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GDH

粵海制革有限公司

GUANGDONG TANNERY LIMITED

(Incorporated in Hong Kong with limited liability)

(Stock Code: 1058)

2018 ANNUAL RESULTS ANNOUNCEMENT

HIGHLIGHTS

	For the year ended 31 December		
	2018	2017	Change
Sales volume of cowhides (in thousand square feet)	**14,155**	16,684	-15.2%
Revenue (in thousand HK$)	**238,317**	322,146	-26.0%
Loss for the year (in thousand HK$)	**(81,241)**	(99,623)	+18.5%
Basic loss per share (in HK cent)	**(15.10)**	(18.52)	+18.5%
Key Indicators (As at 31 December)	**2018**	2017	Change
Current Ratio	**2.85 times**	2.75 times	+3.6%
Quick Ratio	**1.16 times**	0.99 times	+17.2%
Debt to asset ratio	**79.2%**	64.1%	+23.6%
Total assets (in thousand HK$)	**284,736**	420,915	-32.4%
Net asset value per share (HK$)	**0.11**	0.28	-60.7%

FINANCIAL RESULTS

The board of directors (the "Board") of Guangdong Tannery Limited (the "Company") announces the consolidated results of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2018 together with comparative figures.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

	Notes	**2018** *HK$'000*	2017 *HK$'000*
REVENUE	*4*	**238,317**	322,146
Cost of sales		**(273,592)**	(369,583)
Gross loss		**(35,275)**	(47,437)
Other income and gains	*4*	**3,356**	5,894
Selling and distribution expenses		**(2,081)**	(2,131)
Administrative expenses		**(28,155)**	(28,015)
Impairment on items of plant and equipment		**(12,365)**	(21,794)
Other operating income/(expenses), net		**(542)**	1,409
Finance costs	*5*	**(5,973)**	(6,808)
LOSS BEFORE TAX	*5*	**(81,035)**	(98,882)
Income tax expense	*6*	**(206)**	(741)
LOSS FOR THE YEAR		**(81,241)**	(99,623)
LOSS PER SHARE	*7*		
- Basic		**HK(15.10) cents**	HK(18.52) cents
- Diluted		**HK(15.10) cents**	HK(18.52) cents

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	2018	2017
	HK$'000	*HK$'000*
LOSS FOR THE YEAR	**(81,241)**	(99,623)
OTHER COMPREHENSIVE INCOME/(LOSS)		
Other comprehensive income/(loss) that will not be reclassified to profit or loss in subsequent periods:		
Surplus/(deficits) on revaluation of buildings	**(219)**	4,185
Income tax effect	**55**	(1,046)
	(164)	3,139
Other comprehensive income/(loss) that may be reclassified to profit or loss in subsequent periods:		
Exchange differences on translation of foreign operations	**(10,774)**	22,364
OTHER COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR, NET OF TAX	**(10,938)**	25,503
TOTAL COMPREHENSIVE LOSS FOR THE YEAR	**(92,179)**	(74,120)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	**2018** **HK$'000**	2017 HK$'000
NON-CURRENT ASSETS			
Property, plant and equipment		**47,057**	65,887
Prepaid land lease payments		**11,459**	12,313
Total non-current assets		**58,516**	78,200
CURRENT ASSETS			
Inventories		**134,131**	218,900
Receivables, prepayments and deposits	*9*	**64,576**	93,641
Pledged bank balances		**-**	1,066
Cash and bank balances		**27,513**	29,108
Total current assets		**226,220**	342,715
CURRENT LIABILITIES			
Trade payables	*10*	**38,009**	49,551
Other payables and accruals	*11*	**36,531**	28,902
Tax payable		**113**	33
Loan from a fellow subsidiary		**-**	41,177
Due to a PRC joint venture partner		**1,131**	1,131
Provision		**3,640**	3,816
Total current liabilities		**79,424**	124,610
NET CURRENT ASSETS		**146,796**	218,105
TOTAL ASSETS LESS CURRENT LIABILITIES		**205,312**	296,305
NON-CURRENT LIABILITIES			
Loans from the immediate holding company		**142,379**	141,138
Deferred tax liabilities		**3,840**	3,895
Total non-current liabilities		**146,219**	145,033
Net assets		**59,093**	151,272
EQUITY			
Share capital		**75,032**	75,032
Other reserves		**(15,939)**	76,240
Total equity		**59,093**	151,272

Notes:

(1) BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (which include all Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for buildings classified as property, plant and equipment and bills receivable which have been measured at fair value. These financial statements are presented in Hong Kong dollars ("HK$") and all values are rounded to the nearest thousand (HK$'000) except when otherwise indicated.

