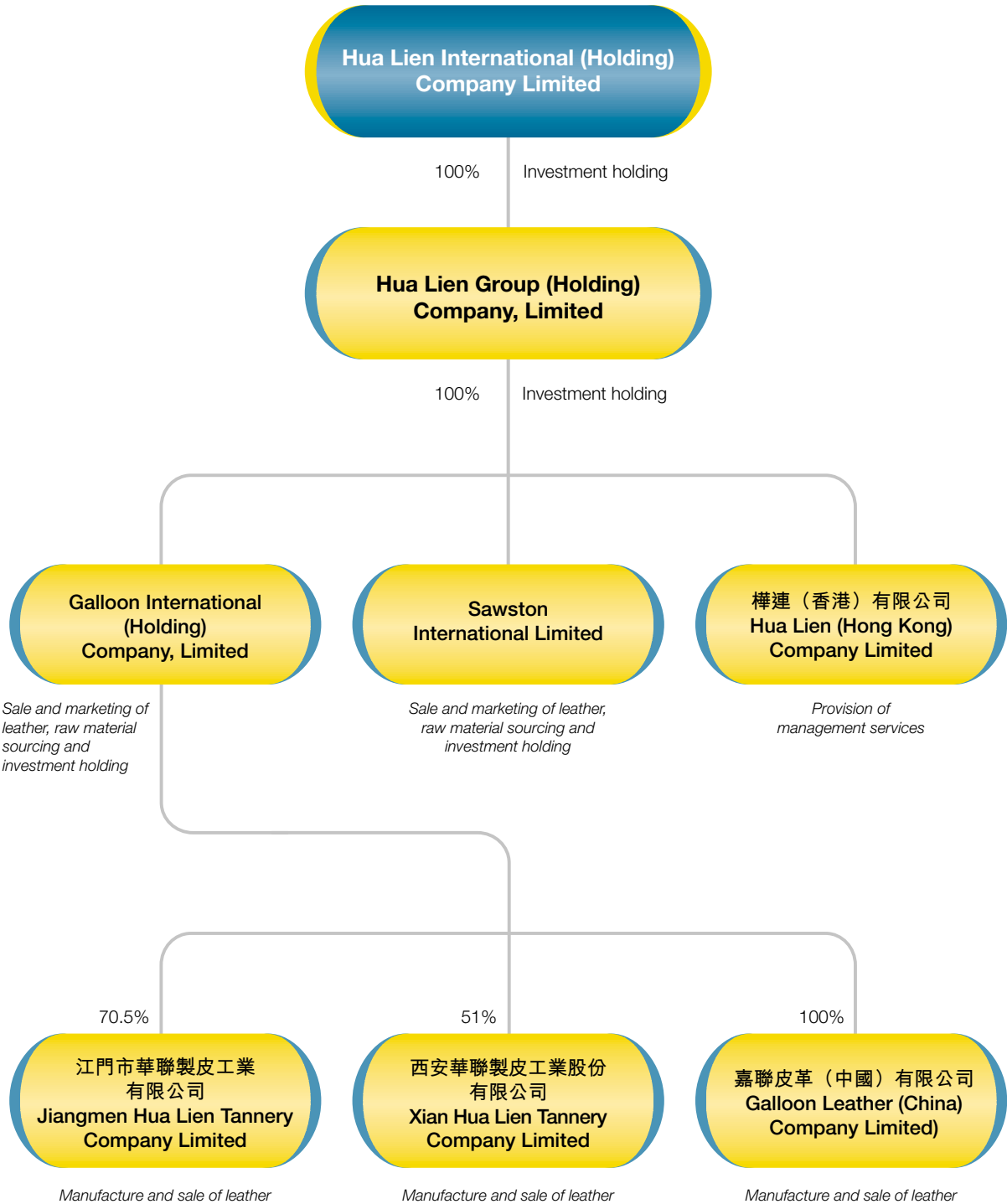
## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Union Registrars Limited  
Room 1803  
Fook Lee Commercial Centre  
Town Place, 33 Lockhart Road  
Wanchai  
Hong Kong

## WEBSITE

[http://www.finance.thestandard.com.hk/en/comp\\_detail\\_link.asp?code=0969](http://www.finance.thestandard.com.hk/en/comp_detail_link.asp?code=0969)

# Group Structure





## Chairman's Statement

**“The Group will continue to dedicate itself to manufacture the best quality leather that fulfill the needs and exceed the expectation of our customers.”**

**Mr. SHIH Chian Fang Chairman**

### BUSINESS REVIEW

For the year ended 31st December 2006, the Group had a turnover of HK\$718,909,000, a 17.8 percent decrease compared to HK\$874,629,000 in 2005. The decrease in turnover was mainly brought by the suspension of operation of production plant in Xian in September 2006.

The Group's net loss attributable to the equity holders of the Company for the year ended 31st December 2006 was HK\$73,362,000 compared to net profit attributable to equity holders of HK\$3,585,000 in 2005. Basic loss per share was HK10.68 cents (2005: Basic earning per share of HK0.52 cents). The loss for the year was mainly resulted from the 112 million impairment losses on property, plant and equipment, inventories and trade receivables in relation to the suspended production plant in Xian.

With regard to geographical market segments, USA remained to be the main contributor to the Group's turnover. For the year ended 31st December 2006, turnover from USA represents 79.3 percent of total sales turnover as compared to 87.9 percent in 2005 and the business from the PRC market showed an increase of 8.6 percent as compared the same period in 2005. As mentioned in the Interim Report, the change was due to a shift in the market focus of the Company in response to the decrease of order from USA and the Group increased the sales to the PRC customers. The increase in segment result in other countries was the income derived from the processing of raw cowhides for other tanneries in the South East Asia.

## Chairman's Statement



Turnover and contribution to operating profit is derived from dedication to quality.

### FINANCIAL REVIEW

#### Liquidity and Financial Resources

During the year, the Group has relied primarily upon funds generated internally from the Group's operating activities and revolving credit facilities provided by the Group's principal bankers. As at 31st December 2006, the Group's total borrowings is HK\$182,564,000 as compared to HK\$204,972,000 at 31st December 2005. Of the total borrowings, HK\$182,564,000 (2005: HK\$204,614,000) is repayable within one year and HK\$Nil (2005: HK\$358,000) is repayable after one year.

Shareholders' funds of the Group as at 31st December 2006 amounts to HK\$644,451,000 (2005: HK\$699,823,000). The Group's gearing ratio which is measured on the basis of the Group's total borrowings over the shareholders' funds as at 31st December 2006 is 28.3% (2005: 29.3%).

The sales and purchases of the Group are mainly denominated in Renminbi and United States dollar. Hence, the Group's exposure to foreign exchange risk is expected to be minimal. Bank borrowings are also mainly denominated in Renminbi and United States dollar and the interests are charged on a floating rate basis. The Group's management oversees the movement of interest rates very closely and takes appropriate measures to minimise the Group's interest rate risks whenever necessary.

#### Contingent Liabilities

At the balance sheet date, the Company had given guarantees to banks in respect of general banking facilities granted to subsidiaries and the aggregate amount utilised by subsidiaries amounted to approximately HK\$10 million (2005: HK\$47 million).

The Group reached settlement of legal claim with Bank of East Asia, Shenzhen Branch against Jiangmen Hua Lien Tannery Co Ltd ("Jiangmen Hua Lien") for principal of Rmb11,241,000 (approximately equivalent of HK\$11,241,000) and interest thereon through a mutually agreed repayment schedule dated on 23rd March, 2007.

# Chairman's Statement

## FINANCIAL REVIEW (Cont'd)

### Pledge of Assets

At 31st December 2006, certain of the Group's prepaid lease payment on land use right, property, plant and equipment with an aggregate carrying value of approximately HK\$137 million (2005: HK\$120 million), inventories of approximately HK\$52 million (2005: HK\$80 million) and bank deposits of approximately HK\$1.5 million (2005: HK\$10 million) were pledged to banks to secure general banking facilities granted to the Group.

On 12th September 2006, Bank of China, Xian Branch which lent USD9.8 million to the Xian Hua Lien Tannery Co. Ltd. ("Xian Hua Lien") obtained a writ from 陝西省高級人民法院 (Shannxi Province Highest People's Court) that granted the bank the legal rights to freeze and sequester all the assets of the Xian Hua Lien including property, plant and equipment, inventories, accounts receivables and bank balances. At balance sheet date, Bank of China, Xian Branch sequestered the bank account, the property, plant and equipment and inventories of Xian Hua Lien as additional security. Due to the suspension of operation of Xian Hua Lien and full provision against the assets had made, the sequestered assets have no carrying value at the balance sheet date.

### Employee Remuneration Policy

At 31st December 2006, the Group employed 771 (2005: 1,106) full time management, administrative and production staff in Hong Kong, Taiwan and the PRC.

The Group's emolument policies are formulated on the bases of individual performance and the salary trend in the various regions, and are reviewed every year. The Company has set up share options plan and provides staff quarters to staff in the PRC.

## PROSPECTS

On the supply side, the upward trend in cost of raw hides and labour in China will continuously drive up the operating cost in 2007. On the demand side, the sales for the first quarter of 2007 is satisfactory. A new leather processing arrangement have signed with one of the world-leading tannery, it is expected that additional revenue will generate in third quarter of 2007.

## DIVIDEND

The Board of Directors does not recommend the payment of a dividend for the year ended 31st December 2006 (2005: Nil)

By order of the Board

**Shih Chian Fang**

*Chairman*

Hong Kong, 25th April 2007

# Profile of Directors and Senior Management

## DIRECTORS

### Executive Directors

**Mr. SHIH Chian Fang**, aged 46, was appointed Chairman of the Company in March 2006 and as Executive Director in May 2001. He is also the executive vice general manager of Jiangmen Hua Lien Tannery Co. Ltd. (the “Jiangmen Hua Lien”). Mr. Shih has over 22 years of experience in the tannery business. He joined the Group in October 1992.

