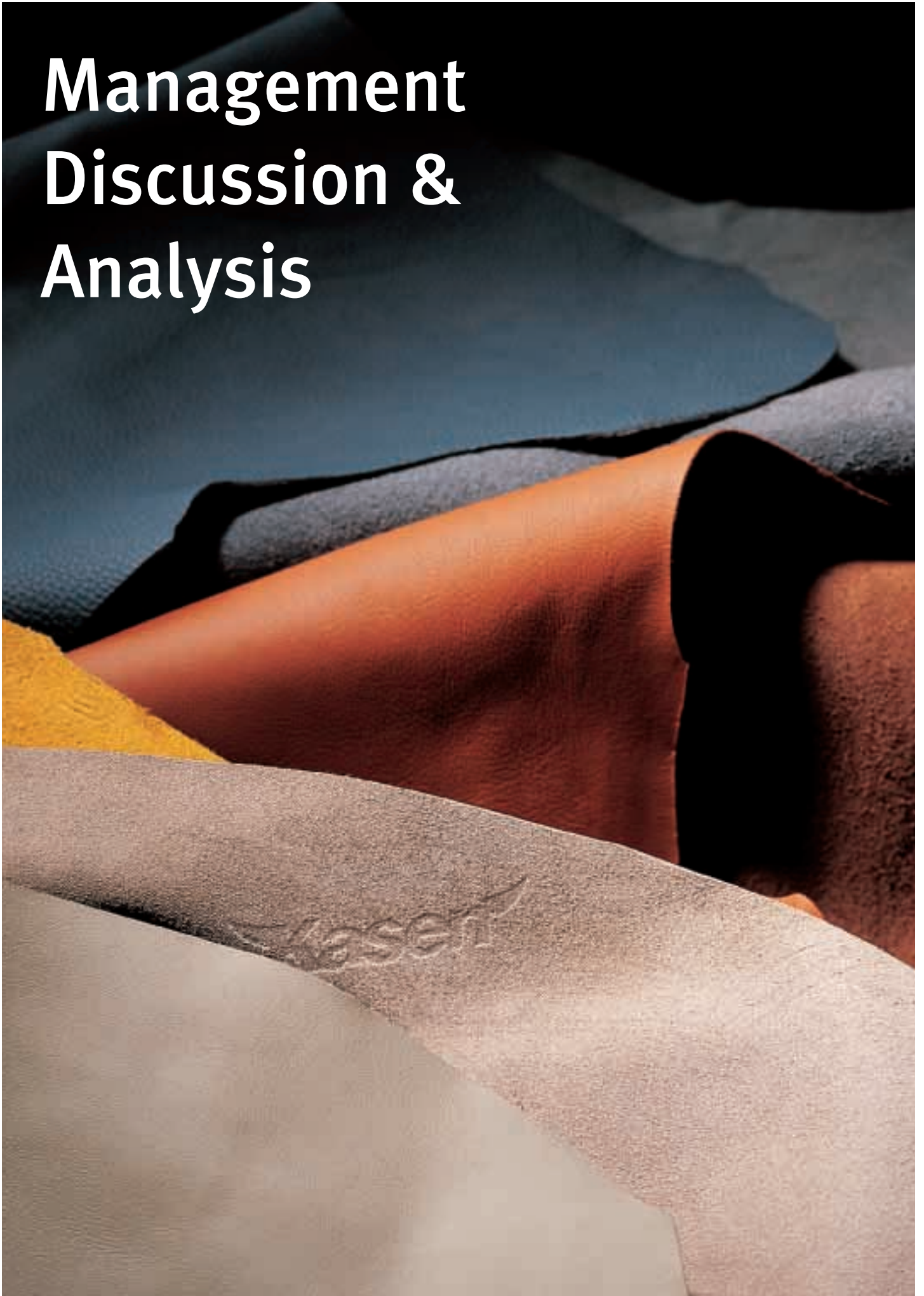


Management Discussion & Analysis



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GROUP PROFILE

The Group is a leading upholstered furniture and leather products manufacturer based in China. It purchases and processes raw cowhides and wet blues into finished leather and fully assembled upholstered furniture. Its principal products are leather and fabric upholstered furniture, sofa covers, furniture leather, automotive leather, footwear leather, etc. The Group primarily manufactures its upholstered furniture products in accordance with the designs of its customers, who market the Group's products under their own brand names. The Group's major customers of upholstered furniture include leading American furniture companies, such as Furniture Brands International, Inc., Berkline/Benchcraft LLC, La-Z-Boy Incorporated, Bernhardt Furniture Company, American Signature Inc., Rooms To Go, Inc. and other major international furniture companies. The Group also benefited from the trend that many companies around the world increasingly outsourced their production process to countries such as China to take advantage of their lower labour costs, the economies of scale and the stable supply of numerous products.