The financial information relating to the years ended 31 December 2018 and 31 December 2017 included in this preliminary announcement of annual results for the year ended 31 December 2018 does not constitute the Company's statutory annual consolidated financial statements for those years, but in respect of the year ended 31 December 2017, is derived from those financial statements. Further information relating to these statutory financial statements required to be disclosed in accordance with section 436 of the Companies Ordinance is as follows:

The Company has delivered the financial statements for the year ended 31 December 2017 to the Registrar of Companies as required by section 662(3) of, and Part 3 of Schedule 6 to, the Companies Ordinance and will deliver the financial statements for the year ended 31 December 2018 in due course.

Auditors' reports have been prepared on the financial statements of the Group for both years. The auditors' reports were unqualified; did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying its reports; and did not contain a statement under sections 406(2), 407(2) or (3) of the Companies Ordinance.

Basis of consolidation

The consolidated financial statements include the financial statements of the Group for the year ended 31 December 2018. A subsidiary is an entity (including a structured entity), directly or indirectly, controlled by the Company. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (i.e., existing rights that give the Group the current ability to direct the relevant activities of the investee).

When the Company has, directly or indirectly, less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

(a) the contractual arrangement with the other vote holders of the investee;
(b) rights arising from other contractual arrangements; and
(c) the Group's voting rights and potential voting rights.

The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. The results of subsidiaries are consolidated from the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

Profit or loss and each component of other comprehensive income are attributed to the owners of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control described above. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it derecognises (i) the assets (including goodwill) and liabilities of the subsidiary, (ii) the carrying amount of any non-controlling interest and (iii) the cumulative translation differences recorded in equity; and recognises (i) the fair value of the consideration received, (ii) the fair value of any investment retained and (iii) any resulting surplus or deficit in profit or loss. The Group's share of components previously recognised in other comprehensive income is reclassified to profit or loss or retained profits, as appropriate, on the same basis as would be required if the Group had directly disposed of the related assets or liabilities.

(2) CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

The Group has adopted the following new and revised HKFRSs for the first time for the current year's financial statements.

Amendments to HKFRS 2	*Classification and Measurement of Share-based Payment Transactions*
Amendments to HKFRS 4	*Applying HKFRS 9 Financial Instruments with HKFRS 4 Insurance Contracts*
HKFRS 9	*Financial Instruments*
HKFRS 15	*Revenue from Contracts with Customers*
Amendments to HKFRS 15	*Clarifications to HKFRS 15 Revenue from Contracts with Customers*
Amendments to HKAS 40	*Transfers of Investment Property*
HK(IFRIC)-Int 22	*Foreign Currency Transactions and Advance Consideration*
Annual Improvements 2014-2016 Cycle	Amendments to HKFRS 1 and HKAS 28

Other than as explained below regarding the impact of HKFRS 9 and HKFRS 15, the adoption of the above new and revised standards has had no significant financial effects on these financial statements.

The nature and the impact of the new and revised HKFRSs are described below:

(a) HKFRS 9 *Financial Instruments* replaces HKAS 39 *Financial Instruments: Recognition and Measurement* for annual periods beginning on or after 1 January 2018, bringing together two aspects of the accounting for financial instruments: classification and measurement, and impairment.

The Group has recognised the transition adjustments against the applicable opening balances in equity at 1 January 2018. Therefore, the comparative information was not restated and continues to be reported under HKAS 39.

Classification and measurement
The following information sets out the impacts of adopting HKFRS 9 on the statement of financial position, including the effect of replacing HKAS 39's incurred credit loss calculations with HKFRS 9's expected credit losses ("ECLs").

A reconciliation between the carrying amounts under HKAS 39 and the balances reported under HKFRS 9 as at 1 January 2018 is as follows:

	Note	Category	HKAS 39 measurement Amount HK$'000	Reclassification HK$'000	HKFRS 9 measurement Amount HK$'000	Category
Financial assets						
Trade receivables		L&R[1]	37,313	-	37,313	AC[2]
Bills receivable	(i)	L&R[1]	53,223	(53,223)	-	AC[2]
	(i)		-	53,223	53,223	FVOCI[3]
Financial assets included in prepayments, other receivables and deposits		L&R[1]	1,742	-	1,742	AC[2]
Pledged bank balances		L&R[1]	1,066	-	1,066	AC[2]
Cash and bank balances		L&R[1]	29,108	-	29,108	AC[2]
			122,452	-	122,452	
Financial liabilities						
Trade payables		AC[2]	49,551	-	49,551	AC[2]
Financial liabilities included in other payables and accruals		AC[2]	22,646	-	22,646	AC[2]
Due to a PRC joint venture partner		AC[2]	1,131	-	1,131	AC[2]
Loan from the immediate holding company		AC[2]	141,138	-	141,138	AC[2]
Loan from a fellow subsidiary		AC[2]	41,177	-	41,177	AC[2]
			255,643	-	255,643	

[1] L&R: Loans and receivables
[2] AC: Financial assets or financial liabilities at amortised cost
[3] FVOCI: Financial assets at fair value through other comprehensive income

Note:

(i) The objective of the Group of holding the bills receivable is to collect contractual cash flows and to sell before its contractual maturity for working capital management. The Group considered these receivables are managed within a business model to collect contractual cash flows and to sell the financial assets. Accordingly, the Group has reclassified its bills receivable from loans and receivables at amortised cost to financial assets at fair value through other comprehensive income.