**Mr. LIAW Yuan Chian**, aged 51, is the managing director of the Company and founder of the Group. He is also the general manager of the Group and is responsible for the overall planning and development, corporate policy making and management of the Group. Mr. Liaw has over 27 years of experience in the tannery business. He joined the Group in October 1992.

**Ms. CHEN Ling**, aged 33, was appointed as Executive Director in March 2006. She is also the manager of sales and purchasing department of the Group. Ms. Chen has over 11 years solid experience in sales and purchasing. She joined the Group in October 1995.

### Independent non-executive Directors

**Mr. FU Heng Yang**, aged 53, holds a bachelor degree in Economics from Culture University, Taiwan. Before the Company's directorship appointment in October 1999, Mr. Fu has already possessed over 20 years of accounting, finance and corporate management experience in a textile company in Taiwan whose shares are being traded in Taiwan Stock Exchange Corporation.

**Mr. YU Chi Jui**, aged 52, has been an independent non-executive director since May 2001. He has over 17 years experience in sales and marketing in Taiwan and the PRC.

**Ms. LI Xiao Wei**, aged 35, was appointed as independent non-executive director in September 2004. She has over 6 years experience in sales and marketing in the PRC.

## SENIOR MANAGEMENT

**Mr. WAN Hok Shing**, aged 40, is the financial controller and company secretary of the Group. He is responsible for the overall accounting and financial matters of the Group. Mr. Wan holds a bachelor's degree with honours in hospitality management from the Hong Kong Polytechnic University, a diploma of legal studies with distinction from the University of Hong Kong and a diploma of logistics management from the Institute of Supply Chain Management. He has over 14 years of experience in auditing and accounting. Prior to joining the Group in August 1999, he worked for a listed company in Hong Kong and has over four years of working experience in an international accounting firm. He is a fellow member of the Hong Kong Institute of Certified Public Accountants and the Association of Chartered Certified Accountants, an associate member of the Institute of Chartered Secretaries and Administrators and the Hong Kong Institute of Company Secretaries and a member of the Institute of Supply Chain Management.



# Directors' Report

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The directors present their annual report and the audited financial statements for the year ended 31st December 2006.

## PRINCIPAL ACTIVITIES

The Company acts as an investment holding company and provides corporate management services. The activities of its principal subsidiaries are set out in note 30 to the financial statements.

## RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31st December 2006 are set out in the consolidated income statement on page 22.

The directors do not recommend the payment of a dividend in respect of the year ended 31st December 2006.

## FINANCIAL SUMMARY

A summary of the results, assets and liabilities of the Group for the past five financial years is set out on page 56.

## PROPERTY, PLANT AND EQUIPMENT

During the year, the Group acquired property, plant and equipment at a cost of approximately HK\$0.6 million for the purpose of expanding its business. Details of these and other movements in the property, plant and equipment of the Group during the year are set out in note 13 to the financial statements.

## SHARE CAPITAL

Details of the Company's share capital are set out in note 23 to the financial statements.

## DISTRIBUTABLE RESERVES OF THE COMPANY

As at 31st December 2006, the company's reserves available for distribution consisted of contributed surplus of HK\$468,576,000 (2005: HK\$468,576,000) and accumulated profits of HK\$7,328,000 (2005: HK\$7,780,000)

## MAJOR CUSTOMERS AND SUPPLIERS

The aggregate sales attributable to the Group's five largest customers during the year accounted for approximately 20% of the Group's total sales and the Group's largest customer accounted for approximately 8% of the Group's total sales.

The aggregate purchases attributable to the Group's five largest suppliers during the year accounted for approximately 32% of the Group's total purchases and the Group's largest supplier accounted for approximately 11% of the Group's total purchases.

At no time during the year did a director, an associate of a director or any shareholder (which to the knowledge of the directors owns more than 5% of the Company's issued share capital) have an interest in any of the Group's five largest suppliers.

## DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

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

### Executive directors:

Mr. Shih Chian Fang  
Mr. Liaw Yuan Chian ("Mr. Liaw")  
Ms Chen Ling (appointed on 28 March 2006)  
Mr. Chaiteerath Boonchai (resigned on 28 March 2006)

### Independent non-executive directors:

Mr. Fu Heng Yang  
Mr. Yu Chi Jui  
Ms. Li Xiao Wei

In accordance with Articles 99 and 116 of the Company's Articles of Association, Mr. Liaw and Ms. Li Xiao Wei retire by rotation and, being eligible, offer themselves for re-election at the forthcoming annual general meeting.

The terms of office of each of the independent non-executive directors is the period up to his retirement by rotation as required by the Company's Articles of Association.

Mr. Liaw have entered into a service contract with the Company for an initial term of three years commencing from 5th January 2000, which will continue thereafter unless and until terminated by either party by giving to the other party not less than six months' prior written notice.

None of the directors being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation (other than statutory compensation).

# Directors' Report

## BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Biographical details of the Directors and the senior management of the Group are set out in the section headed "Profiles of Directors and Senior Management" on pages 7 of this annual report.

## DIRECTORS' INTERESTS IN SECURITIES

As at 31st December 2006, the interests of the directors and their associates in the ordinary shares in the Company as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, were as follows;

Name of director	Beneficial Owner	Number of ordinary shares held		Approximate % of the issued share capital
		Held by controlled corporation (Note)	Total	
Mr. Liaw	–	363,500,039	363,500,039	52.96%
Mr. Fu Heng Yang	216,000	–	216,000	0.03%

Note: Mr. Liaw was deemed to be interested in 363,500,039 ordinary shares in the Company, which were held by Joyce Services Limited, a company in which Mr. Liaw has a 62.59% beneficial interest.

As at 31st December 2006, Mr. Liaw held 126,000 non-voting deferred shares in Hua Lien (Hong Kong) Company Limited, the Company's subsidiary. The rights and restrictions of such non-voting deferred shares are set out in note 30 to the financial statements.

Save as disclosed above and other than one nominee ordinary share in Hua Lien (Hong Kong) Company Limited held by Mr. Liaw in trust for Hua Lien Group (Holding) Company, Limited, the Company's subsidiary, none of the directors or their associates had any interests or short positions in any securities of the Company or any of its associated corporation as at 31st December, 2006.

## SHARE OPTIONS

The Company's share option scheme (the "Scheme") which was adopted pursuant to a resolution passed by shareholders on 4th January 2000 for the primary purpose of providing incentives to directors and eligible employees, will expire on 3rd January 2010. Under the Scheme, the Board of Directors of the Company may grant options to eligible employees, including directors of the Company and its subsidiaries, to subscribe for shares in the Company.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders.

Options granted must be taken up within 30 days of the date of offer, upon payment of HK\$1 per grant. Options may be exercised at any time from the period commencing on the date falling 6 months after the date of grant of the share option to the 5th anniversary of the date of grant. The exercise price is determined by the directors of the Company, and will not less than the higher of the closing price of the Company's shares on the date of grant, the average closing price of the shares for the five business days immediately preceding the date of grant and the nominal value of the shares.

No options have been granted or agreed to be granted under the Scheme since its adoption.

## ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Other than the share option scheme as disclosed above, at no time during the year was the Company, its holding company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of share in, or debentures of, the Company or any other body corporate.

## SUBSTANTIAL SHAREHOLDERS

As at 31st December 2006, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that other than the interests disclosed under the heading "Directors' interest in securities", the following shareholders had notified the Company of the relevant interests or short positions in the issued share capital of the Company.

<b>Name of Shareholder</b>	<b>Capacity</b>	<b>Number of ordinary shares held</b>	<b>% of the issued share capital</b>
Wong Pi Chao	Beneficial Owner	48,826,000	7.1%

The interest disclosed above represents long position in the shares of the Company.

# Directors' Report

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## **SUBSTANTIAL SHAREHOLDERS** (Cont'd)

Save as disclosed herein, the Company has not been notified of any other person (other than a director or a chief executive of the Company) who had an interest or a short position in the shares of the Company as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO as at 31st December 2006.

## **CONNECTED TRANSACTIONS**

Details of a discloseable connected transaction in respect of a lease agreement entered into between Xian Hua Lien Tannery Co., Ltd. (the "Xian Hua Lien"), a subsidiary of the Company, and a minority shareholder of Xian Hua Lien are set out on note 26(a) to the financial statements. In the opinion of the independent non-executive directors, the transaction entered into by the Group was in the ordinary course of business and in accordance with the terms of the lease agreement.

Save as disclosed above, there were no other transactions which is required to be disclosed as connected transactions in accordance with the requirements of the Listing Rules.

## **DIRECTORS' INTEREST IN CONTRACTS OF SIGNIFICANCE**

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

## **PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES**

At no time during the year, did the Company nor any of its subsidiaries purchase, sell or redeem any of the Company's listed securities.

## **SUFFICIENCY OF PUBLIC FLOAT**

The Company has maintained a sufficient public float throughout the year ended 31st December 2006.

## **PRE-EMPTIVE RIGHTS**

There is no provision for pre-emptive rights under the Company's Articles of Association, or the laws in the Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.



## EMOLUMENT POLICY

The remuneration committee reviews the Group emolument policy and structure for all remuneration of the Directors and senior management of the Group, having regard to the Group's operating result, individual performance and comparable market statistics.

The Company has adopted a share option scheme as incentive to directors and eligible employees, details of the scheme are set out as "Share Options" above.

## CORPORATE GOVERNANCE

Details of corporate governance are set out in the section headed "Corporate Governance Report" in this annual report.

## AUDIT COMMITTEE

The audit committee comprises all three independent non-executive Directors. Mr. Fu Heng Yang is the Chairman of the Committee. Summary of duties and works of the Committee is set out in the "Corporate Governance Report" in this annual report.