As at December 31, 2005, the gross floor area of our production facilities amounted to 1,300,000 square meters, with an annual production capacity of 240,000,000 square feet of sofa leather, 30,000,000 square feet of automotive leather, 6,500,000 seats of upholstered sofa and 10,000,000 seats of sofa cover.

Year 2005 was an important milestone in the Group's development history. On October 20, 2005, the Group was successfully listed on the Stock Exchange of Hong Kong. The Haining Higher Point Sofa Industrial Park, which was established by the Group as a major investor, moved forward from a construction stage into a commercial operation stage.

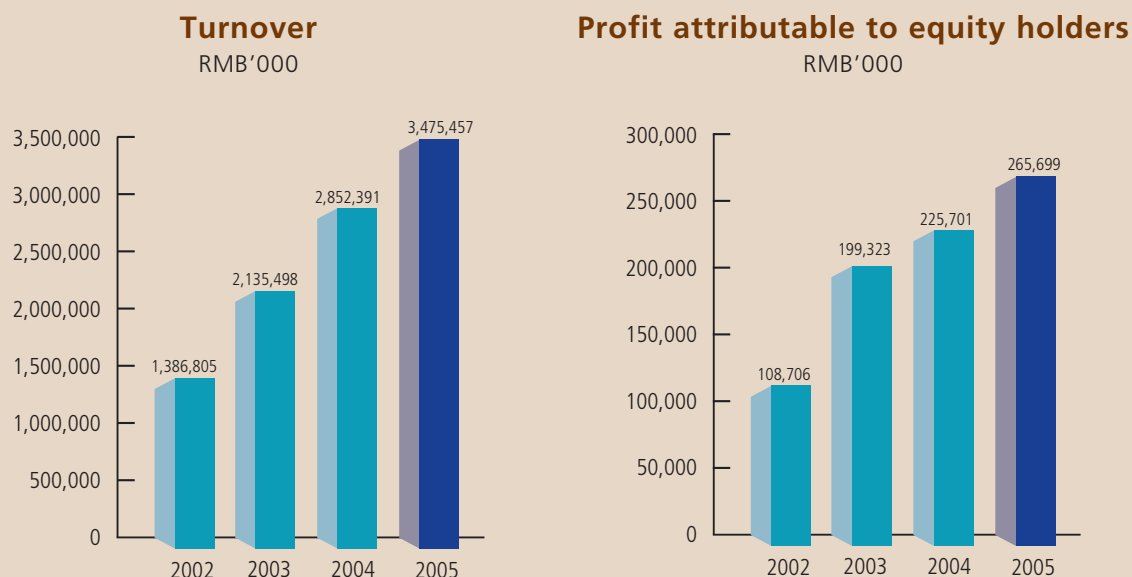
OVERVIEW

For the year ended December 31, 2005, the Group's turnover increased 21.8% to RMB3,475,457,000 (2004: RMB2,852,391,000), while its profit for the year rose 11.0% to RMB260,354,000 (2004: RMB234,530,000). The profit attributable to equity holders of the Company for 2005 was RMB265,699,000 as compared to RMB225,701,000 in 2004.



Management Discussion & Analysis (cont'd)

The following chart shows the consolidated turnover and profit attributable to equity holders of the Company for the four years ended December 31, 2005:



Overall Gross Profit Margin

The Group's gross profit margin in 2005 was 15.8%, representing an improvement as compared to 15.6% in 2004.

The Group's principal raw materials are raw cowhides and wet blues, which accounted for 46.5% of the total cost of sales in 2005. The prices for raw cowhides in international market remained comparatively stable in 2005, which was the major contributor to the Group's steady gross profit margin.

However, RMB's further appreciation and costs rising in China brought challenge to the manufacturing and export industries that operate in the country. The Group was able to offset the negative impact of rising labour costs in China by improving its operation efficiency. By importing its principal raw material for production, the Group partially offset the impact of RMB's appreciation.