Impairment

There was no significant impact on the financial statements upon transition from the aggregate opening impairment allowances under HKAS 39 to ECL allowances under HKFRS 9 for the financial assets of the Group as at 1 January 2018.

(b) HKFRS 15 and its amendments replace HKAS 11 *Construction Contracts*, HKAS 18 *Revenue* and related interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers. HKFRS 15 establishes a new five-step model to account for revenue arising from contracts with customers. Under HKFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in HKFRS 15 provide a more structured approach for measuring and recognising revenue. The standard also introduces extensive qualitative and quantitative disclosure requirements, including disaggregation of total revenue, information about performance obligations, changes in contract asset and liability account balances between periods and key judgements and estimates. As a result of the application of HKFRS 15, the Group has changed the accounting policy with respect to revenue recognition.

The Group has adopted HKFRS 15 using the modified retrospective method of adoption. Under this method, the standard can be applied either to all contracts at the date of initial application or only to contracts that are not completed at this date. The Group has elected to apply the standard to contracts that are not completed as at 1 January 2018. Initial application of HKFRS 15 has no cumulative effect on the timing and measurement of revenue recognition for the sale of processing leather as at 1 January 2018.

The nature of the adjustments as at 1 January 2018 and the reasons for the significant changes in the statement of financial position as at 31 December 2018 are described below:

Presentation of contract assets and liabilities

Under HKFRS 15, a receivable is recognised only if the Group has an unconditional right to consideration. If the Group recognises the related revenue before being unconditionally entitled to the consideration for the promised goods and services in the contract, then the entitlement to consideration is classified as a contract asset. Similarly, a contract liability, rather than a payable, is recognised when a customer pays consideration, or is contractually required to pay consideration and the amount is already due, before the Group recognises the related revenue. For a single contract with the customer, either a net contact asset or a net contract liability is presented. For multiple contracts, contract assets and contract liabilities of unrelated contracts are not presented on a net basis.

Consideration received from customers in advance

Before the adoption of HKFRS 15, the Group recognised consideration received from customers in advance as receipts in advance included in other payables. Under HKFRS 15, the amount is classified as contract liabilities which is included in other payables and accruals.

Upon adoption of HKFRS 15, the Group reclassified HK$1,308,000 from receipts in advance to contract liabilities which is included in other payables as at 1 January 2018 in relation to the consideration received from customers in advance as at 1 January 2018.

As at 31 December 2018, under HKFRS 15, HK$4,120,000 was reclassified from receipts in advance to contract liabilities included in other payables in relation to the consideration received from customers in advance.

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

Amendments to HKFRS 3	*Definition of a Business*[2]
Amendments to HKFRS 9	*Prepayment Features with Negative Compensation*[1]
Amendments to HKFRS 10 and HKAS 28 (2011)	*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*[4]
HKFRS 16	*Lease*[1]
HKFRS 17	*Insurance Contracts* [3]
Amendments to HKAS 1 and HKAS 8	*Definition of Material* [2]
Amendments to HKAS 19	*Plan Amendment, Curtailment or Settlement* [1]
Amendments to HKAS 28	*Long-term Interests in Associates and Joint Ventures* [1]
HK(IFRIC)-Int 23	*Uncertainty over Income Tax Treatments*[1]
Annual Improvements 2015-2017 Cycle	Amendments to HKFRS 3, HKFRS 11, HKAS 12 and HKAS 23[1]

[1] Effective for annual periods beginning on or after 1 January 2019
[2] Effective for annual periods beginning on or after 1 January 2020
[3] Effective for annual periods beginning on or after 1 January 2021
[4] No mandatory effective date yet determined but available for adoption

(3) OPERATING SEGMENT INFORMATION

No separate analysis of operating segment information is presented by the Group as over 90% of the Group's revenue, results and assets related to the processing and sale of semi-finished and finished leather in Mainland China during the year.

Information about a major customer

Revenue of approximately HK$21,068,000 (2017: HK$34,726,000) was derived from sales to a single customer, which constituted less than 10% (2017: 10.8%) of the total revenue during the year ended 31 December 2018.