## REMUNERATION COMMITTEE

Pursuant to the requirement of the CG code, the Board has established the Remuneration Committee on 1st January 2005. The remuneration committee comprises all three independent non-executive Directors. Mr. Fu Heng Yang is the Chairman of the Committee. Summary of duties and works of the Committee is set out in the "Corporate Governance Report" in this annual report.

## AUDITORS

A resolution will be submitted to the annual general meeting of the Company to re-appoint Messrs. HLM & Co. as auditors of the Company.

On behalf of the Board

**Liaw Yuan Chian**

Hong Kong, 25th April 2007

# Corporate Governance Report

The Company acknowledges the importance of good corporate governance practices and believes that maintaining high standard of corporate governance practices is crucial to the development of the Company.

During the financial year ended 31st December 2006, the Company complied with the Code contained in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), except for certain areas of non-compliance that are discussed later in this report.

## A. DIRECTORS

### A.1 The Board

The Board has the collective responsibility for leadership and control of, and for promoting the success of, the Group by directing and supervising the Company's affairs. The Board sets strategies for the Group and monitors the performance of the management.

During the financial year ended 31st December 2006, the board held four regular meetings at approximately quarterly intervals according to the Code. The attendance of each director is set out as follows:

<b>Name of Director</b>	<b>Number of attendance</b>
Mr. Shih Chian Fang (appointed as Chairman 28 March 2006)	4/4
Mr Liaw Yuan Chian	4/4
Mr. Chaiteerath Boonchai (resigned on 28 March 2006)	1/4
Ms. Chen Ling (appointed on 28 March 2006)	3/4
Mr. Fu Heng Yang	4/4
Mr. Yu Chi Jui	4/4
Ms. Li Xiao Wei	4/4

### A.2 Chairman and Managing Director

The Company segregates the role of Chairman from the Managing Director. Mr. Shih Chian Fang is the Chairman of the Company and Mr. Liaw Yuan Chian is the Managing Director of Company. The Chairman provides leadership to the Board and is responsible for overall strategic planning and corporate development, whereas the Managing Director is responsible for policy making and corporate management in order to implement the strategies approved by the Board.

### A.3 Board composition

The Board comprises three Executive Directors, being Mr. Shih Chian Fang (Chairman of the Board), Mr. Liaw Yuan Chian (Managing Director) and Ms. Chen Ling, and three Independent Non-Executive Directors, being Mr. Fu Heng Yang, Mr. Yu Chi Jui and Ms. Li Xiao Wei. The profiles of the Directors, which are set out on pages 7, demonstrate a balance of skills and experience of the Board.

# Corporate Governance Report

## A. DIRECTORS (Cont'd)

### A.4 Appointment, re-election and removal

The code provision A.4.1 provides that non-executive director should be appointed for a specific term, subject to re-election. None of the existing independent non-executive directors of the Company is appointed for a specific term. However, all the independent non-executive directors are subject to retirement by rotation at each annual general meeting under the Articles of Association of the Company. As such, the company considers that sufficient measures have been taken to ensure that the Company's corporate governance practices are no less exacting than those in the CG code.

The Company currently does not have a nomination committee. To maintain high quality of the Board with a balance of skills and experience, the Board will identify individuals suitably qualified to become Directors when necessary. The Board will consider the experience, qualification and other relevant factors, including the standards set out in rules 3.08 and 3.09 of the listing Rules and rule 3.13 of the Listing Rules in case of Independent Non-executive Directors, of the eligible candidates. During the year, the Board considered and approved the appointment of an additional Executive Director.

### A.5 Responsibilities of directors

The newly appointed director have received a comprehensive formal induction on the first occasion of his appointment and the directors are continually updated with the regulatory requirements, business activities and development of the Group to facilitate the discharge of their responsibilities.

The independent non-executive directors participate actively in the Board Meetings. They bring an independent judgement on issues of strategy, policy, performance, accountability, resources, key appointments and standards of conduct. They will lead where potential conflicts of interest arise in connected transaction. They are also members of Audit committee and remuneration committee.

The company has adopted the Model Code for Securities Transaction by Directors of Listed Companies (the "Model Code") as set out in Appendix 10 to the Listing Rules as its own code of conduct regarding securities transactions by the directors. Having made specific enquiry of all directors, all directors declared that they have complied with the Model Code throughout the year.

# Corporate Governance Report

## A. DIRECTORS (Cont'd)

### A.6 Supply of and access of information

In respect regular board meetings, an agenda and accompanying board papers of the meeting are sent in full to all directors at least 3 days before the intended date of a meeting.

The management has the obligation to supply the Board and the various committees with adequate information in a timely manner to enable the members to make informed decisions. Each director has separate and independent access to the Group's senior management to acquire more information than is volunteered by management and to make further enquiries if necessary.

## B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

### B.1. The level and make-up of remuneration and disclosure

The Remuneration Committee of the Company was established in January 2005. The Remuneration Committee comprised the three Independent Non-executive Directors. Mr. Fu Heng Yeng is the Chairman of the Remuneration Committee.

The primary function is to make recommendations to the Board on the Group's policy and structure for all remuneration of directors and senior management. The Remuneration Committee adopted the Code Provision B.1.3. to be the terms of reference.

During the year, the Remuneration Committee has held one committee meeting. The attendance of the Remuneration Committee members at the Remuneration Committee meeting was as follows:

<b>Name of Member</b>	<b>Number of attendance</b>
Mr. Fu Heng Yeng (Chairman of the remuneration committee)	1/1
Mr. Yu Chi Jui	1/1
Ms. Li Xiao Wei	1/1

The chairman of the Remuneration Committee will report the findings and recommendations of the Remuneration Committee to the Board after the meeting. For the financial year ended 31st December 2006, the Remuneration Committee has considered and approved the Group's policy for the remuneration of directors and senior management. The Remuneration Committee has assessed the performance of the executive directors and considered the remuneration package executive directors by reference to the prevailing packages with companies listed on the main board of the Stock Exchange. Details of the remuneration of directors are disclosed on an individual basis and are set out in note 8 to the financial statements.

## C. ACCOUNTABILITY AND AUDIT

### C.1 Financial reporting

The management provides such explanation and information to the Board so as to enable the Board to make an informed assessment of the financial and other information put before the Board for approval.

The directors acknowledge their responsibility to prepare the financial statements that give a true and fair view of the state of affairs of the Group. The Board was not aware of any material uncertainties relating to events or conditions that might cast significant doubt upon the Group's ability to continue as a going concern, the Board has prepared the financial statement on a going concern basis.

The responsibility of the external auditors, Messrs. HLM & Co. is to form an independent opinion, based on their audit, on those consolidated financial statements prepared by the Board and to report their opinion solely to the shareholders of the Company and for no other purpose.

### C.2 Internal Control

The Board is responsible for the Group's internal control system and for reviewing its effectiveness. Through the Audit committee, the Board has reviewed the effectiveness of the system. No material deficiencies have been identified so far. The Board considered the Group's internal control system effective and that there were no significant areas of concern, which might affect the shareholders of the Company.



# Corporate Governance Report

## C. ACCOUNTABILITY AND AUDIT (Cont'd)

### C.3 Audit Committee

The Audit Committee comprised the three Independent Non-executive Directors of the Company. The chairman of the Audit Committee is Mr. Fu Heng Yeng who possess extensive experience in accounting and financial matters.

The Audit Committee is mainly responsible for providing an independent review and supervision of the financial reporting process and the Group's internal control system. The terms of reference are reviewed to include the provisions referred in Code Provision C.3.3.

During the year, the Audit Committee held two meetings. The attendance of the Audit Committee members at the audit committee meetings was as follows:

<b>Name of Member</b>	<b>Number of attendance</b>
Mr. Fu Heng Yeng (Chairman of the Audit Committee)	2/2
Mr. Yu Chi Jui	2/2
Ms. Li Xiao Wei	2/2

The following was a summary of the work performed by the Audit Committee in 2006

1. review the financial statements for the year ended 31st December 2005 and the annual results announcement with a recommendation to the board for approval; and
2. review the financial statements for the six months period ended 30th June 2006 and the interim results announcement with a recommendation to the Board for approval.

At the Audit Committee meeting on 23rd April 2007, the Audit Committee reviewed the Company's financial statements for the year ended 31st December 2006 and the annual results announcement with a recommendation to the Board for approval.

The Audit Committee recommend the re-appointment of Messrs. HLM & Co. as external auditors of the Group for 2007 and that the relevant resolution shall put forth for the consideration of the shareholders of the Company and their approval at the 2007 annual general meeting of the Company.

# Corporate Governance Report

## C. ACCOUNTABILITY AND AUDIT (Cont'd)

### C.4 Fee paid/payable to Group's auditors

For the financial year ended 31st December 2006, the fee paid/payable to the Group's auditors, HLM & Co. is set out as follows:

	HK\$'000
Services rendered	
– audit services	380
– non-audit services	–
	<u>380</u>

## D. DELEGATION BY THE BOARD

### D.1 Management functions

The board is responsible for determining the overall strategy and corporate development and ensuring the business operations are properly monitored. The Board reserves the right to decide all policy matters of the Group and material transactions.

The Board delegates the day-to-day operations to general managers and departments heads who are responsible for the different aspects of the operations of the Group.

### D.2. Board committees

The Company has maintained the Audit committee and the Remuneration Committee throughout the year to oversee particular aspects of the Group's affairs. Each of these committees has terms of reference, which deal clearly with their authority and duties. The chairman of the committees will report the finding and recommendations of the committees to the Board after each meeting. The minutes of all meetings of the committees are circulated to the Board for information.

# Corporate Governance Report

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## E. COMMUNICATION WITH SHAREHOLDERS

### E.1 Effective communication

Shareholders are encouraged to attend the annual general meeting of the Company for which at least 21 days' notice is given. The chairman of the Board has attended at the annual general meeting to be available to answer the questions of the shareholders of the Company.

Separate resolutions are proposed at the annual general meeting on each substantially separate issue, including the election of individual director.

