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粤海制革

GUANGDONG TANNERY LIMITED

粵海制革有限公司

(Incorporated in Hong Kong with limited liability)

(Stock Code: 01058)

2019 ANNUAL RESULTS ANNOUNCEMENT

HIGHLIGHTS

	For the year ended 31 December		
	2019	2018	Change
Sales volume of cowhides (in thousand square feet)	**11,439**	14,155	-19.2%
Revenue (in thousand HK$)	**178,020**	238,317	-25.3%
Loss for the year (in thousand HK$)	**(38,994)**	(81,241)	+52.0%
Basic loss per share (in HK cent)	**(7.25)**	(15.10)	+52.0%
Key Indicators (As at 31 December)	**2019**	2018	Change
Current Ratio	**3.01 times**	2.85 times	+5.6%
Quick Ratio	**1.72 times**	1.16 times	+48.3%
Debt to asset ratio	**93.4%**	79.2%	+17.9%
Total assets (in thousand HK$)	**238,733**	284,736	-16.2%
Net asset value per share (HK$)	**0.03**	0.11	-72.7%

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 2019 together with comparative figures.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

	Notes	**2019**	2018
		HK$'000	*HK$'000*
REVENUE	*4*	**178,020**	238,317
Cost of sales		**(183,815)**	(273,592)
Gross loss		**(5,795)**	(35,275)
Other income and gains	*4*	**4,530**	3,356
Selling and distribution expenses		**(1,586)**	(2,081)
Administrative expenses		**(24,628)**	(28,155)
Impairment on items of plant and equipment		**(860)**	(12,365)
Other operating expenses, net		**(4,895)**	(542)
Finance costs	*5*	**(5,694)**	(5,973)
LOSS BEFORE TAX	*5*	**(38,928)**	(81,035)
Income tax expense	*6*	**(66)**	(206)
LOSS FOR THE YEAR		**(38,994)**	(81,241)
LOSS PER SHARE	*7*		
- Basic		**HK(7.25) cents**	HK(15.10) cents
- Diluted		**HK(7.25) cents**	HK(15.10) cents

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	2019	2018
	HK$'000	*HK$'000*
LOSS FOR THE YEAR	**(38,994)**	(81,241)
OTHER COMPREHENSIVE LOSS		
Other comprehensive loss that will not be reclassified to profit or loss in subsequent periods:		
Deficits on revaluation of buildings	**(2,258)**	(219)
Income tax effect	**563**	55
	(1,695)	(164)
Other comprehensive loss that may be reclassified to profit or loss in subsequent periods:		
Exchange differences on translation of foreign operations	**(3,664)**	(10,774)
OTHER COMPREHENSIVE LOSS FOR THE YEAR, NET OF TAX	**(5,359)**	(10,938)
TOTAL COMPREHENSIVE LOSS FOR THE YEAR	**(44,353)**	(92,179)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	**2019**	2018
		HK$'000	*HK$'000*
NON-CURRENT ASSETS			
Property, plant and equipment		**42,484**	47,057
Prepaid land lease payments		**-**	11,459
Right-of-use assets		**11,208**	-
Total non-current assets		**53,692**	58,516
CURRENT ASSETS			
Inventories		**78,930**	134,131
Receivables, prepayments and deposits	*9*	**56,384**	64,576
Pledged bank balances		**895**	-
Cash and bank balances		**48,832**	27,513
Total current assets		**185,041**	226,220
CURRENT LIABILITIES			
Trade payables	*10*	**33,621**	38,009
Other payables and accruals	*11*	**20,010**	36,531
Tax payable		**63**	113
Interest-bearing bank borrowings		**3,152**	-
Due to a PRC joint venture partner		**1,131**	1,131
Provision		**3,560**	3,640
Total current liabilities		**61,537**	79,424
NET CURRENT ASSETS		**123,504**	146,796
TOTAL ASSETS LESS CURRENT LIABILITIES		**177,196**	205,312
NON-CURRENT LIABILITIES			
Loans from the immediate holding company		**142,379**	142,379
Other payables	*11*	**15,797**	-
Deferred tax liabilities		**3,277**	3,840
Total non-current liabilities		**161,453**	146,219
Net assets		**15,743**	59,093
EQUITY			
Share capital		**75,032**	75,032
Other reserves		**(59,289)**	(15,939)
Total equity		**15,743**	59,093

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 2019 and 31 December 2018 included in this preliminary announcement of annual results for the year ended 31 December 2019 does not constitute the Company's statutory annual consolidated financial statements for those years, but in respect of the year ended 31 December 2018, 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 2018 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 2019 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 2019. 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.