(4) REVENUE, OTHER INCOME AND GAINS

An analysis of revenue is as follows:

	2018	2017
	HK$'000	*HK$'000*
Revenue from contracts with customers		
Sale of processed leather	**238,317**	322,146

	2018	2017
	HK$'000	*HK$'000*
Other income and gains		
Finance income	**47**	68
Sale of scrap materials	**1,914**	1,240
Government grants*	**865**	15
Foreign exchange gains, net	**-**	3,648
Others	**530**	923
	3,356	5,894

* During the year ended 31 December 2018, the Group received HK$865,000 (2017: HK$15,000) from the PRC local government as a support to the Group's PRC operations.

(5) LOSS BEFORE TAX

The Group's loss before tax is arrived at after charging/(crediting):

	2018 *HK$'000*	2017 *HK$'000*
Cost of inventories sold	**272,605**	345,579
Auditors' remuneration	**1,450**	1,375
Depreciation	**5,849**	11,024
Interests on:		
Bank loans and discounting bills receivable to banks	**994**	2,556
Loans from the immediate holding company	**4,337**	3,847
Loan from a fellow subsidiary	**642**	405
	5,973	6,808
Employee benefit expense (excluding directors' remuneration):		
Wages and salaries	**24,606**	29,032
Pension scheme contribution (defined contribution schemes)*	**3,503**	3,347
	28,109	32,379
Foreign exchange differences, net	**536**	(3,648)
Provision for inventories**	**987**	24,004
Minimum lease payments under operating leases in respect of land and buildings	**960**	900
Amortisation of prepaid land lease payments	**299**	291
Impairment of financial assets, net		
Impairment of trade receivables#	**514**	1,616
Impairment of financial assets included in prepayments, other receivables and deposits, net#	**28**	76
	542	1,692
Write-off of items of property, plant and equipment#	**-**	1,567
Loss on disposal of items of property, plant and equipment#	**-**	136
Reversal of accruals#	**-**	(4,804)

* At 31 December 2018 and 2017, the Group had no forfeited contribution available to reduce its contributions to the pension schemes in future years.

** This item is included in the "Cost of sales" on the face of the consolidated statement of profit or loss.

\# These items are included in the "Other operating income/(expenses), net" on the face of the consolidated statement of profit or loss.

(6) INCOME TAX

No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits arising in Hong Kong during the year (2017: Nil). Taxes on profits assessable in Mainland China have been calculated at the rate of tax prevailing in Mainland China in which the Group operates.

	2018	2017
	HK$'000	*HK$'000*
Current - Mainland China		
Charge for the year	**206**	74
Underprovision in prior years	**-**	17
Deferred	**-**	650
Total tax charge for the year	**206**	741

(7) LOSS PER SHARE

The calculation of the basic loss per share amount is based on the loss for the year and the weighted average number of ordinary shares of 538,019,000 (2017: 538,019,000) in issue during the year.

The calculations of basic and diluted loss per share are based on:

	2018	2017
	HK$'000	*HK$'000*
Loss		
Loss for the year, used in the basic loss per share calculation	**81,241**	99,623

	Number of shares	
	2018	2017
Shares		
Weighted average number of ordinary shares in issue during the year used in the basic loss per share calculation	**538,019,000**	538,019,000

(8) DIVIDEND

The Board does not recommend the payment of a final dividend (2017: Nil).

(9) RECEIVABLES, PREPAYMENTS AND DEPOSITS

	Notes	**2018** *HK$'000*	2017 HK$'000
Trade receivables	(i)	**32,037**	37,313
Bills receivable	(i)	**26,031**	53,223
Prepayments, deposits and other receivables	(ii)	**6,508**	3,105
		64,576	93,641

Notes:

(i) The Group's trading terms with customers are mainly on credit, except for new customers, where payment in advance is normally required. Invoices are normally payable within 60 days of issuance, except for certain well-established customers, where the terms are extended to 150 days. Each customer has a maximum credit limit. The Group seeks to maintain tight control over its outstanding receivables in order to minimise credit risk. Overdue balances are reviewed regularly by senior management. In view of the aforementioned and the fact that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. The Group does not hold any collateral or other credit enhancements over its trade receivable balances. Trade receivables are non-interest-bearing. The carrying amounts of trade and bills receivable approximate their fair values.

An ageing analysis of the trade and bills receivables as at the end of the reporting period, based on the settlement due date, is as follows:

	2018 *HK$'000*	2017 *HK$'000*
Current	**53,964**	89,618
Less than 3 months	**2,932**	2,085
3 to 6 months	**1,543**	510
More than 6 months	**1,724**	-
	60,163	92,213
Impairment	**(2,095)**	(1,677)
	58,068	90,536

Movements in the loss allowance for impairment of trade receivables are as follows:

	2018 *HK$'000*	2017 *HK$'000*
At 1 January	**1,677**	-
Impairment losses	**514**	1,616
Exchange realignment	**(96)**	61
At 31 December	**2,095**	1,677

The Group estimated the expected loss rate of bills receivable is minimal and no ECLs in respect of the balance as at 31 December 2018 was made.