OPERATING EXPENSES, TAXATION AND PROFIT ATTRIBUTABLE TO EQUITY HOLDERS

Rising oil price had little influence on the Group's distribution costs, as the marine freight charges of almost all the exporting business of the Group were borne by the customers. However, the percentage of distribution costs to turnover rose slightly to 2.3% (2004: 2.0%) of the turnover, as the share of finished upholstered furniture export to the total turnover of the Group increased and land transportation cost from factory to port also climbed up.

In regard of administrative expenses, though the remuneration of the management increased in 2005, the percentage of administrative expenses to turnover remain unchanged at 3.3%, for the operating efficiency was improved after productivity of the Group increased.

Management Discussion & Analysis (cont'd)

In 2005, interest-bearing loans continued to be one of the major funding sources of the Group, and finance costs increased to RMB111,540,000 (2004: RMB95,419,000), of which the interest incurred by the Convertible Loans granted to the Group by Warburg Pincus amounted to RMB13,249,000 (2004: RMB14,899,000). After the initial public offering of the Group's shares, the above Convertible Loans were converted into the Group's equity, and the accumulated interests not yet paid during the past years in total of RMB32,823,000 were fully transferred into shareholders' equity.

Most of the Group's operations are carried out in the economic and technological development zones and coastal open areas of the PRC where allow income tax relieves in accordance with relevant income tax laws and regulations, so the overall effective tax rate of the Group remains approximately 6.6% (2004: 8.8%).

In September 2004, the Group redeemed the equity interests held by minority shareholders in most of its subsidiaries, except five joint ventures located in the Higher Point Sofa Industrial Park, so in 2005 minority shareholders continued to be interested in the five joint ventures located in the Higher Point Sofa Industrial Park. Profit attributable to minority shareholders represented -2.1% (2004: 3.8%) of profit after taxation .

For reasons mentioned above, profit attributable to equity holders of the Company increased by approximately 17.7% to RMB265,699,000.

SALES ANALYSIS BY PRODUCTS

Upholstered Furniture

Upholstered furniture remained the core products of the Group, and its sales accounted for 79.3% of the total turnover in 2005. As the upholstered furniture industry in the Group's principal export regions increasingly outsourced its production, the Group's upholstered furniture operation was able to increase by 35.5% in 2005, among which, the fabric upholstered furniture operation grew especially fast, up by 54.0% and took up 13.7% of the total turnover (2004: 10.9%).

Furniture Leather

Furniture leather produced by the Group continued to be well received by overseas and domestic furniture producers, which contributed to a rapid growth in this operation in 2005. Although the Group gave priority to meet the internal requirement of its fast growing leather upholstered furniture division, the external sales of the furniture leather operation still managed to grow by 20.6% in 2005.

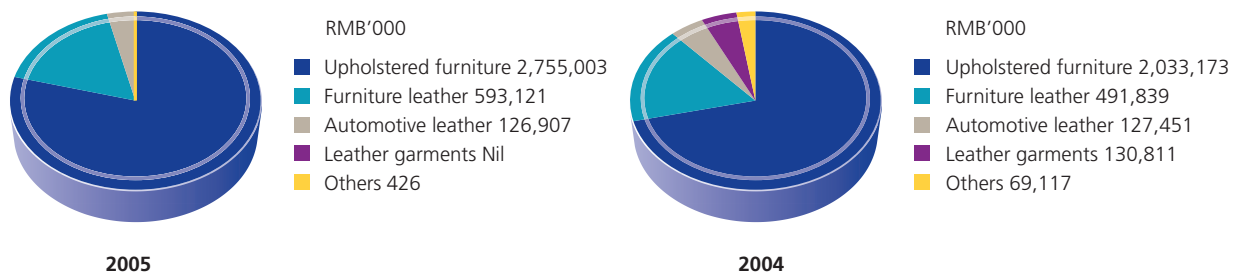


Management Discussion & Analysis (cont'd)

Automotive Leather

In contrast, the automotive leather operation did not achieve the expected growth in 2005, with its turnover at the same level as 2004. It was principally due to that the operation commenced in 2003 and it usually takes quite a long time to obtain product certificates from the auto makers.

