



CHITALY HOLDINGS LIMITED

(Incorporated in the Cayman Islands with limited liability)

Interim Report 2005



INTERIM RESULTS

The Board of Directors of Chitaly Holdings Limited (the "Company") is pleased to announce the unaudited interim result of the Company and its subsidiaries (collectively the "Group") for the six months ended 30 June 2005 (the "Interim Period") together with the unaudited comparative figures for the same period in 2004. These interim financial statements as set out in the interim results were reviewed by the Audit Committee of the Company.

CONDENSED CONSOLIDATED INCOME ACCOUNT

For the six months ended 30 June 2005

	Notes	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
TURNOVER	3	232,024	182,132
Cost of sales		(151,959)	(122,244)
Gross profit		80,065	59,888
Other revenue	4	17,734	10,541
Selling and distribution costs		(12,897)	(8,323)
Administrative expenses		(17,816)	(10,782)
Share option reserve		(6,587)	–
Other operating expenses		(34)	(26)
PROFIT FROM OPERATING ACTIVITIES	5	60,465	51,298
Finance cost	6	(186)	–
Share of losses of associate		(217)	–
PROFIT BEFORE TAX		60,062	51,298
Tax	7	(10,729)	(6,763)
NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		49,333	44,535
DIVIDENDS			
Final		34,113	27,908
Proposed Interim	8	25,276	29,240
		59,389	57,148
EARNINGS PER SHARE			
– basic	9	20.2 cents	18.9 cents
– diluted	9	19.4 cents	18.3 cents

CONDENSED CONSOLIDATED BALANCE SHEET

30 JUNE 2005

	Notes	As at 30 June 2005 (Unaudited) HK\$'000	As at 31 December 2004 (Restated) (Unaudited) HK\$'000
NON-CURRENT ASSETS			
Fixed assets		177,602	169,951
Investment in an associate		6,547	–
Investments		522	–
Intangible assets		26,242	7,292
		210,913	177,243
CURRENT ASSETS			
Inventories	10	68,288	81,797
Accounts receivable	11	25,917	16,219
Prepayments, deposits and other receivables		63,691	68,281
Cash and cash equivalents		71,840	85,758
		229,736	252,055
CURRENT LIABILITIES			
Accounts payable	12	44,151	69,782
Tax payables		64,183	57,054
Other payables and accruals		47,075	49,623
Interest-bearing bank loan		757	729
		156,166	177,188

CONDENSED CONSOLIDATED BALANCE SHEET (continued)

30 JUNE 2005

	Notes	As at 30 June 2005 (Unaudited) HK\$'000	As at 31 December 2004 (Restated) (Unaudited) HK\$'000
NET CURRENT ASSETS		73,570	74,867
TOTAL ASSETS LESS CURRENT LIABILITIES		284,483	252,110
NON-CURRENT LIABILITIES			
Interest-bearing bank loans		11,892	12,271
Deferred tax liabilities		6,363	6,363
		18,255	18,634
		266,228	233,476
CAPITAL AND RESERVES			
Issued capital	13	24,607	24,367
Reserves	14	216,345	174,996
Proposed interim dividend		25,276	–
Proposed final dividend		–	34,113
		266,228	233,476

Tse Kam Pang
Director

Ma Gary Ming Fai
Director

CONDENSED CONSOLIDATED SUMMARY STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2005

	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Total equity at 1 January	233,476	164,874
Exchange differences on translation of the financial statements of foreign entities and net gains and losses not recognised in the consolidated profit and loss account	(275)	206
Net profit for the period from ordinary activities attributable to shareholders	49,333	44,535
Exercise of share options	11,220	17,633
Share option reserve	6,587	–
Dividends paid on ordinary shares	(34,113)	(27,908)
Total equity at 30 June	266,228	199,340

CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2005

	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Net cash inflow from operating activities	56,260	23,650
Net cash outflow from investing activities	(46,935)	(22,854)
Net cash outflow from financing activities	(23,243)	(10,275)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(13,918)	(9,479)
Cash and cash equivalents at beginning of period	85,758	77,392
CASH AND CASH EQUIVALENTS AT END OF PERIOD	71,840	67,913
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS		
Cash and bank balances	71,840	67,913