(ii) As at 31 December 2018, a provision of HK$394,000 (2017: HK$385,000) was made for other receivables with a gross carrying amount of HK$394,000 (2017: HK$385,000).

Movements in the provision for impairment of other receivables are as follows:

	2018	2017
	HK$'000	*HK$'000*
At 1 January	**385**	288
Impairment losses, net	**28**	76
Exchange realignment	**(19)**	21
At 31 December	**394**	385

The carrying amounts of other receivables approximate their carrying values.

(10) TRADE PAYABLES

An ageing analysis of the trade payables as at the end of the reporting period, based on the date of receipt of goods, is as follows:

	2018	2017
	HK$'000	*HK$'000*
Within 3 months	**28,127**	32,104
3 to 6 months	**5,670**	14,266
Over 6 months	**4,212**	3,181
	38,009	49,551

The trade payables of the Group are non-interest-bearing and are normally settled on terms of 90 days. The carrying amounts of trade payables approximate their fair values.

(11) OTHER PAYABLES AND ACCRUALS

	Note	**2018** *HK$'000*	2017 *HK$'000*
Other payables and accruals	(i)	**32,411**	27,594
Contract liabilities		**4,120**	-
Receipts in advance		**-**	1,308
		36,531	28,902

Note:

(i) Included in the other payables is accrued interest of HK$10,537,000 (2017: HK$7,441,000) due to the immediate holding company which is repayable on demand, and arose from loans from the immediate holding company.

Other payables of the Group are non-interest-bearing and have an average term of three months. The carrying amounts of other payables approximate their fair values.

CHAIRMAN'S STATEMENT

RESULTS

I would like to present to the shareholders that the consolidated loss attributable to shareholders of the Group for 2018 was HK$81,241,000 (2017: HK$99,623,000), representing a decrease in loss of 18.5%. Basic loss per share was HK15.10 cents (2017: HK18.52 cents).

DIVIDEND

The Board does not recommend the payment of a final dividend for the year ended 31 December 2018 (2017: Nil).

REVIEW

The year of 2018 witnessed an overall economic downturn in the industry, coupled with a continuous tightening of the environmental protection policies and requirements in relation to the industry. This led to production disruptions among small regional footwear manufacturers, which in turn reduced the demand for footwear leather. Besides, in view of the constant diversification of footwear materials and the growing trend of using new materials as alternatives, the market demand for real leather was gradually dwindling, with de-capacity continuing to gain momentum in the industry. Meanwhile, the increase in the tariffs on US-imported goods led to a rise in the procurement costs, lowering the profitability of industry enterprises and constituting ginormous pressure for the production and operations of the leather processing industry. Against the macro backdrop of an overall diminishing demand in the market, the Group's operating results recorded a loss during the year. In the course of the year, adhering to the business strategy of "stable operations to ensure asset safety", the Group stepped up its efforts in stock reduction with destocking and the realization of positive cash flows as its objectives, so as to ensure funding for the Group's normal operations. Meanwhile, the Group stepped up its efforts in proprietary research and development, enhanced the promotion of its products, worked toward the construction and refinement of environmentally friendly facilities, endeavored to maintain stable production and operations, and mitigated the risks arising from operating business under the weak economic environment.

In response to the dwindling footwear leather market, at the beginning of the year, the Group formulated its budget plan with reference to the market changes to set its production and business targets. Against the backdrop of a more rigorous law enforcement in relation to environmental protection, the Group made reasonable production arrangements during the year through the adjustment and optimization of its technical skills, and reinforced its production sites management as well as products quality inspection and testing for ensuring compliance with the environmental protection indicators and requirements, which mitigated the adverse effects arising from changes in the operating environment to a certain extent. In terms of sales, during the year, the Group proactively tapped into weak markets, refined its customer positioning, and stepped up its efforts toward customer visits, so as to stay abreast of the market changes and prevailing product trends. The Group also endeavored to explore directions for future product development, sparing no effort in furthering its stock reduction. In terms of procurement, during the year, the Group exercised rigorous control over procurement size by adopting a targeted inventory replenishment approach that only involved small quantities but multiple batches, which led to further improvements in its inventories in terms of both structure and aggregate volume, enhanced the development and sales of the work in progress and finished goods constituting the inventories, and contributed to the positive conversion of inventories to cash flows.