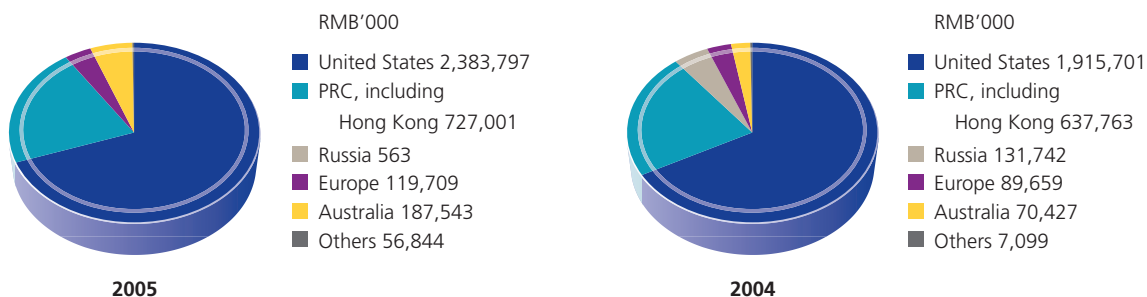
The following chart shows the segmental turnover in 2005 by product type and their comparative figures in 2004.

**SALES ANALYSIS BY REGIONS**

In 2005, the Group continued to expand its markets in the US, Europe and Australia. In line with the ongoing outsourcing trend of consumption products in the regions, the Group's sale increased strongly in these markets. The Group's sales in the US, Europe and Australia increased by 24.4%, 33.5% and 166.3% respectively; and, as a percentage to the total sales, the turnovers in the US, Europe and Australia accounted for 68.6%, 3.4% and 5.4% respectively.

The Group's sales to the PRC domestic market mainly involved furniture leather and automotive leather, the turnover of which represented 20.9% of its total sales. Business in this segment increased by 14.0% in 2005.

The following chart shows the segmental turnover in 2005 by geographical location and their comparative figures in 2004.



Management Discussion & Analysis (cont'd)

THE HIGHER POINT PROJECT

The Group commenced to establish Higher Point Sofa Industrial Park in Haining city, Zhejiang province, in 2004 to expand its production capacity. It was planned to include eight upholstered furniture factories after completion, with three factories to be wholly owned by the Group and other five factories to be run in the form of joint-ventures.

For the year ended December 31, 2005, one of the Group's wholly-owned subsidiaries and other five joint-ventures (collectively referred to as the "Higher Point Enterprises") in Higher Point Sofa Industrial Park formally commenced operation. The total sales amounted to RMB925,916,000 in 2005 (2004: RMB265,722,000), representing an increase of 248.5%. The Higher Point Enterprises recorded remarkable achievement in developing customers, which was reflected in the successful expansion of the Group's customer base and revenue sources, and currently became an important part of Group's operation.

As Higher Point Project was still in its preliminary stage, most workers were not well trained which resulted in a lower production efficiency. For the year ended December 31, 2005, the overall gross profit margin of the Higher Point Enterprises was 10.2%, which was lower than the average level of the Group, while the net profit was just at breakeven point. Along with the improvement of the workers' skills and the continuous rapid growth in operations, it is anticipated that the performance of the Higher Point Enterprises will be improved substantially in near future.

CAPITAL EXPENDITURE

As most investments by the Group to increase production capacity completed in previous years up to 2004, the capital expenditure in 2005 was reduced significantly to RMB231,468,000 (2004: RMB739,558,000). The capital expenditure in 2005 was mainly used in (1) construction of additional production facilities required for normal operation by Higher Point Project; (2) replacement of old furniture leather equipment with new ones; and (3) purchase of new equipment for producing automotive leather. The principal expenditure for these items were approximately RMB99,193,000, RMB66,600,000 and RMB23,339,000 respectively.

FINANCIAL RESOURCES AND LIQUIDITY

Public Offering

In late October 2005, the Shares were listed on the Stock Exchange of Hong Kong by way of public offering and placing. Out of a total of 304,220,000 Shares at initial offer price HK\$2.55 per Share under the public offering and placing, we were offering 202,809,074 Shares and the selling shareholders were offering 101,410,926 Shares. The Company successfully raised HK\$517,163,000, equivalent to RMB539,246,000, through its initial public offering. Of the total proceeds, approximately HK\$40 million was paid for underwriting commission and expenses. At the end of 2005, the Group had used approximately RMB251 million and RMB32 million from the proceeds to repay short-term bank loans and to fund its capital expenditure respectively. The remaining amounts were deposited in short term demand bank deposits. The actual use of proceeds is in line with the guidelines as set out in the prospectus relating to the initial public offering.