### E.2 Voting by poll

The right to demand a poll will set out in the circular to shareholders of the Company dispatched in May for 2007 Annual General Meeting held in June 2007.

# Independent Auditors' Report

恒健會計師行

**HLM & Co.**

**Certified Public Accountants**

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## **TO THE MEMBERS OF HUA LIEN INTERNATIONAL (HOLDING) COMPANY LIMITED**

*(Incorporated in the Cayman Islands with limited liability)*

We have audited the the consolidated financial statements of Hua Lien International (Holding) Company Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 22 to 55, which comprise the consolidated and Company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## **DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS**

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## **AUDITORS' RESPONSIBILITY**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **OPINION**

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31st December 2006 and of the Group's loss and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**HLM & Co.**

Certified Public Accountants  
Hong Kong, 25th April 2007

# Consolidated Income Statement

For the year ended 31st December 2006

	Notes	2006 HK\$'000	2005 HK\$'000
Turnover		<b>718,909</b>	874,629
Cost of sales		<b>(694,855)</b>	(832,005)
Gross profit		<b>24,054</b>	42,624
Other operating income		<b>14,565</b>	5,562
Distribution costs		<b>(408)</b>	(720)
Administrative expenses		<b>(31,786)</b>	(25,555)
Impairment losses on property, plant and equipment, inventories and trade receivables	6	<b>(112,242)</b>	–
(Loss) profit from operations	7	<b>(105,817)</b>	21,911
Interest on bank borrowings wholly repayable within five years		<b>(8,619)</b>	(10,271)
(Loss) profit before tax		<b>(114,436)</b>	11,640
Income tax income (expenses)	10	<b>1,597</b>	(3,414)
(Loss) profit for the year		<b>(112,839)</b>	8,226
Attributable to:			
Equity holders of the Company		<b>(73,362)</b>	3,585
Minority interests		<b>(39,477)</b>	4,641
		<b>(112,839)</b>	8,226
Dividend	11	–	–
(Loss) earnings per share (cents)	12	<b>(10.68)</b>	0.52



# Consolidated Balance Sheet

As at 31st December 2006

	Notes	2006 HK\$'000	2005 HK\$'000
<b>Non-current assets</b>			
Property, plant and equipment	13	<b>221,065</b>	270,562
Prepaid lease payments on land use rights	14	<b>43,441</b>	41,948
Deferred tax assets	16	<b>27,560</b>	22,653
		<b>292,066</b>	335,163
<b>Current assets</b>			
Inventories	17	<b>186,173</b>	245,628
Trade and other receivables	18	<b>444,483</b>	436,166
Prepaid lease payments on land use rights	14	<b>1,024</b>	966
Pledged bank deposits	22(iii)	<b>1,500</b>	10,100
Bank balances and cash	19	<b>13,107</b>	35,816
		<b>646,287</b>	728,676
<b>Current liabilities</b>			
Trade and other payables	20	<b>78,825</b>	80,998
Loan from a director	21	<b>16,832</b>	16,848
Tax liabilities		<b>11,799</b>	12,850
Amounts due to minority shareholders of subsidiaries		<b>1,786</b>	1,165
Bank borrowings – due within one year	22	<b>182,564</b>	204,614
		<b>291,806</b>	316,475
<b>Net current assets</b>		<b>354,481</b>	412,201
<b>Total assets less current liabilities</b>		<b>646,547</b>	747,364
<b>Non-current liabilities</b>			
Bank borrowings – due after one year	22	<b>–</b>	358
<b>Net assets</b>		<b>646,547</b>	747,006
<b>Capital and reserves</b>			
Share capital	23	<b>68,640</b>	68,640
Reserves		<b>575,811</b>	631,183
<b>Equity attributable to shareholders</b>		<b>644,451</b>	699,823
<b>Minority interests</b>		<b>2,096</b>	47,183
<b>Total equity</b>		<b>646,547</b>	747,006

The financial statements on pages 22 to 55 were approved and authorised for issue by the Board of Directors on 25th April 2007 and are signed on its behalf by:

**Liaw Yuan Chian**  
DIRECTOR

**Shih Chian Fang**  
DIRECTOR

# Balance Sheet

As at 31st December 2006

	Notes	2006 HK\$'000	2005 HK\$'000
Non-current asset			
Interests in subsidiaries	15	<b>547,331</b>	547,262
Current assets			
Bank balances and cash		<b>22</b>	22
Current liabilities			
Other payables		<b>813</b>	814
Loan from a director		<b>317</b>	227
Amount due to a subsidiary		<b>1,679</b>	1,247
		<b>2,809</b>	2,288
Net current liabilities		<b>(2,787)</b>	(2,266)
Net assets		<b>544,544</b>	544,996
Capital and reserves			
Share capital	23	<b>68,640</b>	68,640
Reserves	24	<b>475,904</b>	476,356
Shareholders' funds		<b>544,544</b>	544,996

**Liaw Yuan Chian**  
*DIRECTOR*

**Shih Chian Fang**  
*DIRECTOR*

# Consolidated Statement of Changes in Equity

For the year ended 31st December 2006

	Share capital	Translation reserve	Goodwill reserve	Special reserve (note i)	PRC statutory reserves		Accumulated profits	Total	Minority interests	Total
					(note ii)					
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January 2005	68,640	6,480	(24,509)	238,966	20,266	386,378	696,221	47,834	744,055	
Transfer	-	-	-	-	1,030	(1,030)	-	-	-	
Exchange difference arising on translation of foreign operations	-	17	-	-	-	-	17	-	17	
Net profit for the year	-	-	-	-	-	3,585	3,585	4,641	8,226	
Pre-determined distribution	-	-	-	-	-	-	-	(5,292)	(5,292)	
At 31st December 2005 and 1st January 2006	68,640	6,497	(24,509)	238,966	21,296	388,933	699,823	47,183	747,006	
Transfer	-	-	-	-	614	(614)	-	-	-	
Exchange difference arising on translation of foreign operations	-	17,990	-	-	-	-	17,990	-	17,990	
Net loss for the year	-	-	-	-	-	(73,362)	(73,362)	(39,477)	(112,839)	
Pre-determined distribution	-	-	-	-	-	-	-	(5,610)	(5,610)	
At 31st December 2006	68,640	24,487	(24,509)	238,966	21,910	314,957	644,451	2,096	646,547	

## Notes:

- (i) The special reserve of the Group represents the difference between the nominal amount of the ordinary share capital issued by the Company in exchange for the nominal amount of the share capital of Hua Lien Group (Holding) Company, Limited acquired pursuant to the group reorganisation in 2000.
- (ii) As stipulated by the relevant laws and regulations for foreign investment enterprises in the People's Republic of China (the "PRC"), the PRC subsidiaries of the Group are required to provide for three reserve funds, being a statutory surplus reserve fund, an enterprise expansion fund, and a staff welfare and incentive bonus fund. Appropriations to such reserve funds are made out of net profit after tax of the statutory financial statements of the PRC subsidiaries and the amount and allocation basis are decided by their respective board of directors annually. The statutory surplus reserve fund can be used to make up prior year losses of the PRC subsidiaries, if any, and can be applied in conversion into capital by means of capitalisation issue. The enterprise expansion fund is used for expanding the capital base of the PRC subsidiaries by means of capitalisation. The staff welfare and incentive bonus fund is reserve for future expenditure on staff welfare and incentive bonus.

The appropriations to the statutory surplus reserve fund and enterprise expansion fund are reflected in the consolidated balance sheet under shareholders' funds as PRC statutory reserves; however, the appropriation to staff welfare and incentive bonus fund is charged to consolidated income statement and the unused portion is recorded as a current liability.

- (iii) The joint venture partner of Jiangmen Hua Lien Tannery Co. Ltd. is entitled to a pre-determined distribution throughout the entire cooperative joint venture period. Details of those pre-determined distribution is set out in note 26(c).

# Consolidated Cash Flow Statement

For the year ended 31st December 2006

	2006 HK\$'000	2005 HK\$'000
<b>OPERATING ACTIVITIES</b>		
(Loss)profit from operating activities before tax	<b>(114,436)</b>	11,640
Adjustments for:		
Impairment losses on property, plant and equipment, inventories and trade receivables	<b>112,242</b>	–
Allowance for bad and doubtful receivables, net	<b>11,912</b>	2,217
Write-back on allowance for obsolete and slow moving inventories	<b>(847)</b>	(658)
Depreciation and amortisation of property, plant and equipment	<b>34,398</b>	40,694
Amortisation of prepaid lease payment	<b>1,024</b>	966
Loss on disposal of property, plant and equipment	<b>147</b>	740
Impairment loss on available-for-sale financial assets	–	233
Interest income	<b>(639)</b>	(466)
Interest expense	<b>8,619</b>	10,271
Operating cash flows before movements in working capital	<b>52,420</b>	65,637
Decrease in inventories	<b>10,870</b>	11,557
Increase in trade and other receivables	<b>(59,772)</b>	(107,477)
Decrease in amounts due from minority shareholders of subsidiaries	<b>621</b>	–
(Decrease) increase in trade and other payables	<b>(2,173)</b>	43,806
Decrease in bills payable	–	(15,486)
Increase in amounts due to minority shareholders of subsidiaries	–	1,020
Cash generated from (used in) operations	<b>1,966</b>	(943)
Hong Kong Profits Tax paid	<b>(25)</b>	–
PRC enterprise income tax paid	<b>(3,158)</b>	(4,566)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(1,217)</b>	(5,509)
<b>INVESTING ACTIVITIES</b>		
Purchase of property, plant and equipment	<b>(626)</b>	(1,456)
Interest received	<b>639</b>	466
Decrease in pledged bank deposits	<b>8,600</b>	3,124
Proceeds from disposal of property, plant and equipment	<b>12</b>	2
<b>NET CASH GENERATED FROM INVESTING ACTIVITIES</b>	<b>8,625</b>	2,136