PROSPECTS

In 2019, economic downturn is expected to carry on in the industry. Given the continuously dwindling overall demand in the footwear leather market, the tannery industry will be met with further challenges. The Group would follow through with each strategic deployment in a holistic approach, adhere to the business strategy of “stable operations to ensure asset safety”, and undertake its various activities with a focus on a proactive compression of inventory, a commitment to maintaining its positive cash flows and operational stability. The Group would steadfastly further its operating strategy on destocking, perform product research and development with reference to its inventories, and focus on the development of products with a high added value, so as to bring about further improvements in the inventories in terms of both structure and aggregate volume. Meanwhile, the Group would continue to step up its efforts in market research and survey, enhance the promotion of its products, and maintain the stability of its production and sales. Besides, the Group would continue to foster the construction of a risk control system, and enhance its supervision over safe production in order to ensure compliance with the environmental protection requirements, while making every effort to mitigate all risks and striving to reduce losses.

Sun Jun
Chairman

Hong Kong, 28 March 2019

MANAGEMENT DISCUSSION AND ANALYSIS

Results

The Group's consolidated loss attributable to shareholders for the year ended 31 December 2018 was HK$81,241,000, representing a decrease of loss of HK$18,382,000, or 18.5% as compared to the consolidated loss attributable to shareholders of HK$99,623,000 for last year.

The net asset value of the Group as at 31 December 2018 was HK$59,093,000, representing a decrease of HK$92,179,000 and HK$43,226,000 as compared to the net asset value as at 31 December 2017 and 30 June 2018, respectively.

The Board does not recommend the payment of a final dividend for the year ended 31 December 2018.

Business Review

In 2018, amid the constant changes in the external market environment, an increasing variety of footwear materials as well as the diversification of consumers' demands, de-capacity gained further momentum in the footwear leather industry. The aforesaid, coupled with more stringent governance levels in relation to environmental protection, led to the closure or production suspension of small- and medium-sized footwear manufacturers, resulting in a continuous shrinkage of the demand in the footwear leather market, thus exerting hefty pressure on the production and operation of the leather processing industry. During the year, the Group adhered to its prudent operating strategy with "stable operations to ensure asset safety" as its principal operating concept. Nonetheless, the Group recorded a loss given the fall of both sales volume and selling prices, which further compressed the profitability of the Group. During the year, in order to mitigate the adverse effects arising from the weak economic environment, on one hand, the Group tapped into markets, refined its customer positioning, and proactively developed its external subcontracting business so as to endeavor to reduce its fixed costs; on the other hand, it enhanced its inventory development, adjusted its product structure and stepped up its destocking efforts, in a bid to transform slow-moving inventory into cash flows and ensure funding for the Group's normal operations. To a certain extent, the above measures have mitigated the operating risks arising from the downturn in the industry.

On environmental protection, the national government has been continuously raising its minimum statutory requirements for environmental protection on operations, such that environmental investigations and enquiries are constantly commenced across the country. This has resulted in a large number of small- and medium-sized footwear manufacturers going out of business or suspending their production, which has in turn led to a decline in demand across the entire downstream real leather market. During the year, faced with the adverse and complex external environment, the Group continued to promote the use of clean production technology in order to ensure compliance with sewage discharge standards. Meanwhile, the Group also took active steps in following up with sludge clean-up and transportation and enhanced its all-embracing internal controls in relation to environmental protection, thereby addressing environmental investigations and enquiries properly and ensuring that no environmental protection incident would arise for which the Group might be held liable, which would serve to maintain its operational stability.

During the year, the total production volume of cowhides was 13,051,000 sq. ft., representing a decrease of 3,329,000 sq. ft. or 20.3% as compared to 16,380,000 sq. ft. for last year. The production volume of grey hides was 3,812 tons, representing a decrease of 3,896 tons or 50.5% as compared to 7,708 tons for last year. During the year, the total sales volume of cowhides was 14,155,000 sq. ft., representing a decrease of 2,529,000 sq. ft. or 15.2% as compared to 16,684,000 sq. ft. for last year. The sales volume of grey hides was 4,010 tons, representing a decrease of 3,712 tons or 48.1% as compared to 7,722 tons for last year.

The consolidated turnover of the Group for 2018 was HK$238,317,000, representing a decrease of HK$83,829,000 or 26.0% from HK$322,146,000 for last year, of which the sales value of cowhides amounted to HK$223,663,000 (2017: HK$296,705,000), representing a decrease of 24.6%, and that of grey hides and other products amounted to HK$14,654,000 (2017: HK$25,441,000), representing a decrease of 42.4%. During the year, the growing trend of using new materials as alternatives, the overall diminishing demand prevailing in the footwear leather market, an inadequate purchasing power of footwear manufacturers and fierce market competition, as well as the Group's enhanced efforts toward the marketing of low-priced products for destocking purposes during the year, all led to tumbled sales volume and unit prices of footwear leather products, accompanied by a decline in sales revenue.