NOTES TO FINANCIAL STATEMENTS

30 June 2005

1. ACCOUNTING POLICIES

The condensed consolidated interim financial statements are prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting” and with the applicable disclosure requirements of Appendix 16 to Rules Governing the Listing of Securities on the Stock Exchange (the “Listing Rules”). The accounting policies and basis of preparation adopted in the preparation of the interim financial statements are the same as those used in the annual financial statements for the year ended 31 December 2004, except in relation to a number of new and revised Hong Kong Financial Reporting Standards (“HKFRSs”, which also include HKASs and Interpretations) that affect the Group and are adopted for the first time for the current period’s financial statements.

The adoption of the new HKFRSs, except those new HKFRSs mentioned below, had no material impact on the accounting policies of the Group and the methods of computation in the Group’s condensed consolidated financial statements. The impact of adopting the following new HKFRSs is summarised as follows:

(a) **HKAS 17 – Leases**

In prior periods, leasehold land and buildings held for own use were stated at cost less accumulated depreciation and any impairment losses. Upon the adoption of HKAS 17, the Group’s leasehold interest in land and buildings is separated into leasehold land and leasehold buildings. The Group’s leasehold land is classified as an operating lease, because the title of the land is not expected to pass to the Group by the end of the lease term, and is reclassified from fixed assets to prepaid land premiums/land lease payments, while leasehold buildings continue to be classified as part of property, plant and equipment. Prepaid land premiums for land lease

1. ACCOUNTING POLICIES (continued)

(a) HKAS 17 – Leases (continued)

payments under operating leases are initially stated at cost and subsequently amortised on the straight-line basis over the lease term. When the lease payments cannot be allocated reliably between the land and building elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment. This change in accounting policy has had no effect on the condensed consolidated income statement and retained earnings. The comparatives on the condensed consolidated balance sheet for the year ended 31 December 2004 have been restated to reflect the reclassification of leasehold land.

(b) HKFRS 2 – Share-based Payment

In prior periods, no recognition and measurement of share-based transactions in which employees (including directors) were granted share options over shares in the Company was required until such options were exercised by employees, at which time the share capital and share premium were credited with the proceeds received. Upon the adoption of HKFRS 2, when employees (including directors) render services as consideration for equity instruments (“equity-settled transactions”), the cost of the equity-settled transactions with employees is measured by reference to the fair value at the date at which the instruments are granted. The fair value is determined by an external valuer using a binomial model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company, if applicable. The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (the “vesting date”). The cumulative expense recognised for equity-settled transactions at each balance sheet date until the vesting date reflects the extent to which the vesting period has expired and the Group’s best estimate of the number of equity instruments

1. ACCOUNTING POLICIES (continued)

(b) HKFRS 2 – Share-based Payment (continued)

that will ultimately vest. The charge or credit to the income statement for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied. The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

(c) HKFRS 3 – Business Combinations and HKAS 36 – Impairment of Assets

In prior periods, goodwill/negative goodwill arising on acquisitions prior to 1 January 2001 was eliminated against consolidated capital reserve in the year of acquisition and was not recognised in the income statement until disposal or impairment of the acquired business. Goodwill arising on acquisitions on or after 1 January 2001 was capitalised and amortised on the straight-line basis over its estimated useful life and was subject to impairment testing when there was any indication of impairment. Negative goodwill was carried in the balance sheet and was recognized in the consolidated income statement on a systematic basis over the remaining average useful life of the acquired depreciable/amortisable assets, except to the extent it related to expectations of future losses and expenses that were identified in the acquisition plan and that could be measured reliably, in which case, it was recognised as income in the consolidated income statement when the future losses and expenses were recognised.

Upon the adoption of HKFRS 3 and HKAS 36, goodwill arising on acquisitions is no longer amortised but subject to an annual impairment review (or more frequently if events or changes in circumstances indicate that the carrying value may be impaired). Any impairment loss recognised for goodwill is not reversed in a subsequent period.