Total Borrowings

As at December 31, 2005, the Group's total borrowings amounted to RMB1,291,738,000 (2004: RMB1,880,251,000). Such decrease in total borrowing was primarily because (1) the Group utilised proceeds raised through its initial public offering to repay part of its loans; (2) Warburg Pincus's Convertible loans granted to the Group were converted into equity; and (3) cash flow from operation of the Group was significantly improved.

Management Discussion & Analysis (cont'd)



As at December 31, 2005, the Group's total borrowings primarily comprise of (1) short-term borrowings of RMB1,191,246,000 provided by local banks, bearing an interest rate ranging from 4.0% to 8.1% per annum; and (2) long-term borrowings of RMB90,092,000 provided by local banks, bearing an interest rate ranging from 5.1% to 6.0% per annum; and (3) government debt of RMB10,400,000, bearing an interest rate of 2.55%.

Turnover Period, Liquidity and Gearing

The Group's inventory primarily represented raw cowhides and wet blues used for production, accounting for approximately 44.4% of the total inventory. In 2005, the Group endeavoured to control inventory level and managed to decrease its inventory turnover period to 172 days (2004: 211 days).

In 2005, the Group maintained export credit insurances and appropriately extended the credit terms to certain substantial customers, resulting in an increase in trade receivable turnover days to 54 days (2004: 35 days).

The Group attempted to shorten the accounts payable credit term so as to cut the purchase costs. As a result, the trade payable turnover days decreased to 77 days (2004: 102 days).

As the Group's operating cashflow continuously improved in 2005, as at December 31, 2005, its current ratio and quick ratio increased to 1.38 (2004: 0.94) and 0.71 (2004: 0.43), respectively. The Group's cash and cash equivalent balance was RMB372,278,000 (2004: RMB213,458,000).

Mainly due to the completion of its initial public offering in the year, the Group's gearing was significantly improved. Such ratios included: (1) bank borrowings to total assets, (2) bank borrowings to equity and (3) net debts (i.e. net balance between bank borrowings and cash and cash equivalent) to equity, dropped from 38.8%, 130.3% and 112.5% as at December 31, 2004 to 28.8%, 55.8% and 39.6% as at December 31, 2005, respectively. Interest rate coverage (i.e. the ratio of profit from operating activities over finance costs) was approximately 3.5 times (2004: 3.7 times). A high interest rate coverage reflected that the leverage level of the Group remained healthy.

FOREIGN EXCHANGE EXPOSURE

As the Group's businesses are principally export-related and transactions are primarily denominated in US dollars, the Directors consider the Group is exposed to foreign exchange fluctuation risks. However, as a substantial portion of procurements of the Group is denominated in US dollars, such risks can be reduced partly through natural hedges. Therefore, the Group neither used any financial instrument for hedging purposes during the year, nor had any hedging instrument outstanding as at December 31, 2005.

SYNDICATED LOAN

In late December 2005, the Group obtained a syndicated loan in aggregate of HK\$125,000,000 arranged by CITIC Capital Markets Limited, with a term of three years, which will be principally used for general working capital of the Group. The three-year-term syndicated loan, drawn down in January 2006, bears interest at 2.00% over 12-month Hong Kong Interbank Offered Rate per annum.

Management Discussion & Analysis (cont'd)

CONTINGENT LIABILITIES

A cross-guarantee arrangement was entered into between the Group and Haining Changhai Packaging and Printing Co., Ltd. ("Haining Changhai"). The Group gave guarantee in favour of the lenders for several bank loans, in total amount of RMB67,897,000, borrowed by Haining Changhai as at December 31, 2005. Such loans will become due from March 26, 2006 to December 15, 2006, and after repayment of such loans, no guarantee will be given to other loans.

PLEDGE OF ASSETS

The Group pledged deposits to banks to secure the bills payable issued by the Group and the bank facilities granted to the Group. The deposits carry an average interest rate of 0.72%.