(1) BASIS OF PREPARATION (continued)

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 9	*Prepayment Features with Negative Compensation*
HKFRS 16	*Leases*
Amendments to HKAS 19	*Plan Amendment, Curtailment or Settlement*
Amendments to HKAS 28	*Long-term Interests in Associates and Joint Ventures*
HK(IFRIC)-Int 23	*Uncertainty over Income Tax Treatments*
Annual Improvements to HKFRSs 2015-2017 Cycle	Amendments to HKFRS 3, HKFRS 11, HKAS 12 and HKAS 23

Other than as explained below regarding the impact of HKFRS 16, the adoption of the above new and revised standards has had no significant financial effects on these financial statements.

(a) HKFRS 16 replaces HKAS 17 *Leases*, HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*, HK(SIC)-Int 15 *Operating Lease*s - *Incentives* and HK(SIC)-Int 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model to recognise and measure right-of-use assets and lease liabilities, except for certain recognition exemptions.

The Group has adopted HKFRS 16 using the modified retrospective method with the date of initial application of 1 January 2019. Under this method, the standard has been applied retrospectively with the cumulative effect of initial adoption recognised as an adjustment to the opening balance of accumulated losses at 1 January 2019, and the comparative information for 2018 was not restated and continued to be reported under HKAS 17 and related interpretations.

<u>New definition of a lease</u>
Under HKFRS 16, a contract is, or contains, a lease if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration. Control is conveyed where the customer has both the right to obtain substantially all of the economic benefits from use of the identified asset and the right to direct the use of the identified asset. The Group elected to use the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases applying HKAS 17 and HK(IFRIC)-Int 4 at the date of initial application. Contracts that were not identified as leases under HKAS 17 and HK(IFRIC)-Int 4 were not reassessed. Therefore, the definition of a lease under HKFRS 16 has been applied only to contracts entered into or changed on or after 1 January 2019.

(2) CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

As a lessee – Leases previously classified as operating leases

Nature of the effect of adoption of HKFRS 16

The Group has lease contracts for various items of property. As a lessee, the Group previously classified leases as either finance leases or operating leases based on the assessment of whether the lease transferred substantially all the rewards and risks of ownership of assets to the Group. Under HKFRS 16, the Group applies a single approach to recognise and measure right-of-use assets and lease liabilities for all leases, except for two elective exemptions for leases of low-value assets (elected on a lease-by-lease basis) and leases with a lease term of 12 months or less ("short-term leases") (elected by class of underlying asset). Instead of recognising rental expenses under operating leases on a straight-line basis over the lease term commencing from 1 January 2019, the Group recognises depreciation and impairment (if any) of the right-of-use assets and interest accrued on the outstanding lease liabilities as finance costs.

Impact on transition

Lease liabilities at 1 January 2019 were recognised based on the present value of the remaining lease payments, discounted using the incremental borrowing rate at 1 January 2019 and included in other payables and accruals. The right-of-use assets were measured at the amount of the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to the lease recognised in the statement of financial position immediately before 1 January 2019.

All these assets were assessed for any impairment based on HKAS 36 on that date. The Group elected to present the right-of-use assets separately in the statement of financial position. This includes the leased assets of HK$11,747,000 that were reclassified from the prepaid land lease payments (both non-current and current portions).

The Group has used the following elective practical expedients when applying HKFRS 16 at 1 January 2019:

- Applying the short-term lease exemptions to leases with a lease term that ends within 12 months from the date of initial application;
- Applying a single discount rate of lease with reasonably similar characteristics; and
- Using hindsight in determining the lease term where the contract contains options to extend/terminate the lease.