1. ACCOUNTING POLICIES (continued)

(c) HKFRS 3 – Business Combinations and HKAS 36 – Impairment of Assets (continued)

The transitional provisions of HKFRS 3 have required the Group to eliminate at 1 January 2005 the carrying amounts of accumulated amortisation with a corresponding entry to the cost of goodwill and to derecognise the carrying amounts of negative goodwill (including that remaining in consolidated capital reserve) against retained earnings. Goodwill previously eliminated against consolidated capital reserve remains eliminated against consolidated capital reserve and is not recognised in the income statement when all or part of the business to which the goodwill relates is disposed of or when a cash-generating unit to which the goodwill relates becomes impaired.

2. SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES

Following the adoption of the HKFRSs, the opening balances of the following accounts were adjusted retrospectively. The details of the prior period adjustments and opening adjustments are summarized as follows:

(a) Effect on opening balance of total equity at 1 January 2005

Effect of new policies (Increase/(decrease))	Capital reserve (Unaudited) HK\$'000	Retained earnings (Unaudited) HK\$'000	Total (Unaudited) HK\$'000
Prior period adjustments:			
HKFRS 2			
Employee share option scheme	1,862	(1,862)	–
<hr/>			
Net increase/ (decrease) in total equity before opening adjustments	1,862	(1,862)	–
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2. SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES (continued)

(b) No effect on opening balance of total equity at 1 January 2004

There is no effect on opening balance of total equity at 1 January 2004.

The following tables summarise the impact on profit after tax, income or expenses recognized directly in equity and capital transactions with equity holders for the six-month periods ended 30 June 2005 and 2004 upon the adoption of the new HKFRSs.

(c) Effect on profit after tax for the six months ended 30 June 2005 and 2004

	For the six months ended 30 June	
	2005 Equity holders of the parent (Unaudited) HK\$'000	2004 Equity holders of the parent (Unaudited) HK\$'000
Effect of new policies (Increase/(decrease))		
HKFRS 2		
Employee share option scheme	6,587	–
Total effect for the period	6,587	–
Effect on earnings per share:		
Basic	HK2.7 cents	–
Diluted	HK2.6 cents	–

2. SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES (continued)

- (d) Effect on income or expenses recognized directly in equity and capital transactions with equity holders for the six months ended 30 June 2005 and 2004

Effect of new policies (Increase/(decrease))	For the six months ended 30 June	
	2005 Equity holders of the parent (Unaudited) HK\$'000	2004 Equity holders of the parent (Unaudited) HK\$'000
HKFRS 2 Employee share option scheme	6,587	–
Total effect for the period	6,587	–

3. SEGMENT INFORMATION

The Group's operating business are structured and managed separately according to the nature of their operations and the products they provide. Each of the Group's business segments represents a strategic business unit that offers products which are subject to risks and returns that are different from those of the other business segments. The following table presents revenue and results of the Group's primary segments.

	For the six months ended 30 June					
	2005			2004		
	Manufacturing of furniture (Unaudited) HK\$'000	Retailing of furniture (Unaudited) HK\$'000	Total (Unaudited) HK\$'000	Manufacturing of furniture (Unaudited) HK\$'000	Retailing of furniture (Unaudited) HK\$'000	Total (Unaudited) HK\$'000
Revenue:						
External sales	219,758	12,266	232,024	182,132	-	182,132
	219,758	12,266	232,024	182,132	-	182,132
Segment results	59,895	370	60,265	40,758	-	40,758
Unallocated income			193			10,540
Finance costs			(186)			-
Share of losses of associates			(210)			-
Tax			(10,729)			(6,763)
Profit for the period			49,333			44,535

3. SEGMENT INFORMATION (continued)

An analysis of the Group's turnover by location of customers is as follows:

	For the six months ended 30 June	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Sales to the People's Republic of China ("PRC")	228,904	180,603
Sales to elsewhere	3,120	1,529
	232,024	182,132

An analysis of the Group's profit from operating activities by location of customers is as follows:

	For the six months ended 30 June	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Sales to the PRC	59,658	50,864
Sale to elsewhere	807	434
	60,465	51,298

