

REPORT OF THE DIRECTORS

The directors of Chitaly Holdings Limited (the "Company") are pleased to present their report together with the audited financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2003.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. Details of the principal activities of the subsidiaries are set out in note 16 to the financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

RESULTS AND DIVIDENDS

The Group's profit for the year ended 31 December 2003 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 20 to 50.

An interim dividend of HK6.0 cents per ordinary share was paid on 20 August 2003 to the shareholders on the register of members on 15 August 2003. The directors recommend the payment of a final dividend of HK12.0 cents per ordinary share in respect of the year, to shareholders on the register of members on 30 April 2004.

USE OF PROCEEDS FROM THE COMPANY'S INITIAL PUBLIC OFFERING

Upon the listing of the Company's shares on the Stock Exchange of Hong Kong Limited ("HKSE") on 15 May 2002 and issue of shares on the same date, the proceeds, after netting of related expenses paid and payable, were approximately HK\$32 million. As at 31 December 2003, HK\$10 million, HK\$12 million and HK\$5 million were used for the construction of new factories, for purchase of machinery and equipment and for marketing and promotional activities, respectively. The remaining proceeds are deposited in financial institutions and licensed banks in Hong Kong.

SUMMARY FINANCIAL INFORMATION

The following is a summary of the consolidated/combined financial results and of consolidated/combined assets and liabilities of the Group for the last five financial years, prepared on the basis set out in the note below:

	Year ended 31 December				
	2003 HK\$'000	2002 HK\$'000	2001 HK\$'000	2000 HK\$'000	1999 HK\$'000
RESULTS					
Turnover	300,719	207,020	164,758	143,669	102,823
Profit before tax	88,998	51,252	37,615	31,326	27,918
Tax	(11,754)	(6,738)	(5,138)	(4,715)	(3,475)
Net profit from ordinary activities attributable to shareholders	77,244	44,514	32,477	26,611	24,443

SUMMARY FINANCIAL INFORMATION (Continued)

	2003	2002	2001	2000	1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
ASSETS AND LIABILITIES					
Non-current assets	134,167	75,662	45,319	42,642	20,180
Current assets	142,422	118,931	53,536	32,793	33,347
Current liabilities	(105,352)	(61,571)	(53,525)	(40,542)	(30,245)
Non-current liabilities	(6,363)	(6,363)	–	(3,440)	(3,440)
Net assets	164,874	126,659	45,330	31,453	19,842

Note: The summary of the combined results of the Group for the three years ended 31 December 2001 and the combined balance sheets of the Group as at 31 December 1999, 2000 and 2001 have been extracted from the Company's prospectus dated 2 May 2002. The results of the Group for the years ended 31 December 2002 and 2003 and its assets and liabilities as at those dates are those set out on pages 20 and 21 of the financial statements, respectively, and are presented on the basis set out in note 3 to the financial statements.

ESTABLISHMENT OF SUBSIDIARIES

During the year, Chitaly Furniture Limited ("Chitaly HK"), a subsidiary of the Company, established five wholly owned companies, Guangzhou Fufa Furniture Limited ("Fufa") in the PRC, Hong Kong Wong Chiu Furniture Holding Limited ("Wong Chiu"), King Apex International Limited ("King Apex"), Lead Concept Development Limited ("Lead Concept") and Smart Excel International Limited ("Smart Excel") in the British Virgin Islands (the "BVI"). Fufa is engaged in manufacturing and trading of furniture. Wong Chiu is engaged in trading of furniture. King Apex is engaged in provision of design services. Lead Concept is engaged in provision of customer services. Smart Excel is engaged in provision of quality control services.

FIXED ASSETS

Details of movements in the fixed assets of the Group for the year ended 31 December 2003 are set out in note 14 to the financial statements.

SHARE CAPITAL AND SHARE OPTIONS

Details of movements in the Company's share capital and share options during the year, together with the reasons therefor, are set out in note 21 to the financial statements.

RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in note 22 to the financial statements and in the consolidated statement of changes in equity, respectively.