Financial impact at 1 January 2019

The impact arising from the adoption of HKFRS 16 at 1 January 2019 was as follows:

	Increase/(decrease)
	HK$'000
Assets	
Increase in right-of-use assets	13,256
Decrease in prepaid land lease payments	(11,459)
Decrease in receivables, prepayments and deposits	(288)
Increase in total assets	1,509
Liabilities	
Increase in other payables and accruals	1,509

(2) CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

The lease liabilities as at 1 January 2019 reconciled to the operating lease commitments as at 31 December 2018 are as follows:

	HK$'000
Operating lease commitments as at 31 December 2018	1,736
Less: Commitments relating to short-term leases and those leases with a remaining lease term ended on or before 31 December 2019	(71)
	1,665
Weighted average incremental borrowing rate as at 1 January 2019	4.88%
Lease liabilities as at 1 January 2019	1,509

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*[1]
Amendments to HKFRS 9, HKAS 39 and HKFRS 7	*Interest Rate Benchmark Reform* [1]
Amendments to HKFRS 10 and HKAS 28 (2011)	*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*[3]
HKFRS 17	*Insurance Contracts* [2]
Amendments to HKAS 1 and HKAS 8	*Definition of Material* [1]

[1] Effective for annual periods beginning on or after 1 January 2020
[2] Effective for annual periods beginning on or after 1 January 2021
[3] 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 major customers

During the year ended 31 December 2019, revenue of approximately HK$34,203,000 (2018: Nil) and HK$22,856,000 (2018: HK$21,068,000) were derived from sales to two customers (2018: a single customer) which constituted 19% (2018: Nil) and 13% (2018: 9%) of the total revenue, respectively.

(4) REVENUE, OTHER INCOME AND GAINS

An analysis of revenue is as follows:

	2019	2018
	HK$'000	*HK$'000*
Revenue from contracts with customers		
Sale of processed leather	**178,020**	238,317

Revenue from contracts with customers

(i) Disaggregated revenue information

Revenue is recognised when goods are transferred at a point in time to customers. The amount of revenue recognised in the current reporting period that was included in the contract liabilities at the beginning of the reporting period was HK$3,701,000 (2018: HK$896,000).

(ii) Performance obligations

Information about the Group's performance obligations is summarised below:

Sale of goods

The performance obligation is satisfied upon delivery of the goods at a point in time and payment is generally due within 90 to 180 days from date of delivery, except for new customers, where payment in advance is normally required.

	2019	2018
	HK$'000	*HK$'000*
Other income and gains		
Finance income	**72**	47
Sale of scrap materials	**762**	1,914
Government grants*	**1,019**	865
Income from subcontracted leather processing	**2,399**	-
Others	**278**	530
	4,530	3,356

* During the year ended 31 December 2019, the Group received HK$1,019,000 (2018: HK$865,000) 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):

	2019	2018
	HK$'000	*HK$'000*
Cost of inventories sold	**175,928**	272,605
Auditors' remuneration	**1,500**	1,450
Depreciation of property, plant and equipment	**1,985**	5,849
Depreciation of right-of-use assets	**949**	-
Amortisation of prepaid land lease payments	**-**	299
Interests on:		
Bank loans and discounting bills receivable to banks	**174**	994
Lease liabilities	**74**	-
Loans from the immediate holding company	**5,078**	4,337
Loan from a fellow subsidiary	**-**	642
Due to the immediate holding company	**368**	-
	5,694	5,973
Employee benefit expense (excluding directors' remuneration):		
Wages and salaries	**21,633**	24,606
Pension scheme contribution (defined contribution schemes)*	**2,834**	3,503
	24,467	28,109
Foreign exchange differences, net	**-**	536
Provision for inventories**	**7,887**	987
Minimum lease payments under operating leases in respect of land and buildings	**-**	960
Lease payments not included in the measurement of lease liabilities	**71**	-
Impairment of financial assets, net		
Impairment of trade receivables#	**2,207**	514
Impairment/(reversal of impairment) of financial assets included in prepayments, other receivables and deposits, net#	**(37)**	28
	2,170	542
Impairment of right-of-use assets#	**1,855**	-

* At 31 December 2019 and 2018, 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 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 (2018: 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.

	2019	2018
	HK$'000	*HK$'000*
Current - Mainland China		
Charge for the year	**148**	206
Overprovision in prior years	**(82)**	-
Total tax charge for the year	**66**	206

(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 (2018: 538,019,000) in issue during the year.

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

	2019	2018
	HK$'000	*HK$'000*
Loss		
Loss for the year, used in the basic loss per share calculation	**38,994**	81,241

	Number of shares	
	2019	2018
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

No adjustment has been made to the calculation of the basic loss per share amounts presented for the years ended 31 December 2019 and 2018 as there was no dilutive event during the years ended 31 December 2019 and 2018.

(8) DIVIDEND

The Board does not recommend the payment of a final dividend for the year ended 31 December 2019 (2018: Nil).