EMPLOYEES AND EMOLUMENTS POLICIES

As at December 31, 2005, the Group employs a total of approximately 15,000 full time employees (2004: 14,827) which included management staff, technicians, salespersons and workers. For the year ended December 31, 2005, the Group's total expenses on the remuneration of employees is RMB237,063,000 and represents 6.82% of the operating revenue of the Group. The Group's emolument policies are formulated on the performance of individual employees, which will be reviewed regularly every year. Apart from provident fund scheme (in accordance with the provisions of the Mandatory Provident Fund Schemes Ordinance for Hong Kong employees) or state-managed retirement pension scheme (for the PRC employees) and medical insurance, discretionary bonuses and employee share options are also awarded to employees according to the assessment of individual performance.

FUTURE PLANS AND PROSPECTS

The Group aims to become one of the world's leading manufacturers of leather products and upholstered furniture. To achieve this goal, the Group continues its effort in expanding its market share, strengthening product portfolios, further reducing production costs and forming strategic alliances with globally reputable leading manufacturers, so as to strengthen the Group's competitive edges in product development.

Upholstered Furniture Business

The US is currently the largest market for the Group's upholstered furniture products. Although statistics show that there is a slowdown in real estate industry in the US, the Group does not consider that it will have impact on further expansion of the Group's business in the US. This is primarily due to the fact that US brand name furniture companies will continue to save costs through manufacture outsourcing, while export from countries with low production costs (including the PRC) to the US will maintain its strong growth.

At present, the percentage of upholstered furniture imported from the PRC to the US total consumption remains at a comparatively low level, thus the US market still promises a great potential. The Group will continue to explore the US market by taking advantage of the established business relationship with leading upholstered furniture companies in the US. The Group will consider a realignment of the logistics arrangement for export to the US so as to assist its customers to reduce their logistics costs and to strengthen the Group's competitive edges.

The year 2005 witnessed a fast growth in the Group's sale of fabric upholstered furniture to the US market, representing an increase of 54%. As fabric upholstered furniture accounted for more than 70% of the total consumption of upholstered furniture in the US, and the import share in this section is comparatively low, accordingly, the Group will continue to develop more new lines of fabric upholstered furniture products.

Management Discussion & Analysis (cont'd)

European countries, Australia and other countries will also increase manufacture outsourcing to the PRC, which is evidenced by the fast growth in the Group's Europe and Australia businesses in 2005. The Group will put more efforts in these markets for faster growth.

In 2005, the Group's Higher Point Project achieved significant progress in turnover and gained several key customers. The Group anticipates that the sales from the Higher Point Enterprises will continue to grow rapidly in future and their profitability will improve significantly.

Furniture Leather Business

The Group purchases raw cowhides, wet blues and other raw materials and processes them into finished leather for the production of leather products and upholstered furniture. The Group is currently the largest finished leather producer in the PRC.

As a vertically integrated producer, the Group's leading position in the furniture leather industry allows it to win upholstered furniture customers' confidence through low costs, high quality and fast delivery schedule. The Group will continue to develop new lines of leather products with constantly improved textures, appearances and styles to cater its customers' needs. Meanwhile, the Group will continue to seek for alternative materials to ensure a competitive edge supported by low costs.

Automotive Leather Business

Although the development of its automotive leather operation in 2005 was disappointing, the Group remains optimistic in the outlook for the automotive leather market. At present, the Group is carrying out tests on automotive leather required for new automotive models by several automotive manufacturers at home and abroad and has obtained various product certifications. The Group anticipates that its automotive leather operation will experience a fast growth in future, but its contribution to the Group's overall turnover will be insignificant in near future.

In 2005, a joint venture was established by the Group and MELX, a leading leather producer in Japan, to develop various businesses including automotive leather products. The joint venture will increase the sales of automotive leather products to Japanese automakers.

Other Operations

To make full use of cowhides resources to enhance its profitability, the Group has carried out trial production of footwear leather since 2005, but its contribution to the Group's overall turnover will be insignificant in near future.

In order to make full use of its advantages in cutting and sewing and to improve the utilization of production facilities, from the beginning of 2006, the Group has expanded its business into the field of outdoor leisure products, mainly including tents, sleeping bags, outdoor furniture, etc. In February 2006, a supply agreement was entered into between the Group and North Pole Limited, an associate of the Group, with a term of three years. The transaction was approved at the Extraordinary General Meeting held on March 31, 2006.