4. OTHER INCOME AND GAINS

	For the six months ended 30 June	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Bank interest income	116	102
Service income	11,891	10,267
Gain on revaluation of property	5,650	–
Others	77	172
Other revenue	17,734	10,541

5. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities was determined after charging the following:–

	For the six months ended 30 June	
	2005 HK\$'000	2004 HK\$'000
Depreciation of owned assets	7,834	6,313
Amortisation of licence rights of trademarks	141	–
Share of losses of associate	217	–

6. FINANCE COSTS

	For the six months ended 30 June	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Interest on mortgage loan	186	–

7. TAX

Hong Kong profits tax has not been provided during the period. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

	For the six months ended 30 June	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Group:		
Current – Macao profits tax	7,942	4,900
Current – PRC corporate income tax	2,787	1,863
Total tax charge for the period	10,729	6,763

7. TAX (continued)

Macao income tax has been calculated at the statutory tax rate of 15.75% on the estimated assessable profits for the year of Hong Kong Wong Chiu Furniture Holding Limited ("Wong Chiu") which is engaged in the trading of furniture.

Pursuant to the Macao SAR's Offshore Laws, Sino Full Macao Commercial Offshore Limited ("Sino Full"), a Macao Offshore Company, is exempted from all the taxes, including income tax, industrial tax and stamp duties.

According to the Income Tax Law of the PRC on Enterprises with Foreign Investment and Foreign Enterprise, Wanlibao (Guangzhou) Furniture Limited, Guangzhou Fufa Furniture Limited and Simply (Dongguan) Furniture Limited, wholly owned subsidiaries of the Company established in Guangzhou and Dongguan, the PRC, are subject to a preferential corporate income tax rate of 24%, and are exempt from PRC corporate income tax for the first two profitable years of its operations, and thereafter, are eligible for a 50% relief from PRC corporate income tax for the following three years.

King Apex International Limited, Lead Concept Development Limited and Smart Excel International Limited are engaged in the provision of quality control, design and customer services respectively. Provision for tax on the estimated assessable profit of each of these subsidiaries arising from their operations in the PRC has been calculated at the rate of PRC corporate income tax during the year, which is currently 33%.

8. INTERIM DIVIDENDS

The directors have determined that an interim dividend of HK9.5 cents per share amounting to HK\$25,276,270 should be paid to the shareholders of the Company whose names appear in the Register of Members on 20 September 2005 and payable on 27 September 2005.

The Register of Members of the Company will be closed from 15 September 2005 to 20 September 2005, both days inclusive, during which period no transfer of shares will be effected.

In order to qualify for the interim dividend, all transfers accompanied by the relevant share certificates must be lodged with Tengis Limited at G/F., Bank of East Asia, Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong, not later than 4:30 pm on 14 September 2005.

9. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the unaudited net profit from ordinary activities attributable to shareholders for the period of HK\$49,333,000 (2004: HK\$44,535,000) and the weighted average of 244,492,667 (2004: 235,632,000) ordinary shares.

The calculation of diluted earnings per share is based on the unaudited net profit from ordinary activities attributable to shareholders for the period of HK\$49,333,000 (2004: HK\$44,535,000). The weighted average number of ordinary shares used in the calculation is the 244,492,667 (2004: 235,632,000) ordinary shares, as used in the basic earnings per share calculation; and the weighted average of 9,892,788 (2004: 8,078,333) ordinary shares assumed to have been issued at no consideration on the deemed exercise of all share options with dilutive effect during the period.

10. INVENTORIES

	As at 30 June 2005 (Unaudited) HK\$'000	As at 31 December 2004 (Unaudited) HK\$'000
Raw materials	8,809	24,515
Work-in-progress	8,066	12,206
Finished goods	51,413	45,076
	68,288	81,797

As at the balance sheet date, no inventories were stated at net realisable value (2004: Nil).