In terms of sales, in light of the use of diversified footwear materials in the market, a reduced demand for real leather, and leather overcapacity in recent years, some of the domestic branded footwear manufacturers have met with operational difficulties, and small- and medium-sized industry enterprises have been seen to suspend their production or go out of business, all resulting in a year-on-year decrease in demand in the tannery market. Faced with the abovementioned hardship, during the year, the Group stepped up its efforts in marketing and on-site market research with particular reference to the market changes and prevailing product trends. It increased its devotion to product research and development with a focus on the development of product varieties that would foster destocking. Besides, the Group was proactively engaged in product promotion and order tracking, and enhanced its sales efforts in relation to the low- and middle-end markets, thereby refining its customer positioning. Meanwhile, the Group strengthened its production sites control and management, as well as safeguarding the product quality and enhancing the added value of its products.

In terms of purchasing, during the year, the Group closely monitored the domestic and international price movements of cowhides, and continuously stepped up its exploration of and research on the latest market circumstances. With stringent control over procurement and a focus on inventory reduction as its overall strategy, the Group adopted a targeted raw materials replenishment approach that involved procurement in small quantities but with multiple batches, such that the funding pressure could be eased. Moreover, in view of the Group's concern surrounding the surges in the prices of chemicals, it implemented procurement of chemicals in a group- or batch-wise manner and was engaged in bargaining and price negotiations with suppliers of chemicals. It reinforced its dynamic management of warehouses and took active steps in identifying alternative products, thereby controlling the costs of chemicals as well as mitigating the risks of chemicals being degenerated and its inventories becoming stagnant. During the year, with destocking and the realization of cash flows as the foremost priorities, the total purchases amounted to HK$166,398,000, representing a decrease of 43.0% as compared to the same period last year.

As of 31 December 2018, the Group's consolidated inventory amounted to HK$134,131,000 (31 December 2017: HK$218,900,000), representing a decrease of HK$84,769,000 or 38.7% over that of 31 December 2017. The Group steadfastly implemented its operating strategy on destocking, strengthened the synergy among production, supply and sales, developed its sales channels, and furthered the research and development in relation to its technical skills. Factoring in the market demands, the Group performed reasonable group processing and adjustments regarding its inventories in a bid to transform slow-moving inventories into cash flows and ensure funding for the Group's normal operations. The Group reassessed the value of inventories based on its aging and net realizable value, and a net provision for inventories of HK$987,000 was made for the year 2018 (2017: HK$24,004,000).

As at 31 December 2018, the Group's property, plant and equipment amounted to HK$47,057,000 (31 December 2017: HK$65,887,000), representing a decrease of HK$18,830,000 or 28.6% over that of 31 December 2017. Due to the posting of a loss in the operating results of the Group during the year, the recoverable amount of the plant and equipment was calculated by using a value in use calculation based on the discounted cash flow method, and an impairment loss of HK$12,365,000 in respect of the plant and equipment was made for the year 2018 (2017: HK$21,794,000).

Financial Review

As at 31 December 2018, the Group's cash and cash equivalents amounted to HK$27,513,000 (31 December 2017: HK$29,108,000), representing a decrease of HK$1,595,000 or 5.5% as compared to the same as at 31 December 2017, which was denominated in Hong Kong dollars (5.7%), Renminbi (92.5%) and United States dollars (1.8%). During the year, net cash inflow from operating activities was HK$40,801,000, which was mainly attributable to a reduction in inventory, resulting in an increase in net cash inflow. Net cash outflow from investing activities was HK$375,000, which was mainly attributable to a decrease in pledged bank deposits. Net cash outflow from financing activities amounted to HK$40,764,000, which mainly consisted of the repayment of short-term loan from a fellow subsidiary.

As at 31 December 2018, the Group's interest-bearing borrowings amounted to HK$142,379,000 in total (31 December 2017: HK$128,956,000), of which interest-bearing borrowings in Hong Kong dollars amounted to HK$65,000,000, and interest-bearing borrowings in United States dollars amounted to HK$77,379,000. The Group's borrowings consisted of long-term unsecured borrowings from the immediate holding company with a balance of HK$142,379,000, on which interests were charged at floating rates.

As at 31 December 2018, the Group's gearing ratio of the interest-bearing borrowings to shareholders' equity plus interest-bearing borrowings was 70.7% (31 December 2017: 46.0%). During the year, the annual interest rates of the borrowings ranged from approximately 2.3% to 5.7%. The Group's interest expenses during the year amounted to HK$5,973,000, representing a decrease of 12.3% from the same period last year, which was mainly attributable to a decrease in the loan amounts granted by banks during the year.