DISTRIBUTABLE RESERVES

As at 31 December 2003, the Company's share premium, contributed surplus and accumulated losses accounts available for cash distribution and/or distribution in specie amounted to HK\$15,770,000. The distributable reserves include the Company's share premium and contributed surplus, in total of HK\$48,162,000 at 31 December 2003,

REPORT OF THE DIRECTORS

which may be distributed provided that immediately following the date on which the dividend is proposed to be distributed, the Company will be in a position to pay off its debts as and when they fall due in the ordinary course of business.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of association or the laws of the Cayman Islands, being the jurisdiction in which the Company was incorporated, which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

During the year, the Company repurchased certain of its shares on the HKSE and these shares were subsequently cancelled by the Company. Further details of these transactions are set out in note 21 to the financial statements.

During the year, the Company repurchased its own shares through the HKSE as follows:

Month of purchase	Number of ordinary shares of HK\$0.10 each	Price per share		Aggregate consideration paid HK\$'000
		Highest HK\$	Lowest HK\$	
October 2003	4,542,000	2.200	2.325	10,651
November 2003	152,000	2.300	2.300	357
December 2003	40,000	2.325	2.325	94
	<u>4,734,000</u>			<u>11,102</u>

The repurchased shares were cancelled during the year and the issued share capital of the Company was reduced by the par value thereof.

Except as disclosed above, neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

CHARITABLE CONTRIBUTIONS

During the year, the Group did not make any charitable contributions (2002: Nil).

MAJOR CUSTOMERS AND SUPPLIERS

Sales to the Group's five largest customers accounted for approximately 20% of the Group's turnover for the year and sales to the Group's largest customer included therein amounted to 5%. Purchases from the Group's five largest suppliers accounted for approximately 53% of the total purchases for the year and purchases from the Group's largest supplier included therein amounted to 19%.

None of the directors of the company or any of their associates or any shareholders (which, to the best knowledge of the directors, owns more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers and/or suppliers.

DIRECTORS

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

Executive directors:

Tse Kam Pang, chairman

Lam Toi

Lam Ning, Joanna

Independent non-executive directors:

Tsao Kwang Yung, Peter

Ma Gary Ming Fai

In accordance with article 87 of the Company's articles of association, one-third of the directors will retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

The directors of the Company, including the independent non-executive directors, but excluding the chairman of the board of directors of the Company, are subject to retirement by rotation and re-election in accordance with the provisions of the Company's articles of association.

DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 8 to 9 of this annual report.

DIRECTORS' SERVICE CONTRACTS

Each of the executive and independent non-executive directors has entered into a service agreement with the Company for an initial term of two years commencing from 1 May 2002, which will continue thereafter until terminated by not less than two months' notice in writing served by either party to the other.

Apart from the foregoing, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS

No director had a significant beneficial interest, either directly or indirectly, in any contracts of significance to the business of the Group to which the Company, or any of its subsidiaries was a party during or at the end of the year.

REPORT OF THE DIRECTORS

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES AND DEBENTURES

The shares of the Company were listed on the Stock Exchange on 15 May 2002. As at 31 December 2003, the interests and short positions of the directors or their associates in the shares of the Company or underlying shares and debentures of the directors, the chief executive or their associates in the share capital of the Company or its associated corporations (within the meaning of Part XV of Securities and Futures Ordinance (the "SFO")), as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, were as follows:

Long positions in ordinary shares of the Company:

Name of director	Notes	Number of shares held, capacity and nature of interest				Percentage of the	
		Directly beneficially owned	Through spouse or minor children	Through controlled corporation	Beneficiary of a trust	Total	Company's issued share capital
Tse Kam Pang	(a)	2,300,000	–	71,450,000	–	73,750,000	31.71%
Lam Toi	(b)	2,300,000	–	71,450,000	–	73,750,000	31.71%
Lam Ning, Joanna		1,900,000	–	–	–	1,900,000	0.82%
		6,500,000	–	142,900,000	–	149,400,000	64.24%

The interests of the directors in the share options of the Company are separately disclosed in note 21 to the financial statements.