11. ACCOUNTS RECEIVABLE

An aged analysis of accounts receivable as at the balance sheet date, based on invoice date, and net of provisions, is as follows:

	As at 30 June 2005 (Unaudited) HK\$'000	As at 31 December 2004 (Unaudited) HK\$'000
Within 30 days	16,973	10,050
31 days to 90 days	7,945	5,411
91 days to 180 days	945	722
Over 180 days	54	36
	25,917	16,219

12. ACCOUNTS PAYABLE

An aged analysis of accounts payable as at the balance sheet date, based on invoice date, is as follows:

	As at 30 June 2005 (Unaudited) HK\$'000	As at 31 December 2004 (Unaudited) HK\$'000
Within 30 days	24,136	38,519
31 days to 90 days	19,394	30,858
91 days to 180 days	105	286
181 days to 360 days	421	4
Over 360 days	95	115
	44,151	69,782

13. ISSUED CAPITAL**Shares**

	Company	
	As at 30 June 2005 (Unaudited) HK\$'000	As at 31 December 2004 (Unaudited) HK\$'000
Authorised: 2,000,000,000 ordinary shares of HK\$0.10 each	200,000	200,000
Issued and fully paid: 246,066,000 ordinary shares of HK\$0.10 each (2004: 243,666,000 ordinary shares of HK\$0.10 each)	24,067	24,367

During the period, the movements in share capital were as follows:

2,400,000 shares of HK\$0.1 each were issued for cash at a subscription price of HK\$4.675 per share pursuant to the exercise of the Company's share options for a total cash consideration, before expenses, of HK\$11,220,000.

Share options

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 consultant of any company in the Group to take up 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.

13. ISSUED CAPITAL (continued)

Share options (continued)

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 the 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 does 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 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 ten 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.

13. ISSUED CAPITAL (continued)**Share options (continued)**

The movements in the number of share options to subscribe for shares in the Company during the period were as follows:

Share option scheme	Number of share options outstanding at 1 January 2005	Number of share options granted during the period	Number of share options exercised during the period	Number of share options outstanding at 30 June 2005	Exercise price per share HK\$	Exercisable period
The Scheme	-	2,300,000	-	2,300,000	5.85	29/1/2005 to 28/1/2015
The Scheme	-	2,400,000	-	2,400,000	5.76	25/2/2005 to 24/2/2015
The Scheme	-	400,000	-	400,000	7.45	30/4/2005 to 29/4/2015
The Scheme	900,000	-	-	900,000	4.80	29/9/2004 to 28/9/2014
The Scheme	6,000,000	-	(2,400,000)	3,600,000	4.675	16/10/2004 to 15/10/2014
	<u>6,900,000</u>	<u>5,100,000</u>	<u>(2,400,000)</u>	<u>9,600,000</u>		

The 2,400,000 share options exercised during the period resulted in the issue of 2,400,000 ordinary shares of the Company and new share capital of HK\$240,000 and share premium of HK\$10,980,000 (before issue expenses), as detailed in note 14 to the financial statements.

At the balance sheet date, the Company had 9,600,000 share options outstanding. The exercise in full of the remaining share options would, under the present capital structure of the Company, result in the issue of 9,600,000 additional ordinary shares of HK\$0.10 each in the Company and proceeds, before relevant share issue expenses, of approximately HK\$51,476,500.

14. RESERVES

	Share premium account HK\$'000	Capital reserve HK\$'000	Exchange fluctuation reserve HK\$'000	Leasehold land and buildings revaluation reserve HK\$'000	Retained profits HK\$'000	Total HK\$'000
At 1 January 2004	3,018	–	(35)	20,150	90,576	113,709
Exercise of share options	16,523	–	–	–	–	16,523
Translation exchange differences arising on consolidation of subsidiaries	–	–	115	–	–	115
Net profit for the year	–	–	–	–	108,002	108,002
Interim dividend	–	–	–	–	(29,240)	(29,240)
Proposed final dividend	–	–	–	–	(34,113)	(34,113)
At 1 January 2005	19,541	–	80	20,150	135,225	174,996
Exercise of share options	10,980	–	–	–	–	10,980
Net profit for the period	–	–	–	–	49,333	49,333
Share option expenses						
For the period	–	6,587	–	–	–	6,587
Prior year adjustment	–	1,862	–	–	(1,862)	–
Proposed interim dividend	–	–	–	–	(25,276)	(25,276)
Translation exchange differences arising on consolidation of subsidiaries	–	–	(275)	–	–	(275)
	30,521	8,449	(195)	20,150	157,420	216,345

MANAGEMENT DISCUSSION AND ANALYSIS

Dividend

The Board of Directors recommends payment of an interim dividend of HK9.5 cents per share for the six months ended 30 June 2005.