# Consolidated Cash Flow Statement

For the year ended 31st December 2006

	2006 HK\$'000	2005 HK\$'000
FINANCING ACTIVITIES		
Repayment of borrowings	<b>(104,415)</b>	(100,130)
Dividends paid to minority shareholders of subsidiaries	<b>(5,610)</b>	(5,292)
Interest paid	<b>(8,619)</b>	(10,271)
Bank borrowings raised	<b>75,500</b>	123,059
Net borrowing from a director	<b>(16)</b>	1,561
NET CASH (USED IN) GENERATED FROM FINANCING ACTIVITIES	<b>(43,160)</b>	8,927
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	<b>(35,752)</b>	5,554
CASH AND CASH EQUIVALENTS AT 1 JANUARY	<b>30,869</b>	25,298
Effect of foreign exchange rate changes	<b>17,990</b>	17
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	<b>13,107</b>	30,869
CASH AND CASH EQUIVALENTS REPRESENT:		
Bank balances and cash	<b>13,107</b>	35,816
Bank overdraft	<b>-</b>	(4,947)
	<b>13,107</b>	30,869

# Notes to the Financial Statements

For the year ended 31st December 2006

## 1. GENERAL

The Company was incorporated as an exempted company with limited liability in the Cayman Islands under the Companies Law of the Cayman Islands and its shares are listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”). Its registered office is at P.O. Box 309, Uglan House, South Church Street, George Town, Grand Cayman, Cayman Islands, British West Indies and principal place of business in Hong Kong is at Unit 2513A, 25th Floor, 113 Argyle Street, Mongkok, Kowloon, Hong Kong. Its ultimate holding company is Joyce Services Limited (“Joyce”), a company which is incorporated in the British Virgin Islands.

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 30.

The consolidated financial statements are presented in Hong Kong dollars, which is the same as the functional currency of the Company.

## 2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (“HKFRSs”)

In the current year, the Group has applied, for the first time, a number of new standards, amendments and interpretations (the “new HKFRSs”) by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), which are either effective for accounting periods beginning on or after 1st December 2005 or 1st January 2006. The adoption of the new HKFRSs has no material effect on how the results for the current or prior accounting periods have been prepared and presented.

The Group has not early applied the following new standards, amendments or interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these new standards, amendments or interpretations will have no material impact on the results and the financial position of the Group.

HKAS 1 (Amendment)	Capital Disclosures <sup>1</sup>
HKFRS 7	Financial Instruments: Disclosures <sup>1</sup>
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economics <sup>2</sup>
HK(IFRIC)-Int 8	Scope of HKFRS 2 <sup>3</sup>
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives <sup>4</sup>
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment <sup>5</sup>

<sup>1</sup> Effective for annual periods beginning on or after 1st January 2007

<sup>2</sup> Effective for annual periods beginning on or after 1st March 2006

<sup>3</sup> Effective for annual periods beginning on or after 1st May 2006

<sup>4</sup> Effective for annual periods beginning on or after 1st June 2006

<sup>5</sup> Effective for annual periods beginning on or after 1st November 2006

# Notes to the Financial Statements

For the year ended 31st December 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the HKICPA.

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31st December each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

### Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gain or loss on the disposal of an entity included the carrying amount of goodwill relating to the entity sold.

In previous years, the goodwill arising on acquisitions prior to 1st January 2001 was held in reserves. The Group has applied the relevant transitional provisions in the HKFRS 3 for non-restatement of such goodwill and the non-recognition of such goodwill in the profit or loss upon disposal or impairment.

### Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment loss.

### Turnover

Turnover represents the net amounts received and receivable for goods supplied to outside customers, less returns and discounts during the year.

### Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

### Property, plant and equipment

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and amortisation and accumulated impairment losses.

Construction in progress is stated at cost less any identified impairment loss which includes all construction costs and other direct costs attributable to such projects. Construction in progress is not depreciated until completion of construction and the asset is being put into use. Costs of completed construction works are transferred to the appropriate categories of property, plant and equipment.

The cost of land use rights is amortised over the period of the rights using the straight line method. Depreciation is charged so as to write off the cost of other items of property, plant and equipment over their estimated useful lives, using the straight line method, at the following rates per annum:

Buildings	2%-5%
Plant and machinery	10%
Furniture and equipment	20%-25%
Motor vehicles	20%

The gain or loss arising from the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the consolidated income statement.

### Impairment

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.



# Notes to the Financial Statements

For the year ended 31st December 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

### Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes income statements items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

### Foreign currencies

Transactions in currencies other than Hong Kong dollars are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in such currencies are re-translated at the rates prevailing on the balance sheet date. Profits and losses arising on exchange are included in net profit or loss for the year.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

### Foreign currencies (Cont'd)

On consolidation, the assets and liabilities of the Group's operations in the People's Republic of China (the "PRC") are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

### Operating leases

Leases where substantially all the risks and rewards of ownership of asset remain with the lessor are accounted for as operating leases. Rentals payable under operating leases are charged to the income statement on a straight line basis over the term of the relevant lease.

### Retirement benefit costs

Payments to state managed retirement benefit schemes and the Mandatory Provident Fund Scheme ("the "MPF Scheme") are charged as expenses when they fall due.

### Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of those financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, tax balances, corporate and financing expenses.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 4. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks: market price (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

### (a) Credit risk

As at 31st December 2006, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to discharge an obligation by the counterparties and financial guarantees issued by the Group is arising from the amount of contingent liabilities disclosed in note 22(v).

In order to minimize the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regards, the directors of the Company consider that the Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a number of counterparties and customers.

### (b) Liquidity risk

In the management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by the management to finance the Group's operations and mitigate the effects of fluctuation in cash flows. The management monitors the utilization of borrowings and ensures compliance with loan covenants.

The Group relies on borrowings as a significant source of liquidity. As at 31st December 2006, the Group has available unutilised overdrafts and short-term bank loan facilities of approximately of HK\$Nil (2005: HK\$Nil) and HK\$2 million (2005: HK\$5 million) respectively.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 4. FINANCIAL RISK MANAGEMENT (Cont'd)

### (c) Cash flow interest rate risk

The Group's cash flow interest rate risk relates primarily to variable-rate borrowings (see note 22 for details of these borrowings). It is the Group's policy to keep its borrowings at floating rate of interests so as to minimize the fair value interest rate risk.

### (d) Foreign currency risk

Foreign currency risk is the risk that the value of assets will fluctuate due to changes in foreign exchange rates.

The Group has no significant currency risk because substantially all assets and liabilities are denominated in Hong Kong dollars, Renminbi or US dollars.

### (e) Fair values

As at 31st December 2006, the carrying amount of cash and cash equivalents, prepayments, deposits and other receivables, accrued liabilities and other payables approximated their fair values due to the short term maturities of these assets and liabilities. The Group considers that these assets and liabilities are included in the balance sheet at amounts approximating to their fair values.

## 5. BUSINESS AND GEOGRAPHICAL SEGMENTS

In accordance with the Group's internal financial reporting, the Group has determined that geographical segments are its primary reporting format.

### Business segment

The Group is solely engaged in the manufacture and sale of leather. All of the Group's turnover, contribution to operating profit and assets were attributable to this business segment.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 5. BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont'd)

### Geographical segments

The Group reports its primary segment information by geographical location of its customers who are principally located in the United States of America ("USA") and the PRC.

Segment information about these geographical markets is presented below:

#### 2006

	USA HK\$'000	PRC HK\$'000	Other HK\$'000	Consolidated HK\$'000
TURNOVER	<b>570,103</b>	<b>148,806</b>	–	<b>718,909</b>
RESULT				
Segment result	<b>1,833</b>	<b>(111,666)</b>	<b>4,016</b>	<b>(105,817)</b>
Finance charges				<b>(8,619)</b>
Loss before tax				<b>(114,436)</b>
Income tax income				<b>1,597</b>
Loss for the year				<b>(112,839)</b>

The following is an analysis of the carrying amount of segment assets and segment liabilities analysed by the geographical location of its customers:

#### 2006

	USA HK\$'000	PRC HK\$'000	Other HK\$'000	Consolidated HK\$'000
ASSETS				
Segment assets	<b>172,723</b>	<b>12,410</b>	–	<b>185,133</b>
Unallocated assets				<b>753,220</b>
Consolidated total assets				<b>938,353</b>
LIABILITIES				
Unallocated liabilities				<b>291,806</b>
OTHER INFORMATION				
Allowance for bad and doubtful receivables, net	<b>6,859</b>	<b>5,053</b>	–	<b>11,912</b>

# Notes to the Financial Statements

For the year ended 31st December 2006

## 5. BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont'd)

### Geographical segments (Cont'd)

2005

	<b>USA</b>	<b>PRC</b>	<b>Other</b>	<b>Consolidated</b>
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
TURNOVER	768,903	105,726	–	874,629
RESULT				
Segment result	19,755	2,004	152	21,911
Finance charges				(10,271)
Profit before tax				11,640
Income tax expenses				(3,414)
Profit for the year				8,226

The following is an analysis of the carrying amount of segment assets and segment liabilities analysed by the geographical location of its customers:

2005

	<b>USA</b>	<b>PRC</b>	<b>Other</b>	<b>Consolidated</b>
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
ASSETS				
Segment assets	216,786	14,550	–	231,336
Unallocated assets				832,503
Consolidated total assets				1,063,839
LIABILITIES				
Unallocated liabilities				316,833
OTHER INFORMATION				
Allowance for bad and doubtful receivables, net	1,807	410	–	2,217

# Notes to the Financial Statements

For the year ended 31st December 2006

## 5. BUSINESS AND GEOGRAPHICAL SEGMENTS (Cont'd)

### Geographical segments (Cont'd)

In addition to the analysis by geographical location of its customers, the following is an analysis of the carrying amount of consolidated segment assets and capital expenditure, analysed by the geographical area in which the assets and liabilities are located:

	Carrying amount of segment assets		Capital expenditure	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Hong Kong	<b>5,384</b>	14,516	–	5
Elsewhere in the PRC	<b>905,409</b>	1,026,670	<b>626</b>	1,451
	<b>910,793</b>	1,041,186	<b>626</b>	1,456

## 6. IMPAIRMENT LOSSES ON PROPERTY, PLANT AND EQUIPMENT, INVENTORIES AND TRADE RECEIVABLES

On 10th August 2006, the Board announced that the Xian production plant (“Xian Hua Lien”) would suspended operation pursuant to a notice issued by 西安市人民政府 (Xian People’s Government) which encouraged enterprises in the region where the Xian production plant was located to relocate to other new industrial and logistics zone in Xian to conform with the government’s plan of town restructuring. At the balance sheet date, the Group was still negotiating with the relevant government authorities for the amount of compensation with respect to the relocation and is looking for another area in Xian for the construction of a new production plant. In consideration that the progress of negotiation is in a stalemate, it is difficult to foresee the time that will be taken from relocation to full production run of new production plant. The Board expects that it may take 2 to 3 years or more.