Notes:

- (a) The 71,450,000 shares of the Company are held by Crisana International Inc. ("Crisana"), a company incorporated in the British Virgin Islands. As at 31 December 2003, Mr. Tse Kam Pang held 100% of the issued share capital of Crisana.
- (b) The 71,450,000 shares of the Company are held by Silver Wave Holdings Limited ("Silver Wave"), a company incorporated in the British Virgin Islands. As at 31 December 2003, Mr. Lam Toi held 100% of the issued share capital of Silver Wave.

Save as disclosed above, none of the directors had registered an interest or short position in the shares, underlying shares of the Company or any of its associated corporations that was required to be recorded pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Apart from as disclosed under the heading "Share option scheme" below, at no time during the year were rights to acquire benefits by means of the acquisition of shares in the Company granted to any director, or their respective spouse or minor children, or were any such rights exercised by them; or was the Company or any of its subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

SHARE OPTION SCHEME

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the Group's operations. Under the Scheme, the directors may, at their discretion, invite any employees, directors or consultants of any company in the Group to acquire options. The Scheme became effective on 26 April 2002 and, unless otherwise cancelled or amended, will remain in force for 10 years from that date.

The maximum number of shares in respect of which options may be granted under the Scheme and under any other share option scheme of the Company pursuant to which options may from time to time be granted to directors, consultants and/or employees of any company in the Group, shall initially not exceed 10% of the relevant class of securities of the Company in issue excluding, for this purpose, shares issued on exercise of options under the Scheme and any other share option scheme of the Company. Upon the grant of options for shares up to 10% of the relevant class of securities of the Company and subject to the approval of the shareholders of the Company in general meetings, the maximum number of shares to be issued under this scheme when aggregated with securities to be issued under any other share option scheme of the Group, may be increased by the board of directors, provided that the shares to be issued upon exercise of all outstanding options do not exceed 30% of the relevant class of securities in issue from time to time.

No option may be granted to any one person such that the total number of shares issued and to be issued upon the exercise of options granted and to be granted to such person in any 12-month period up to the date of the latest grant exceeds 1% of the issued share capital of the Company from time to time.

An option may be exercised in accordance with the terms of the Scheme at any time during the option period (and not more than 10 years after the date of grant). The option period will be determined by the board of directors and communicated to each grantee. The board of directors may provide restrictions on the time during which the options may be exercised. There are no performance targets which must be achieved before any of the options can be exercised. However, the board of directors retains discretion to accelerate vesting of fixed-term options in the event that certain performance targets are met.

The subscription price for the Company's shares under the Scheme will be a price determined by the board of directors and notified to each grantee. The subscription price will be the highest of: (i) the nominal value of a share; and (ii) the closing price of the shares as stated in the Stock Exchange's daily quotation sheet on the date of grant, which must be a trading day; and (iii) the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five trading days immediately preceding the date of grant. An option shall be deemed to have been granted and accepted by an eligible participant (as defined in the Scheme) and to have taken effect when the acceptance form as described in the share option scheme is completed, signed and returned by the grantee with a remittance in favour of the Company of HK\$1.00 by way of consideration for the grant.

As at 31 December 2003, the number of shares issuable under share options granted under the Scheme was 11,100,000, which represented 5% of the Company's shares in issue as at that date. The maximum number of shares issuable under share options may be granted to each eligible participant in the Scheme within any 12-month period up to the date of latest grant, is limited to 1% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to the shareholders' approval in a general meeting.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEME (Continued)

The following share options granted under the Scheme during the year for a consideration of HK\$1.00 per grant are set out below:

Name or category of participant	Type of share option scheme	Number of share options							Date of grant of share options*	Exercise period	Exercise price per share** HK\$	Price of the Company's shares ***	
		At the beginning of the year	Granted during the year	Exercised during the year	Lapsed during the year	Cancelled during the year	At the end of the year	At date of grant of options HK\$				At date of exercise of options HK\$	
Director													
Tse Kam Pang	The Scheme	2,300,000	-	(2,300,000)	-	-	-	17/9/2002	1/1/2003 to 31/12/2005	0.73	0.72	1.42	
	The Scheme	-	2,300,000	-	-	-	2,300,000	18/9/2003	1/1/2003 to 31/10/2006	2.18	2.18	-	
		2,300,000	2,300,000	(2,300,000)	-	-	2,300,000						
Lam Toi	The Scheme	2,300,000	-	(2,300,000)	-	-	-	17/9/2002	1/1/2003 to 31/12/2005	0.73	0.72	1.42	
	The Scheme	-	2,300,000	-	-	-	2,300,000	18/9/2003	1/1/2003 to 31/10/2006	2.18	2.18	-	
		2,300,000	2,300,000	(2,300,000)	-	-	2,300,000						
Lam Ning, Joanna	The Scheme	2,300,000	-	(2,300,000)	-	-	-	17/9/2002	1/1/2003 to 31/12/2005	0.73	0.72	0.86	
Others													
Members of senior management and other employees of the Group	The Scheme	400,000	-	(400,000)	-	-	-	17/9/2002	1/1/2003 to 31/12/2005	0.73	0.72	0.86	
	The Scheme	-	6,500,000	-	-	-	6,500,000	2/5/2003	1/6/2003 to 31/5/2006	1.17	1.17	-	
		400,000	6,500,000	(400,000)	-	-	6,500,000						
In aggregate	The Scheme	7,300,000	-	(7,300,000)	-	-	-						
	The Scheme	-	11,100,000	-	-	-	11,100,000						
		7,300,000	11,100,000	(7,300,000)	-	-	11,100,000						

* The vesting period of the share options is from the date of the grant until the commencement of the exercise period.

** The exercise price of the share options is subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.

*** The price of the Company's shares disclosed as at the date of the grant of the share options is the Stock Exchange closing price on the trading day immediately prior to the date of the grant of the options. The price of the Company's shares disclosed as at the date of the exercise of the share options is the weighted average of the Stock Exchange closing prices over all of the exercises of options within the disclosure line.

SHARE OPTION SCHEME (Continued)

The financial impact of the share options granted is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the profit and loss account or balance sheet for their cost. Upon the exercise of the share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise date are deleted from the register of outstanding options.

The directors do not consider it appropriate to disclose a theoretical value of the share options granted during the year to the directors and members of senior management and other employees of the Group, because in the absence of a readily available market value of the share options on the ordinary shares of the Company, the directors were unable to arrive at an accurate assessment of the value of these share options.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS IN SHARES

At 31 December 2003, the following interests of 5% or more of the issued share capital and share options of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

Long positions:

Name	Number of shares held	Percentage of the Company's share Capital
Crisana	71,450,000	30.72%
Silver Wave	71,450,000	30.72%

Save as disclosed above, no person or corporation, other than directors and chief executive of the Company, whose interests are set out in the section "Directors and chief executive's interests and short positions in the shares and underlying shares and debentures" above, had registered an interest of short position in the shares or underlying shares of the Company that was required to be recorded pursuant to Section 336 of the SFO.

CODE OF BEST PRACTICE

In the opinion of the directors, the Company complied with the Code of Best Practice (the "Code"), as set out in Appendix 14 of the Listing Rules of the HKSE throughout the accounting period covered by the annual report, except that the independent non-executive directors of the Company are not appointed for a specific term as required by paragraph 7 of the Code, but are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Company's articles of associations.

AUDIT COMMITTEE

The Company established an Audit Committee (the "Committee") on 1 May 2002 with written terms of reference in compliance with the Code, as set out in Appendix 14 of the Listing Rules. The primary duties of the Committee are to review and supervise the financial reporting process and internal control systems of the Group. The Committee comprises two independent non-executive directors. The Group's financial statements for the year ended 31 December 2003 have been reviewed by Committee, who are of the opinion that such statements comply with applicable accounting standards, the Listing Rules and legal requirements and that adequate disclosures have been made therein.

REPORT OF THE DIRECTORS

MATERIAL LEGAL PROCEEDINGS

As at 31 December 2003, the Company was not involved in any material litigation or arbitration and no material litigation or claims was pending or threatened or made against the Company as far as the board of directors was aware of.

AUDITORS

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

ON BEHALF OF THE BOARD

Tse Kam Pang

Chairman and Executive Director

Hong Kong

6 April 2004