Business Review

The Group recorded another satisfactory half year with turnover rising 27% to HK\$232 million for the six months ended 30 June 2005. Gross profit margin increased from 32.9% of the same period last year to 34.5%. During the review period, we invested heavily in marketing and promotional activities and expanding our sales and distribution network to further enhance brand awareness among consumers and strengthen our foothold in the industry. We are pleased to see the positive feedback manifested in tremendous growth in sales that our profit from operating activities increased by 17.9% to HK\$60 million for the six months ended 30 June 2005. After taking share options and revaluation of assets into account, profit from operating activities stood at HK\$61 million.

The Chinese Government stepped up its macroeconomic measures to control over-investment during the first half of 2005, which effects were felt by the furniture industry, especially between April and June 2005. However, the Group believes these macroeconomic measures are beneficial to the furniture industry in the long run, thus is confident of the growth potential of the market.

Being owner of the renowned brand names, "Royal", "Knight", and "Simplified", the Group enjoys a significant share in the PRC's furniture market. During the review period, it marketed six series of home furniture, namely "Light Walnut", "Ebony", "Black Walnut", "Glossy", "Light Oak" and "Simplified". We grow our customer base constantly by expanding our product lines. Our furniture are traditionally designed for more mature consumers with large homes. Starting this year, new lines of products were developed and new series launched in the first half of this year included "愛子成龍" for children and "City Living" for young starter homes. Moreover, recently at the August furniture exhibition, two more series - "New Focus" and "i home" - which target also to young homeowners were previewed.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Business Review (continued)

Featuring well-known celebrity Ms. Rosmund Kwan, the Group has been promoting extensively its brands and products via the print media, and on billboards as well as television. We had advertised extensively on television during the review period in order to raise brand awareness. On top of promotion in the domestic market, we also introduced our brands and products to overseas markets, such as Spain and the US, through active participation in international furniture shows. Our products were well received in those markets.

As at 30 June, 2005, the Group's quality products were distributed nationwide through 920 specialty outlets in 29 provinces in China. As a step towards integrating its brands and corporate image, we retrieved franchise rights from franchisees in cities including Shanghai and Shenzhen. The purpose of our involvement in retailing is not to compete with our franchisees, but an effort to set a model retail operation to inspire our franchisees. In its first six months of operation, our retail outlet contributed approximately HK\$370,000 to our net profit. We expect this figure to grow as we approach our peak season in the second half of the year.

As an effort to ensure consistency of our brand images, we also offer sourcing services to franchisees for non-wooden furniture and accessories, such as sofa, mattress, table, cushion, massage chairs, lamps and other decorations. These services are welcomed by franchisees, as evidenced by the additional income from the franchised operation, amounting to approximately HK\$12 million, about 16% more than that of the same period last year. The sourcing service also helped to fortify the business relationship between the Group and its distributors.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)**Prospects**

The PRC Government reinforced its macroeconomic control measures, which had adversely affected the furniture industry in the past months. However, as the measures have been effective in driving speculators out of the property market, they should facilitate healthy economic growth in the long run, which will in turn create a more promising future for the furniture market.

Much of our sales volume comes from newly weds establishing new homes. However, since this lunar year is not a good year for marriage, many may have postponed their weddings and delayed their plan to buy new homes.

In spite of the above factors, the Group manages to achieve satisfactory results in the first half of 2005. While the above factors are expected to continue to have negative impact on the industry, the Group remains cautiously optimistic of its business in the second half of the year.

The Group has been expanding rapidly since listing targeting to establish a distribution network with 1,000 specialty outlets by end of 2005. With over 920 outlets in operation in the first half of the year, we are optimistic about achieving our expansion goal.