(9) RECEIVABLES, PREPAYMENTS AND DEPOSITS

	Notes	**2019**	2018
		HK$'000	HK$'000
Trade receivables	*(i)*	**26,947**	32,037
Bills receivable	*(i)*	**24,963**	26,031
Prepayments, deposits and other receivables	*(ii)*	**4,474**	6,508
		56,384	64,576

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 receivables 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:

	2019	2018
	HK$'000	*HK$'000*
Current	**50,902**	53,964
Less than 3 months past due	**1,109**	2,932
3 to 6 months past due	**1,726**	1,543
More than 6 months past due	**2,389**	1,724
	56,126	60,163
Impairment	**(4,216)**	(2,095)
	51,910	58,068

(ii) As at 31 December 2019, a provision of HK$350,000 (2018: HK$394,000) was made for other receivables with a gross carrying amount of HK$350,000 (2018: HK$394,000).

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

	2019	2018
	HK$'000	*HK$'000*
At 1 January	**394**	385
Impairment losses/(reversal of impairment), net	**(37)**	28
Exchange realignment	**(7)**	(19)
At 31 December	**350**	394

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:

	2019	2018
	HK$'000	*HK$'000*
Within 3 months	**25,781**	28,127
3 to 6 months	**5,021**	5,670
Over 6 months	**2,819**	4,212
	33,621	38,009

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

		2019	2018
		HK$'000	*HK$'000*
Current			
Other payables and accruals	(*Note)*	**18,595**	32,411
Contract liabilities		**530**	4,120
Lease liabilities		**885**	-
		20,010	36,531
Non-current			
Other payables	(*Note)*	**14,980**	-
Lease liabilities		**817**	-
		15,797	-
Total		**35,807**	36,531

Note:

Included in the other payables is accrued interest of HK$14,980,000 due to the immediate holding company as at 31 December 2019 which is interest-free, unsecured, repayable in 2 years from 28 February 2019 and arose from loans from the immediate holding company. As at 31 December 2018, the accrued interest payable of HK$10,537,000 to the immediate holding company was interest-free, unsecured, and repayable on demand.

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 2019 was HK$38,994,000 (2018: HK$81,241,000), representing a decrease in loss of 52.0%. Basic loss per share was HK7.25 cents (2018: HK15.10 cents).

DIVIDEND

The Board does not recommend the payment of a final dividend for the year ended 31 December 2019 (2018: Nil).

REVIEW

In 2019, the overall industry economic downturn and the continuous enhancement of the national environmental protection governance measures resulted in the closure or suspension of production of small and medium footwear manufacturers, which reduced the demand for footwear leather and further exacerbated the effect of excess capacity in the leather industry. In addition, the changes in consumers' perception and the continuous improvement in the performance of new and substitute materials under technological advancement have led to a gradual decline in the demand for genuine leather. Meanwhile, as a result of the escalating trade frictions between China and the United States and the emergence of alternative production capacities abroad, the entire leather manufacturing industry in China declined significantly. The demand and prices for leather declined significantly and the industry demand was in continuous contraction causing a significant impact on the production and operation of leather processing enterprises in China. In face of a shrinking footwear leather market, while the operating results of the Group for the year improved significantly compared to last year, the Group still recorded a loss. During the year, the Group adhered to the overall strategy of maintaining stable operations and cash flow as well as asset safety while implementing measures to strictly control procurement activities and realize inventories to stable levels in order to reduce operating risks under a weak economic environment. The inventory balance decreased gradually and, through inventory realization, pressure on working capital requirements was alleviated to a certain extent. At the same time, the Group actively carried out product research and development, expanded market reach, and strengthened environmental protection efforts.

Facing shrinking market demand, the Group prepared a comprehensive budget at the beginning of the year to determine various production and operation targets. In terms of sales, during the year, the Group continued to strengthen its market research, understand market changes and product trends, and focus on developing high value-added products for existing inventories. At the same time, the Group also stepped up market visits, adjusted marketing strategies in a timely manner, and carried out sales through a combination of self-operation and external processing. In terms of procurement, during the year, the Group strictly controlled the scale of its procurement, actively analyzed the changes in the fur market and the price trend of raw cowhides, and conducted targeted inventory replenishment in small batches and multiple batches to prevent the risk of accumulating a new high-priced inventory. In addition, with the increasing environmental protection requirements in the industry, the Group strengthened product quality inspection and production site management during the year to ensure compliance with environmental protection targets and standards and minimize the negative impact of changes in the operating environment.