In view of future demolition of the buildings of Xian Hua Lien, the uncertainty of the time expected to be required for the negotiation and construction of the new production plant, the possible reduction in the scale of operation of Xian Hua Lien and the rapid change in market demand that creates uncertainty in the suitability and usability of inventories and plant and machinery in future production, the recoverable amount of the existing property, plant and equipment and the net realisable value of inventories are expected to be drastically reduced, therefore impairment losses on property, plant and equipment, and write down of inventories has been made. Furthermore, the suspension of the trade relationships of Xian Hua Lien with their customers had also affected the recoverability of the trade receivables, an appropriate impairment loss was, therefore, made for the possible non-recoverable amount.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 6. IMPAIRMENT LOSSES ON PROPERTY, PLANT AND EQUIPMENT, INVENTORIES AND TRADE RECEIVABLES (Cont'd)

The following impairment losses have been provided:

	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Impairment loss on property, plant and equipment	<b>32,375</b>	–
Impairment loss on trade receivables	<b>30,435</b>	–
Write-down of inventories	<b>49,432</b>	–
	<b>112,242</b>	–

## 7. (LOSS) PROFIT FROM OPERATIONS

	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
(Loss) profit from operations has been arrived at after charging:		
Directors' remunerations (note 8)	<b>1,913</b>	2,398
Retirement benefits scheme contributions	<b>562</b>	699
Other staff costs	<b>13,657</b>	14,329
Total staff costs	<b>16,132</b>	17,426
Depreciation for property, plant and equipment	<b>34,398</b>	40,694
Amortisation of prepaid lease payment on land use rights	<b>1,024</b>	966
Total depreciation and amortisation	<b>35,422</b>	41,660
Net foreign exchange (gains) losses	<b>(3,865)</b>	834
Auditors' remuneration:	<b>465</b>	423
Allowance for bad and doubtful receivables, net	<b>11,912</b>	2,217
Impairment loss on available-for-sale financial assets (included in administrative expenses)	–	233
Loss on disposal of property, plant and equipment	<b>136</b>	740
and after crediting:		
Write-back on allowance for obsolete and slow moving inventories	<b>847</b>	658
Interest income	<b>639</b>	466



# Notes to the Financial Statements

For the year ended 31st December 2006

## 8. DIRECTORS' REMUNERATIONS

Details of remuneration paid by the Group to directors during the year are as follows:

	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Directors' fees	<b>90</b>	228
Salaries and allowances of executive directors	<b>1,823</b>	2,170
Total directors' remunerations	<b>1,913</b>	2,398

Their aggregate emoluments of the directors were within the following bands:

	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
HK\$ nil to HK\$1,000,000	<b>7</b>	6
HK\$1,000,001 to HK\$1,500,000	-	-

During the year, no emoluments were paid by the Group to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 8. DIRECTORS' REMUNERATIONS (Cont'd)

The emoluments paid or payable to each of the 7 (2005: 6) directors were as follows:

The Group	Fees HK\$'000	Salaries, allowances, and other remuneration HK\$'000	Employer's	2006 Total emoluments HK\$'000	2005 Total emoluments HK\$'000
			contributions to retirement benefits schemes HK\$'000		
<b>Executive Directors</b>					
Liaw Yuan Chian	–	840	–	840	923
Shih Chian Fang	–	533	–	533	527
Chaiteerath Boonchai	–	180	–	180	720
Chen Ling	–	270	–	270	–
<b>Independent Non-executive Directors</b>					
Fu Heng Yang	30	–	–	30	30
Yu Chi Jui	30	–	–	30	160
Li Xiao Wei	30	–	–	30	38
	90	1,823	–	1,913	2,398

## 9. EMPLOYEES' EMOLUMENTS

The aggregate emoluments of the five highest paid individuals included three (2005: three) executive directors of the Company, whose emoluments are included in note 8 above. The emoluments of the remaining two (2005: two) highest paid individuals are as follows:

	2006 HK\$'000	2005 HK\$'000
Salaries and allowances	745	949
Retirement benefits scheme contributions	12	12
	<b>757</b>	961

The emoluments of each of the remaining two highest paid individuals did not exceed HK\$1,000,000 in both years.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 10. INCOME TAX (INCOME) EXPENSE

	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Current tax:		
Hong Kong profits tax calculated at 17.5% (2005: 17.5%) of the estimated assessable profit	<b>21</b>	26
PRC enterprise income tax	<b>2,112</b>	3,140
	<b>2,133</b>	3,166
Over provision of Hong Kong profit tax in prior years	<b>(1)</b>	–
Deferred tax (note 16):	<b>(3,729)</b>	248
	<b>(1,597)</b>	3,414

PRC enterprise income tax is calculated at the prevailing rates. Pursuant to the relevant laws and regulations in the PRC, certain of the Company's PRC subsidiaries are entitled to exemption from PRC enterprise income tax for the first two years commencing from their first profit-making year of operation and, thereafter, these PRC subsidiaries will be entitled to a 50% relief from PRC enterprise income tax for the following three years. The tax exemption and tax reduction period can be extended by the relevant tax authorities. The PRC enterprise income tax expense for both years has been provided for after taking these tax incentives into account.

A portion of the Group's profit is not subject to income tax in the jurisdiction in which it operates.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 10. INCOME TAX (INCOME) EXPENSE (Cont'd)

The income tax (income) expense for the year can be reconciled to the (loss) profit per the consolidated income statement as follows:

	2006		2005	
	HK\$'000	%	HK\$'000	%
(Loss) profit before tax	(114,436)		11,640	
Tax at the income tax rate of 23% (2005: 23%) (Note)	(26,320)	(23.0)	2,677	23.0
Tax effect of expenses that are not deductible in determining taxable profit	26,887	23.5	1,966	16.9
Tax effect of income that is not taxable in determining taxable profit	(1,807)	(1.6)	(822)	(7.1)
Tax effect of income under tax reduction period	–	–	(493)	(4.2)
Effect of different tax rates of subsidiaries operating in different province of the PRC	(357)	(0.3)	86	0.7
Others	–	–	–	–
Income tax (income) expense and effective tax rate for the year	(1,597)	(1.4)	3,414	29.3

Note: The income tax rate represents the average of the tax rate in the province in which the PRC subsidiaries are operated.

## 11. DIVIDEND

The directors do not recommend the payment of a dividend in respect of the year ended 31st December, 2006 (2005: Nil).

## 12. (LOSS) EARNINGS PER SHARE

The calculation of the loss per share for the year is based on net loss for the year approximately HK\$73,362,000 (2005: net profit of HK\$3,585,000) and on 686,400,000 shares (2005: 686,400,000 shares) in issue during the year.

The Company has no dilutive potential ordinary shares in issue during the years ended 31st December 2006 and 2005.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 13. PROPERTY, PLANT AND EQUIPMENT

	<b>Buildings</b>	<b>Plant and machinery</b>	<b>Furniture and equipment</b>	<b>Motor vehicles</b>	<b>Construction in progress</b>	<b>Total</b>
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>THE GROUP</b>						
COST						
At 1st January 2005	215,242	354,578	31,152	7,766	8,706	617,444
Additions	72	–	5	–	1,379	1,456
Transfers	6,859	–	–	–	(6,859)	–
Disposals	(1,201)	–	–	(181)	–	(1,382)
At 31st December 2005	220,972	354,578	31,157	7,585	3,226	617,518
Exchange adjustments	13,258	21,842	1,816	443	194	37,553
Additions	–	42	14	–	570	626
Disposals	–	(97)	(217)	(855)	–	(1,169)
At 31st December 2006	234,230	376,365	32,770	7,173	3,990	654,528
DEPRECIATION AND AMORTISATION						
At 1st January 2005	54,650	214,203	31,146	6,903	–	306,902
Provided for the year	11,067	29,291	–	336	–	40,694
Eliminated on disposals	(477)	–	–	(163)	–	(640)
At 31st December 2005	65,240	243,494	31,146	7,076	–	346,956
Exchange adjustments	3,914	14,702	1,713	415	–	20,744
Provided for the year	10,614	23,363	–	421	–	34,398
Impairment loss recognised	26,037	6,338	–	–	–	32,375
Eliminated on disposals	–	(59)	(182)	(769)	–	(1,010)
At 31st December 2006	105,805	287,838	32,677	7,143	–	433,463
NET BOOK VALUES						
At 31st December 2006	128,425	88,527	93	30	3,990	221,065
At 31st December 2005	155,732	111,084	11	509	3,226	270,562

The land and buildings of the Group are situated in the PRC and held under medium-term land use rights.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 14. PREPAID LEASE PAYMENTS ON LAND USE RIGHTS

	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Analysed for reporting purposes as:		
Non-current asset	<b>43,441</b>	41,948
Current asset	<b>1,024</b>	966
	<b>44,465</b>	42,914

The leasehold land is held under medium-term lease and situated in PRC.