As at 31 December 2018, the total banking facilities of the Group were nil. As at 31 December 2017, the total banking facilities of the Group was HK$119,630,000, of which banking facilities of HK$119,630,000 were unutilized. Taking into account the existing cash resources, the Group has adequate financial resources to meet its day-to-day operational requirements.

Capital Expenditure

As at 31 December 2018, the net value of non-current assets including prepaid land lease payments and property, plant and equipment amounted to HK$58,516,000, representing a decrease of HK$19,684,000 over the net value as at 31 December 2017 of HK$78,200,000. The capital expenditure for the year amounted to HK$1,430,000 (2017: HK$4,661,000), which mainly represented the payments for acquisition of machinery and equipment to meet the production requirements of the Group.

Pledge of Assets

As at 31 December 2018, certain of the Group's bank balances with a total of nil (31 December 2017: HK$1,066,000) were pledged to banks to secure general banking facilities granted to the Group.

Foreign Exchange Exposure

The assets, liabilities and transactions of the Group are basically denominated in Hong Kong dollars, United States dollars, European dollars or Renminbi. The Group is exposed to foreign currency risk primarily from import purchases from overseas suppliers that are denominated in a currency other than the functional currency of the operations to which they relate. The currency giving rise to this risk is mainly the United States dollars against Renminbi. The Group did not hedge its exposure to risks arising from fluctuations in exchange rates during the year. Should the Group consider that its exposure to foreign currency risk justifies hedging, the Group may use forward or hedging contracts to reduce the risks.

Remuneration Policy for Employees

As at 31 December 2018, a total of 393 employees (31 December 2017: 461) were employed by the Group. The Group's remuneration policy is based on the Group's operating results and the employees' performance. The Group has adopted a performance-based appraisal scheme for its employees focusing on "accountability and performance". The incentive bonuses to the management, key officers and staff with outstanding performance under the incentive scheme are determined by reference to the Group's operating net cash flow and profit after tax, calculated by various profit rankings and by applying a measure that links bonuses with the operating results of the Group and further taking into account the individual performance of the staff concerned with an aim to motivate the contribution of its employees. In addition, the Group offered social and medical insurances and pension schemes to all employees in different areas.

CORPORATE GOVERNANCE CODE

The Group recognizes the importance of achieving the highest standard of corporate governance consistent with the needs and requirements of its businesses and the best interest of all of its stakeholders and is fully committed to doing so. It is also with these objectives in mind that the Group has applied the principles of the Corporate Governance Code (the "CG Code") contained in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

In the opinion of the directors of the Company, the Company had complied with the code provisions and, where appropriate, the applicable recommended best practices in the CG Code throughout the year ended 31 December 2018 except for the following:

The code provision A.2.1 of the CG Code provides that the roles of chairman and chief executive should be separate and should not be performed by the same individual (the Company regards that the term “chief executive” has the same meaning as the Managing Director of the Company).

Mr. Sun Jun serves as both the Chairman and the Managing Director of the Company with effect from 26 February 2016. The Board believes that vesting the roles of both Chairman and Managing Director in the same person provides the Group with strong and consistent leadership and allows for effective and efficient planning and implementation of business strategies and decisions. It also considers that the current structure of vesting the roles of Chairman and Managing Director in the same person will not impair the balance of power and authority between the Board and the management of the Company. The Board will review the current structure from time to time to ensure appropriate and timely action to meet changing circumstances.

REVIEW OF ANNUAL RESULTS

The annual results of the Group for the year ended 31 December 2018 have been reviewed by the Audit Committee of the Company.

PURCHASE, SALE AND REDEMPTION OF LISTED SECURITIES OF THE COMPANY

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's securities listed on The Stock Exchange of Hong Kong Limited during the year.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed and no transfer of shares will be effected during the period from Thursday, 6 June 2019 to Wednesday, 12 June 2019, both days inclusive, for determining the shareholders' eligibility to attend and vote at the annual general meeting of the Company to be held on Wednesday, 12 June 2019.

In order to qualify for attending and vote at the forthcoming annual general meeting of the Company to be held on Wednesday, 12 June 2019, all transfer documents accompanied by the relevant share certificates must be lodged with the Company's share registrar, Tricor Tengis Limited at Level 22, Hopewell Centre, 183 Queen's Road East, Hong Kong, for registration not later than 4:30 p.m. on Wednesday, 5 June 2019.

By order of the Board
Sun Jun
Chairman and Managing Director

Hong Kong, 28 March 2019

As at the date of this announcement, the Board comprises one Executive Director, namely Mr. Sun Jun; three Non-Executive Directors, namely Mr. Xiao Zhaoyi, Mr. Kuang Hu and Mr. Ding Yatao; and three Independent Non-Executive Directors, namely Mr. Fung Lak, Mr. Choi Kam Fai, Thomas and Mr. Chan Cheong Tat.