PROSPECTS

It is expected that in 2020, de-capacity will continue to intensify in our industry. The novel coronavirus outbreak in China in the recent months resulted in extended work stoppages following the Chinese New Year holiday and delayed the resumption of operations of many enterprises in China and, as a result, various economic activities have been affected to a significant extent, causing a further decrease in the overall market demand and a more challenging environment for the survival of the leather industry.

The Group will focus on reducing losses and carry out various initiatives under the overall operation strategy of "stabilizing production, stabilizing operation, reducing inventory". The Group will continue to focus on destocking, convert slow-moving inventory into cash flow, strengthen product research and development, increase the added value of its product offerings, explore innovative business opportunities and position the Group to work towards realizing profits if and when the markets stabilize and the demand for the Group's product offerings return. The Company will also optimize and integrate its own production processes, actively explore the market, and improve product quality and production efficiency.

With the occurrence of novel coronavirus outbreaks in different parts of the world, the global economic conditions and outlook have become highly uncertain and volatile, which in turn may materially and adversely affect the lending policies of banks and the demand for non-essential consumer products and hence the business and financial conditions of the Group's customers, which may have a knock-on adverse effect on the sourcing, production and sales activities as well as the de-stocking efforts of the Group, which are beyond the control of the Group. The Group will pay close attention to the development and spread of the novel coronavirus outbreaks, timely adjust its operating strategies, strengthen supervision over production safety, ensure the safety of our employees, continue to strengthen comprehensive risk management, ensure that our production complies with environmental protection requirements, strive to reduce various risks, maintain stable production and strive to reduce losses.

Kuang Hu
Chairman

Hong Kong, 27 March 2020

MANAGEMENT DISCUSSION AND ANALYSIS

Results

The Group's consolidated loss attributable to shareholders for the year ended 31 December 2019 was HK$38,994,000, representing a decrease in loss of HK$42,247,000 or a decrease in loss of 52.0% from HK$81,241,000 for the corresponding period last year.

The net asset value of the Group as at 31 December 2019 was HK$15,743,000, representing a decrease of HK$43,350,000 and HK$20,233,000 as compared to the net asset value as at 31 December 2018 and 30 June 2019, respectively.

The Board does not recommend the payment of a final dividend for the year ended 31 December 2019 (2018: Nil).

Business Review

In 2019, the external market environment has changed rapidly, and changing consumer sentiment has further driven the development of footwear by new technologies such as fabric and fly weaving. In addition, the continuous advancement of science and technology has led to the improvement of the performance of ultra-fine fiber and leathers, the continuous shrinking of the demand for leather footwear, and the continuous intensification of de-capacity in the leather industry. In addition, due to large inventory level in the leather industry, the price of raw leather has dropped significantly in recent years, resulting in a sharp increase in inventory costs and increasing pressure on gross profit, which further squeezed the room for profit. During the year, the Group strictly adhered to its prudent operating strategy and adopted "stable operation to ensure asset safety" as its main operating idea. Although sales volume decreased due to the industry downturn, the decrease in unit cost of cattle leather was greater than the decrease in its unit selling price, which resulted in the decrease of gross loss. As a result, the operating results of the Group improved as compared with the corresponding period of last year. On the one hand, the Group strictly controls its procurement, conducts research and development on the existing inventory structure and leather sources, and strives to reduce inventory by consolidating orders from market demand; On the other hand, the Group will continue to strengthen marketing and customer visits, and operate through a combination of self-operation and external processing to ensure stable production and sales. The above measures, to a certain extent, mitigate the operational risks brought by the industry downturn.

In terms of environmental protection, in recent years, the State has stepped up its efforts to strengthen environmental protection management in the industry, and as a result, the environmental protection requirements have become more numerous and stricter. With the continuous improvement of wastewater discharge standards, stringent air emission standards, increasingly difficult industrial waste treatment, and the improvement of a series of requirements such as soil prevention and treatment and low-carbon clean production, the footwear leather industry is facing more severe challenges. During the year, the Group continued to strengthen the management and control of environmental protection, promote the application of clean production technology, strengthen the classification and disposal of solid waste, reduce the total amount of sludge, and ensure the stable operation of the sewage treatment system by adjusting and optimizing the treatment process, so as to ensure that the sewage meets the discharge standards and maintain stable operation.