## 15. INTERESTS IN SUBSIDIARIES

	<b>THE COMPANY</b>	
	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Unlisted shares, at cost	<b>476,175</b>	476,175
Amounts due from subsidiaries	<b>71,156</b>	71,087
	<b>547,331</b>	547,262

The carrying value of the unlisted shares is based on the book values of the underlying net assets of the subsidiaries attributable to the Group as at the date on which the Company became the holding company of the Group under the Group reorganisation in 2000.

Details of the Company's subsidiaries at 31st December 2006 are set out in note 30.

In the opinion of the directors, the amounts due from subsidiaries are unsecured, non-interest bearing and are unlikely to be repayable within one year from the balance sheet date and are therefore shown in the balance sheet as non-current.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 16. DEFERRED TAX ASSETS

The following are the major deferred tax assets recognised by the Group:

	<b>Accelerated accounting depreciation</b>	<b>Inventories</b>	<b>Trade receivables</b>	<b>Total</b>
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January 2005	8,218	3,647	11,036	22,901
Credit to income	1,034	(1,823)	541	(248)
At 31st December 2005 and 1st January 2006	9,252	1,824	11,577	22,653
Exchange Adjustments	555	(72)	695	1,178
(Charge) credit to income (note 10)	873	(834)	3,690	3,729
At 31st December 2006	10,680	918	15,962	27,560

There was no significant unprovided deferred tax for the Group and the Company for the year or at the balance sheet date.

## 17. INVENTORIES

	<b>THE GROUP</b>	
	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Raw materials	<b>56,822</b>	33,269
Work in progress	<b>117,647</b>	194,872
Finished goods	<b>11,704</b>	17,487
	<b>186,173</b>	245,628

# Notes to the Financial Statements

For the year ended 31st December 2006

## 18. TRADE AND OTHER RECEIVABLES

The Group has a policy of allowing an average credit period of 90 days to its trade customers. Included in trade and other receivables are trade receivables of approximately HK\$185,133,000 (2005: HK\$231,336,000), the aged analysis of which at the balance sheet date is as follows:

	THE GROUP	
	2006 HK\$'000	2005 HK\$'000
Up to 30 days	27,255	62,166
31 – 60 days	38,938	77,000
61 – 90 days	48,888	46,906
91 – 180 days	70,052	45,264
181 days to 1 year	–	–
	<b>185,133</b>	231,336

The directors consider that the carrying amount of trade and other receivables approximately their fair value.

## 19. BANK BALANCES AND CASH

Bank balances carry interest at market rates which range from 1.5% to 3.5% (2005: 1% to 2.5%).

## 20. TRADE AND OTHER PAYABLES

Included in trade and other payables are trade payables of approximately HK\$61,438,000 (2005: HK\$61,353,000), the aged analysis of which at the balance sheet date is as follows:

	THE GROUP	
	2006 HK\$'000	2005 HK\$'000
Up to 30 days	4,218	14,651
31 – 60 days	1,015	14,677
61 – 90 days	2,959	13,430
91 – 180 days	16,323	12,676
181 days to 1 year	28,192	4,026
Over 1 year	8,731	1,893
	<b>61,438</b>	61,353

The directors consider that the carrying amount of trade and other payables approximates their fair value.



# Notes to the Financial Statements

For the year ended 31st December 2006

## 21. LOAN FROM A DIRECTOR

The loan from Mr. Liaw Yuan Chian is unsecured, interest-free and is repayable on demand.

## 22. BANK BORROWINGS

	<b>THE GROUP</b>	
	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Secured bank loans	<b>100,192</b>	119,486
Unsecured bank loans	<b>82,372</b>	80,539
Secured bank overdraft	–	4,947
	<b>182,564</b>	204,972

The bank borrowings are repayable as follows:

Within one year or on demand	<b>182,564</b>	204,614
One to two years	–	358
Two to five years	–	–
	<b>182,564</b>	204,972
Less: Amount due within one year shown under current liabilities	<b>(182,564)</b>	(204,614)
Amount due after one year	–	358

The carrying amounts of the Group's borrowings approximate their fair value.

The Group's borrowings that are denominated in currencies other than the functional currencies of the relevant group companies are set out below:

	<b>Denominated in HK\$</b>	<b>Denominated in US\$</b>
As at 31st December 2006	–	9,800,000
As at 31st December 2005	14,074,000	9,800,000

The borrowings denominated in Hong Kong dollars granted by the banks to a Group company are guaranteed by Company. The interest rates for the loans are Hong Kong Inter-bank Offered Rate or Singapore Inter-bank Offered Rate plus a spread, thus exposing the Group to cash flow interest rate risk.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 22. BANK BORROWINGS (Cont'd)

The effective borrowing rate of the Group ranged from 5.18% to 7.02% (2005: 3.49% to 7.18%).

During the year, the Group obtained new loans with aggregate amounts of approximately HK\$75,500,000. The proceeds were used for working capital purpose.

The carrying amount of bank borrowings approximates their fair value as the weighted average interest rates approximate the respective market rates.

At 31st December 2006, the Group's banking facilities were secured by the following:

- (i) Certain of the Group's prepaid lease payment on land use rights, property, plant and equipment with a carrying value as follows:

	THE GROUP	
	2006	2005
	HK\$'000	HK\$'000
Prepaid Lease Payments on land use right and building	85,218	85,979
Plant and machinery	51,849	34,427
	<b>137,067</b>	120,406

- (ii) Inventories of the Group of approximately HK\$52 million (2005: HK\$80 million);
- (iii) Bank deposits of the Group of approximately HK\$1.5 million (2005: HK\$10 million);
- (iv) Cross-guarantees between subsidiaries; and
- (v) The Company's corporate guarantees (at the balance sheet date, the aggregate amounts of facilities utilised by subsidiaries, including bills payable, amounted to approximately HK\$10 million (2005: HK\$47 million)).

On 12th September 2006, Bank of China, Xian Branch which lent USD9.8 million to the Xian Hua Lien obtained a writ from 陝西省高級人民法院 (Shannxi Province Highest People's Court) that granted the bank the legal rights to freeze and sequester all the assets of the Xian Hua Lien including property, plant and equipment, inventories, trade receivables and bank balances. At balance sheet date, Bank of China, Xian Branch sequestered the bank account, the property, plant and machinery and inventories of Xian Hua Lien as additional security. Due to the suspension of operation of Xian Hua Lien and full provision against the assets had been made, the sequestered assets have no carrying value at the balance sheet date.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 23. SHARE CAPITAL

	2006 and 2005 Authorised		2006 and 2005 Issued and fully paid	
	Number of shares	HK\$'000	Number of shares	HK\$'000
Ordinary shares of HK\$0.10 each	1,500,000,000	150,000	686,400,000	68,640

## 24. RESERVES

	Contributed surplus (note i) HK\$'000	Accumulated profits (note ii) HK\$'000	Total HK\$'000
THE COMPANY			
At 1st January 2005	468,576	8,629	477,205
Loss for the year	–	(849)	(849)
At 31st December 2005 and 1st January 2006	468,576	7,780	476,356
Loss for the year	–	(452)	(452)
At 31st December 2006	468,576	7,328	475,904

Notes:

- (i) The contributed surplus of the Company represents the difference between the book value of the underlying net assets of the subsidiaries acquired by the Company under the group reorganisation in 2000 and the nominal value of the Company's shares issued for the acquisition.
- (ii) At 31st December 2006, the Company's reserves available for distribution to shareholders of approximately HK\$475,904,000 (2005: HK\$476,356,000) comprised the contributed surplus of approximately HK\$468,576,000 (2005: HK\$468,576,000) and the accumulated profits of approximately HK\$7,328,000 (2005: HK\$7,780,000).

## 25. CONTINGENT LIABILITIES

The Group reached a settlement of legal claim with Bank of East Asia, Shenzhen Branch against Jiangmen Hua Lien for repayment of the principal of approximately Rmb11,241,000 (approximately equivalent to HK\$11,241,000) and interest thereon through a mutually agreed repayment schedule dated on 23rd March 2007.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 26. COMMITMENTS

(a) Operating lease commitments:

	<b>THE GROUP</b>	
	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Minimum lease payments paid during the year under operating leases in respect of land and buildings and office premises	<b>757</b>	1,386

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	<b>THE GROUP</b>	
	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Within one year	<b>245</b>	1,357
In the second to fifth year inclusive	<b>125</b>	4,621
Over five years	<b>–</b>	2,310
	<b>370</b>	8,288

Operating lease payments principally represent rentals payable by the Group for certain of its factory properties and office premises. Leases are negotiated for terms from 1 to 20 years and rentals are fixed throughout the lease terms.

The Company did not have any significant operating lease commitments at the balance sheet date.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 26. COMMITMENTS (Cont'd)

### (b) Capital commitments:

	<b>THE GROUP</b>	
	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Capital expenditure contracted for but not provided in the financial statements in respect of the acquisition of property, plant and equipment	—	—

The Company did not have any significant capital commitments at the balance sheet date.