The Group is quickly approaching maximum production capacity. With four new series of products introduced this year, effective management of capacity utilization will be critical to our growth in the short term. The Group has secured a piece of land early this year for building a new factory. We expect the first phase of the factory to be completed by end October this year to ease the anticipated capacity constraints.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Prospects (continued)

Construction of the entire plant will be completed in three to five years. By then, the Group's total production capacity will be boosted by 150%.

We operate in a highly competitive environment. The strategies that worked yesterday may not be today's winning formula. Continual product innovation and new strategies are the only assurance to our continuous success. To maintain good profit margins this year, we have introduced four new product series this year.

In July, we successfully raised HK\$100 million through a new issuance of shares to global institutional investors. We wish to thank specially our existing shareholders who have been supporting us over the years, and who subscribed to the placement. The purpose of the placement was to raise fund for acquiring a key competitor - Hing Lee Furniture. Unfortunately, as agreement could not be reached between the companies on related final terms, the acquisition was unsuccessful. We will continue to look for opportunities, which will allow us to further consolidate our business in line with our development strategies and promise accretive earnings growth. We are satisfied with our growth so far this year and are cautiously optimistic about our performance in the near future. The industry environment had been less favorable this first half of the year in comparison with the past years. We believe our industry will be consolidating in the near term. This consolidation process may present opportunities for the Group to grow.

On balance, the July 2005 Renminbi appreciation (2%) should be beneficial to the Group. We expect any further Renminbi appreciation to also be positive.

Riding on our effective marketing strategies, outstanding design capabilities, profitable business model, strong industry reputation and extensive presence in the PRC, we are confident that we will be able to grasp every opportunity ahead and bring the most fruitful returns to our shareholders.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)**Liquidity and financial resources**

As at 30 June 2005, the Group had an unaudited consolidated net asset value of approximately HK\$266 million. (31 December 2004: HK\$233 million). The Group maintained a strong financial position with cash and bank balances of HK\$72 million and had an interest-bearing borrowings of HK\$12.6 million as at 30 June 2005. The Group is principally financed by net cash inflow from operating activities. The Group believes that funds generated from its internal operations are adequate to meet the future requirements of operating its business.

As at 30 June 2005, the Group had no contingent liabilities and bank borrowing except the interest-bearing borrowings mentioned above. As at the same date, the gearing ratio, calculated on the basis of total liabilities over total shareholders' fund was 0.66.

Over 90% of the Group's cash is either denominated in Hong Kong Dollars or Renminbi. The exposure to exchange fluctuation is minimal.

The liquidity of the Group as evidenced by the current ratio (current assets/current liabilities) was 1.47 times, which improved from the 1.42 times applicable at the end of 2004. As at 30 June 2005, the net current assets was approximately HK\$74 million (31 December 2004: HK\$75 million).

Employment and remuneration policy

The total number of employees of the Group as at 30 June 2005 was around 2,000 (2004: 1,500).

The Group's remuneration policies are in line with local market practices where the Group operates and are normally reviewed on an annual basis. In addition to salary payments, there are other staff benefits including provident fund, medical insurance and performance related bonus. Share options may also be granted to eligible employees and persons of the Group. At 30 June 2005, there were 9,600,000 outstanding share options.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

During the six months ended 30 June 2005, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

INTERESTS OF DIRECTORS AND CHIEF EXECUTIVE IN SHARES

As at 30 June 2005, the interests or short positions of the directors and chief executive of the Company in the shares and underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which have been notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under such provisions of the SFO), or which are required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which are required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, to be notified to the Company and the Stock Exchange, were as follows:

Interests in the Company:

Name of Directors	Long position/ Short position	Number of shares	Number of share options ¹	Aggregate percentage of interest as at 30 June 2005 ²
Tse Kam Pang	Long position	76,050,000 ³	–	30.91%
Ma Gary Ming Fai	Long position	–	2,300,000	0.93%
Lam Ning, Joanna	Long position	1,900,000	–	0.77%
Donald H. Straszheim	Long position	–	800,000	0.33%
Yau Chung Hong	Long position	–	200,000	0.08%

Notes:

- The number of share options refers to the number of underlying shares of the Company covered by the share options granted under the section headed "Share Options".