During the year, the total production volume of cowhides was 9,851,000 sq. ft., representing a decrease of 3,200,000 sq. ft. or 24.5% as compared to 13,051,000 sq. ft. of last year. The production volume of grey hides was 1,891 tons, representing a decrease of 1,921 tons or 50.4% as compared to 3,812 tons of last year. During the year, the total sales volume of cowhides was 11,439,000 sq. ft., representing a decrease of 2,716,000 sq. ft. or 19.2% as compared to 14,155,000 sq. ft. for last year. The sales volume of grey hides was 2,290 tons, representing a decrease of 1,720 tons or 42.9% as compared to 4,010 tons of last year.

In 2019, the Group's consolidated turnover was HK$178,020,000, representing a decrease of HK$60,297,000 or 25.3% from HK$238,317,000 of last year, of which, the sales value of cowhides was HK$168,729,000 (2018: HK$223,663,000), representing a decrease of 24.6%; grey hides and other products were HK$9,291,000 (2018: HK$14,654,000), representing a decrease of 36.6%. During the year, the sales revenue of footwear leather products decreased as the sales volume and unit selling price of footwear leather products decreased as a result of the increased threat of substitutes and the decrease in the purchase price of raw cowhides, which led to the decrease in the price of end products.

In terms of sales, in recent years, the industry has experienced economic downturn, the demand for genuine leather has shrunk, and the pressure on the capital of footwear manufacturers has increased, resulting in slow destocking. In addition, strengthened environmental governance has resulted in the closure or suspension of small and medium-sized footwear manufacturers, which led to the continuous shrinking market demand for footwear leather. In the face of the above difficulties, during the year, the Group actively adjusted and improved its product structure, promoted micro-research and development, increased the added value of products and improved the profitability of products. At the same time, the Group re-organized customers in different regions based on the new product structure, selected more quality customers to carry out marketing and visits, paid attention to major areas of customer concentration, consolidated inventory product types, and matched the production of raw cowhides with market demand to ensure the alignment of production and sales.

In terms of procurement, during the year, the Group paid close attention to the price trend of domestic and overseas raw leather market, continuously strengthened the research on market intelligence, and made targeted supplementary raw materials in small batches and in multiple batches to reduce funding pressure. In addition, the Group organized the procurement of raw materials according to the strategy of "production based on sales and procurement based on production", and actively developed new sources of raw cowhides to ensure stable production. During the year, the Group continued to put destocking and realize cash flow as its top priority, with total procurements amounting to HK$115,003,000, representing a decrease of 30.9% as compared to the same period last year.

As at 31 December 2019, the Group's consolidated inventories amounted to HK$78,930,000 (31 December 2018: HK$134,131,000), representing a decrease of HK$55,201,000 or 41.2% as compared to that as at 31 December 2018. During the year, the Group seized the opportunity of market demand, firmly implemented the business strategy of destocking, and sought for suitable customers to promote the sales of finished products through strengthening the integration and rectification of products, so as to effectively alleviate the problem of inventory accumulation. In addition, the Group carried out diversified and innovative businesses, carried out effective order production for slow-moving inventory, optimized inventory structure, and strived to convert slow-moving inventory into cash flow, so as to ensure the working capital needs for the Group's normal operation. The Group made a reassessment based on the inventory ages and its net realizable value and made a net provision for inventories of HK$7,887,000 (2018: HK$987,000) for the year 2019.

As at 31 December 2019, the Group's property, plant and equipment amounted to HK$42,484,000 (31 December 2018: HK$47,057,000), representing a decrease of HK$4,573,000 or 9.7% as compared to that as at 31 December 2018. In view of the loss-making 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 on plant and equipment of HK$860,000 (2018: HK$12,365,000) was made for 2019.

Financial Review

Liquidity and Financial Resources

As at 31 December 2019, the Group's cash and bank balances amounted to HK$48,832,000 (31 December 2018: HK$27,513,000), representing an increase of HK$21,319,000 or 77.5% as compared to that as at 31 December 2018, of which 3.8% were in Hong Kong dollars, 95.4% in Renminbi and 0.8% in US dollars. Net cash inflow from operating activities for the year was HK$25,100,000, which was mainly attributable to the increase in net cash inflow from the decrease in inventories. Net cash outflow from investing activities amounted to HK$2,087,000, which was mainly due to payment for purchase of machinery and equipment and increase in pledged bank balances. Net cash outflow from financing activities was HK$875,000, which was mainly for the principal portion of lease payments.