### (c) Other commitments:

Under the terms of a cooperative joint venture agreement in respect of 江門市華聯製皮工業有限公司 Jiangmen Hua Lien Tannery Co., Ltd. ("Jiangmen Hua Lien", formerly known as 新會華聯製皮工業有限公司 Xin Hui Hua Lien Tannery Co., Ltd.), a subsidiary of the Company, Galloon International (Holding) Company, Limited ("Galloon International") is entitled to all of the net profit or loss of Jiangmen Hua Lien throughout the entire cooperative joint venture period after the payment of a pre-determined distribution by Jiangmen Hua Lien each year to the joint venture partner of Galloon International (the "Joint Venture Partner"). In the event that Jiangmen Hua Lien does not have sufficient distributable profit to make the required payments to the Joint Venture Partner, Galloon International is responsible for making such payments to the Joint Venture Partner as compensation. At 31st December 2006, the pre-determined distributions payable to the Joint Venture Partner over the entire cooperative joint venture period are as follows:

	<b>THE GROUP</b>	
	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Amount payable:		
Within one year	<b>5,610</b>	5,239
One to two years	<b>5,610</b>	5,239
Two to five years	<b>14,725</b>	13,751
Over five years	<b>50,994</b>	52,861
	<b>76,939</b>	77,090

The Company did not have any significant other commitments at the balance sheet date.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 27. SHARE OPTIONS SCHEME

The Company's share option scheme (the "Scheme") which was adopted pursuant to a resolution passed by shareholders on 4th January 2000 for the primary purpose of providing incentives to directors and eligible employees, will expire on 3rd January 2010. Under the Scheme, the Board of Directors of the Company may grant options to eligible employees, including directors of the Company and its subsidiaries, to subscribe for shares in the Company.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders.

Options granted must be taken up within 30 days of the date of offer, upon payment of HK\$1 per grant. Options may be exercised at any time from the period commencing on the date falling 6 months after the date of grant of the share option to the 5th anniversary of the date of grant. The exercise price is determined by the directors of the Company, and will not be less than the higher of the closing price of the Company's shares on the date of grant, the average closing price of the shares for the five business days immediately preceding the date of grant and the nominal value of the shares.

No options have been granted or agreed to be granted under the Scheme since its adoption.

## 28. RETIREMENT BENEFITS SCHEMES

The Group operates the MPF Scheme established under the Mandatory Provident Fund Ordinance for its qualifying employees. The assets of the MPF Scheme are held separately from those of the Group, in funds under the control of trustees.

The PRC subsidiaries are required to contribute a certain percentage, ranging from 18% to 20%, of the payroll of their employees to the retirement benefits schemes to fund the benefits. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the respective schemes.

At the balance sheet date, there were no significant forfeited contributions available to reduce the contribution payable in the future years.

The total cost charged to the consolidated income statement of approximately HK\$0.6 million (2005: HK\$0.7 million) represents contributions payable to these schemes by the Group in respect of the current accounting period.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 29. RELATED PARTY TRANSACTIONS AND BALANCES

During the year, the Group had certain transactions with related parties. Details of these transactions for the year and balances at 31st December 2006 with related parties are as follows:

### (a) Transactions

A subsidiary entered into a lease agreement (the "Lease Agreement") with Xian People's Tannery Factory ("Xian People's Tannery"), the minority shareholder of a subsidiary, to lease the land use rights related to the site on which the factory building of the subsidiary is located at a monthly rental of RMB102,000 (approximately HK\$102,000). During the year, the Group paid rental expense of approximately HK\$525,000 (2005: HK\$1,155,000) to Xian People's Tannery and the amount paid was in the ordinary course of business and in accordance with terms of the Lease Agreement. The lease was terminated in September 2006.

### (b) Balances

Details of balances with the related parties at the balance sheet date is set out in the consolidated balance sheet and note 21.

### (c) Others

Details of an arrangement with a joint venture partner of Galloon International in respect of the distribution of profits in Jiangmen Hua Lien are set out in note 26(c).

### (d) The remuneration of directors and other members of key management during the year was as follows:

	<b>2006</b>	2005
	<b>HK\$'000</b>	HK\$'000
Directors' fee	<b>90</b>	228
Salaries, allowance and benefits in kind	<b>1,823</b>	2,170
Mandatory Provident Fund Contribution	-	-
	<b>1,913</b>	2,398

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends.

# Notes to the Financial Statements

For the year ended 31st December 2006

## 30. SUBSIDIARIES

Details of the Company's subsidiaries at 31st December 2006 are as follows:

Name of company	Place of incorporation/ operations	Nominal value of issued and fully paid share capital/ registered capital	Effective proportion of issued/ registered capital held by the Company	Principal activities
Galloon International (Holding) Company, Limited	British Virgin Islands/ Taiwan	Ordinary share US\$1	100%	Sale and marketing of leather, raw materials sourcing and investment holding
嘉聯皮革(中國)有限公司 Galloon Leather (China) Co, Ltd. ("Galloon Leather") (formerly known as 新會嘉聯皮革工業有限公司 Xin Hui Galloon Tannery Co., Ltd.)	The PRC **	Registered capital US\$21,700,000 <i>Note (iv)</i>	100%	Manufacture and sale of leather
Hua Lien Group (Holding) Company, Limited ("Hua Lien Group (Holding)")	British Virgin Islands/ Hong Kong	Ordinary shares US\$19,193,996 <i>Note (i)</i>	100%	Investment holding
Hua Lien (Hong Kong) Company Limited ("Hua Lien Hong Kong")	Hong Kong	Ordinary shares HK\$10,000 Non-voting deferred shares HK\$15,000,000 <i>Note (ii)</i>	100%	Provision of management services
江門市華聯製皮工業有限公司 Jiangmen Hua Lien	The PRC *	Registered capital US\$14,522,000	70.5% <i>Note (iii)</i>	Manufacture and sale of leather
Sawston International Limited	British Virgin Islands/ Taiwan	Ordinary shares US\$1	100%	Sale and marketing of leather and raw material sourcing
西安華聯製皮工業股份有限公司 Xian Hua Lien Tannery Co., Ltd. ("Xian Hua Lien")	The PRC ***	Registered capital RMB65,600,000	51% <i>Note (v)</i>	Manufacture and sale of leather

\* Company incorporated as limited liability cooperative joint venture enterprise in the PRC.

\*\* Company incorporated as limited liability equity joint venture enterprise in the PRC.

\*\*\* Company as joint stocks limited liability in the PRC.



# Notes to the Financial Statements

For the year ended 31st December 2006

## 30. SUBSIDIARIES (Cont'd)

Notes:

- (i) Hua Lien Group (Holding) is held by the Company directly. All other subsidiaries are held by the Company indirectly.
- (ii) The deferred shares of Hua Lien Hong Kong, which are not held by the Group, practically carry no rights to dividends or to receive notice of or to attend or vote at any of its general meetings or to participate in any distribution on its winding up.
- (iii) Jiangmen Hua Lien is a limited liability cooperative joint venture enterprise with a term of operation to 26th August 2022. Under the terms of the cooperative joint venture agreement, Galloon International holds 70.5% of the registered capital of Jiangmen Hua Lien, but it is entitled to all of the net profit or loss of Jiangmen Hua Lien throughout the entire cooperative joint venture period, after the payment of a pre-determined distribution by Jiangmen Hua Lien each year to the Joint Venture Partner, details of which are set out in note 26 (c).

At the end of the cooperative joint venture period, Galloon International is entitled to the distribution of all the remaining assets of Jiangmen Hua Lien according to its capital contribution ratio in Jiangmen Hua Lien.

- (iv) As at the date of this report, the registered capital of Galloon Leather was paid up to the extent of US\$14,000,000 (2005: US\$14,000,000).
- (v) In January 2003, Xian Hua Lien was approved to change from a limited liability sino-foreign equity joint venture enterprise for a term of operation of 20 years to a joint stock limited liability company with a registered capital of RMB65,600,000.

Since the establishment of Xian Hua Lien, the minority shareholders received 40% of the profit distribution made by Xian Hua Lien in respect of the period from the date of its establishment to 31st December 2006 (rather than in proportion to the 49% equity interest that it holds in Xian Hua Lien) and, pursuant to an agreement made with Galloon International, Hua Lien Hong Kong, Xian Hua Lien, the minority shareholders waived its remaining entitlement to such profit distribution in favour of the Group. The Group therefore effectively had a 60% attributable economic interest in Xian Hua Lien for the period from the date of establishment of Xian Hua Lien to 31st December 2006.

None of the subsidiaries had any debt securities outstanding at the end of the year, or at any time during the year.

## Financial Summary

	Year ended 31st December				
	2002	2003	2004	2005	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>RESULTS</b>					
Turnover	851,428	819,057	861,163	874,629	<b>718,909</b>
Cost of sales	(757,438)	(764,398)	(801,641)	(832,005)	<b>(694,855)</b>
Gross profit	93,990	54,659	59,522	42,624	<b>24,054</b>
Other operating income	11,841	9,196	9,744	5,562	<b>14,565</b>
Distribution cost	(2,153)	(1,931)	(935)	(720)	<b>(408)</b>
Administrative expenses	(44,415)	(36,874)	(27,128)	(25,555)	<b>(31,786)</b>
Factory relocation cost	–	–	–	–	<b>(112,242)</b>
(Loss) profit from operations	59,263	25,050	41,203	21,911	<b>(105,817)</b>
Finance charges	(11,630)	(11,372)	(10,743)	(10,271)	<b>(8,619)</b>
(Loss) profit from ordinary activities before tax	47,633	13,678	30,460	11,640	<b>(114,436)</b>
Income tax income (expense)	(1,192)	(2,300)	(6,126)	(3,414)	<b>1,597</b>
(Loss) profit before minority interests	46,441	11,378	24,334	8,226	<b>(112,839)</b>
Minority interests	(11,143)	(4,237)	(4,566)	(4,641)	<b>39,477</b>
Net (loss) profit for the year	35,298	7,141	19,768	3,585	<b>(73,362)</b>

	As at 31st December				
	2002	2003	2004	2005	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>ASSETS AND LIABILITIES</b>					
Total assets	1,045,327	1,070,327	1,004,981	1,063,839	<b>938,353</b>
Total liabilities	(321,210)	(345,314)	(260,926)	(316,833)	<b>(291,806)</b>
Minority interests	(54,805)	(48,560)	(47,834)	(47,183)	<b>(2,096)</b>
	669,312	676,453	696,221	699,823	<b>644,451</b>

Notes:

1. The Company was incorporated on 27th April 1998 and became the holding company of the Group on 5th January 2000 as a result of the group reorganisation in 2000.