INTERESTS OF DIRECTORS AND CHIEF EXECUTIVE IN SHARES (continued)

2. This represents the percentage of aggregate long position in shares and underlying shares to the total issued share capital of the Company as at 30 June 2005.
3. Of these 76,050,000 shares, 4,600,000 shares were held by Mr. Tse Kam Pang personally and 71,450,000 shares were held by Crisana International Inc., a company which is wholly and beneficially owned by Mr. Tse Kam Pang.
4. Save as otherwise specified under note 3, interests disclosed hereunder were being held by each director in his capacity as beneficial owner.

Save as disclosed above, none of the directors, chief executive or any of their spouses or children under the age of 18 years had any interest or short position in the shares of the Company or any of its associated corporations as defined in the SFO.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 2005, so far as is known to the directors or chief executive of the Company, the following persons (not being a director or chief executive of the Company) had interests or short positions in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Division 2 and 3 of Part XV of the SFO or which were recorded in the register maintained by the Company pursuant to section 336 of the SFO:

Name of Shareholder	Number of Shares	Aggregate percentage of interest as at 30 June 2005 ¹
Crisana International Inc.	71,450,000 ²	29.04%
J.P. Morgan Chase & Co.	32,380,000	13.16%
Lloyd George Investment Management (Bermuda) Limited	22,272,000	9.05%
Fidelity International Limited	17,068,000	6.94%
Deutsche Bank Aktiengesellschaft	13,000,000	5.28%

SUBSTANTIAL SHAREHOLDERS (continued)

Notes:

1. This represents the percentage of aggregate long position in shares and underlying shares to the total issued share capital of the Company as at 30 June 2005.
2. These 71,450,000 shares were held by Crisana International Inc., a company which is wholly and beneficially owned by Mr. Tse Kam Pang, the Chairman of the Company. In addition, Mr. Tse Kam Pang personally held 4,600,000 shares.

Save as disclosed herein, so far as is known to the directors or chief executive of the Company, as at 30 June 2005, no other person had interests or short positions in the shares and underlying shares of the Company which would fall to be disclosed to the Company under provision of Divisions 2 and 3 of Part XV of the SFO or which were recorded in the register kept by the Company under section 336 of the SFO.

CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has complied with the applicable code provisions of the Code on Corporate Governance Practices (the "CG Code") as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited throughout the six months ended 30 June 2005, except for certain deviations. The major areas of deviation are as follows:

Code Provision A.2.1

This Code stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual.

Prior to 27 August 2005, Mr. Tse Kam Pang were both the Chairman and Chief Executive Officer of the Company.

On 27 August, 2005, Mr. Tse Kam Pang resigned as Chief Executive Officer of the Company in order to segregate the duties of the Chairman of the Board from those of the Chief Executive officer. Mr. Tse will remain as Chairman and Executive Director of the Company. Mr. Ma Gary Ming Fai, an Executive Director of the Company, has been appointed as Chief Executive Officer of the Company on the same date.

CODE ON CORPORATE GOVERNANCE PRACTICES (continued)**Code Provision A.4.1**

Code A.4.1 stipulates that non-executive directors should be appointed for a specific term and subject to re-election.

The term of office for non-executive directors are the same as for all directors (i.e. no specific term and subject to retirement from office by rotation and be eligible for re-election in accordance with the provisions of the Company's Memorandum and Articles of Association). At every Annual General Meeting, one-third of the directors for the time being or, if their number is not a multiple of three, the number nearest to but not less than one-third) shall retire from office by rotation .

Remuneration Committee

The Company has set up a Remuneration Committee in accordance with the relevant requirements of the Code on 27 August 2005. The Committee is chaired by Mr. Chang Chu Fai Johnson Francis, and comprising two other members, namely Dr. Donald H. Straszheim and Mr. Yau Chung Hong. All the members of the Committee are independent non-executive directors of the Company.

Model Code for Securities Transaction by Directors

The Company has adopted for compliance by the directors and relevant employees the code of conduct for dealings in securities of the Company as set out in Appendix 10 – Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code"), of the Listing Rules on 27 August 2005.