As at 31 December 2019, the Group's interest-bearing borrowings totalled HK$145,531,000 (31 December 2018: HK$142,379,000), of which Hong Kong dollar interest-bearing borrowings were HK$65,000,000 and United States dollar interest-bearing borrowings were HK$80,531,000. The Group's borrowings mainly arose from: (1) short-term loans provided by banks with the balance of HK$3,152,000, which were secured by bank balances, buildings and prepaid land lease payments of HK$48,904,000 in total, and (2) long-term unsecured borrowings from the immediate holding company with the balance of HK$142,379,000. The above interest-bearing borrowings were charged at floating interest rates.

As at 31 December 2019, the Group's gearing ratio of interest-bearing borrowings to shareholders' equity plus interest-bearing borrowings was 90.2% (31 December 2018: 70.7%). The annual interest rate of the borrowings during the year was approximately 3.0% to 4.3%. During the year, the Group's interest expenses amounted to HK$5,694,000 (2018: HK$5,973,000), representing a decrease of 4.7% as compared with the same period of last year, which was mainly due to the repayment of short-term loan interest from a fellow subsidiary in the same period of last year.

As at 31 December 2019, the Group had total banking facilities of HK$85,170,000 (31 December 2018: Nil) with utilised banking facilities of HK$3,152,000 (31 December 2018: Nil) and unutilised banking facilities of HK$82,018,000 (31 December 2018: Nil). Taking into account the existing cash resources and available credit facilities, the Group has adequate financial resources to meet its day-to-day operational requirements.

Capital Expenditure

As at 31 December 2019, the carrying amount of non-current assets including property, plant and equipment and right-of-use assets amounted to HK$53,692,000, representing a decrease of HK$4,824,000 as over the carrying amount of HK$58,516,000 as at 31 December 2018. The capital expenditure for the year amounted to HK$1,175,000 (2018: HK$1,430,000) in total, which was mainly for the payment of acquisition of machinery and equipment to meet the production needs of the Group.

Pledge of Assets

As at 31 December 2019, the Group's bank deposits of HK$895,000 (31 December 2018: Nil), buildings of HK$36,801,000 (31 December 2018: Nil) and prepaid land lease payments of HK$11,208,000 (31 December 2018: Nil) were pledged to banks to secure general banking facilities.

Foreign Exchange Exposure

The assets, liabilities and transactions of the Group are basically denominated in Hong Kong dollar, United States dollar 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 dollar 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 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 2019, the Group had 378 staff (31 December 2018: 393). 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.

Event After The Reporting Period

The outbreaks of the novel coronavirus in early 2020 casted certain uncertainties on the operating environments of the Group. In early February 2020, Xuzhou City Government announced the suspension of operations in order to prevent the spread of the novel coronavirus. When the epidemic became moderate, the Group resumed its operations in the second half of February 2020. Since the rapid development of the novel coronavirus outbreaks, the Group will closely monitor the situation, continuously assess its impact on the financial conditions and operating results of the Group as well as timely adjust its operating strategies and formulate contingent measures.

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 2019 except for the following:

The code provision A.2.1 of the CG Code provides that the role of the chairman and chief executive should be separate and should not be performed by the same individual. Since 26 February 2016 and up till 2 September 2019, Mr. Sun Jun served as both Chairman and Managing Director of the Company (the Company regards that the term “chief executive” has the same meaning as the Managing Director of the Company). Effective from 3 September 2019, Mr. Kuang Hu acts as Chairman of the Company whereas Mr. Sun continues to act as Managing Director of the Company.

REVIEW OF ANNUAL RESULTS

The annual results of the Group for the year ended 31 December 2019 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 from Tuesday, 16 June 2020 to Friday, 19 June 2020 (both days inclusive), during such period no transfer of shares of the Company will be registered. In order to determine the identity of the members who are entitled to attend and vote at the forthcoming annual general meeting of the Company to be held on Friday, 19 June 2020, all transfer documents accompanied by the relevant share certificates must be lodged with the Company’s share registrar, Tricor Tengis Limited at Level 54, Hopewell Centre, 183 Queen’s Road East, Hong Kong not later than 4:30 p.m. on Monday, 15 June 2020.

By Order of the Board
Kuang Hu
Chairman

Hong Kong, 27 March 2020

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