

Notes to the Financial Statements

For the year ended December 31, 2005

1. GENERAL

The Company is a public limited company incorporated in the Cayman Islands and its shares are listed on the Stock Exchange of Hong Kong Limited ("Stock Exchange") since October 20, 2005. The addresses of the registered office and principal place of business of the Company are disclosed in the corporate information to the annual report.

The Company acts as an investment holding company. Its subsidiaries are principally engaged in the processing of raw cowhides and wet blues into finished leather or fully assembled leather products.

In preparation for listing of the Company's shares on the Stock Exchange, the Company underwent a group reorganization (the "Reorganization"). The Reorganization principally involved (1) the shareholders (the "Founding Shareholder Group") of Zhejiang Kasen Industrial Co., Ltd. ("Zhejiang Kasen"), the then principal operating company and a holding company of certain subsidiaries of the Company, subscribed for a total of 231,095,052 ordinary shares of US\$0.0001 each of the Company on January 14, 2003 and February 14, 2003 respectively, so as to set up a holding company; and (2) a transfer of the entire ownership interest in Zhejiang Kasen to the Company, Zhejiang Kasen and the Company were controlled by the Founding Shareholder Group throughout the Reorganization. The Founding Shareholder Group, as a result of contractual agreements, was regarded as a single entity controlling the Group and governed the financial and operating policies of the Group. In respect of step (2) of the Reorganization above, such contractual agreements include (i) a declaration of trust signed by Mr. Zhu Zhangjin ("Mr. Zhu"), a director and a shareholder of the Company, on February 26, 2003 which declared that 11.00% of the equity interest Mr. Zhu held in the Company was held on trust for two of the shareholders of Zhejiang Kasen ("Township Shareholders") and gave Mr. Zhu the full power to vote in his discretion on behalf of the Township Shareholders; and (ii) a voting agreement dated February 26, 2003 whereby the 21 individual shareholders of Zhejiang Kasen granted Mr. Zhu full power to vote on their behalf all shares owned by them. The declaration of trust and the voting agreement were terminated on September 16, 2004 and October 9, 2005, respectively; and (3) in return for the ownership interest in Zhejiang Kasen transferred by the Founding Shareholder Group, the Founding Shareholder Group subscribed for 421,078,856 further ordinary shares of US\$0.0001 each in the Company on September 16, 2004 and the Reorganization was completed on the same date.

Accordingly, for the purpose of the preparation of the financial statements of the Group, the Group accounted for Zhejiang Kasen as a wholly-owned subsidiary on the basis that the Company has been considered as the holding company of Zhejiang Kasen and its subsidiaries throughout the period, using the principles of common control except for those subsidiaries which were established or acquired during the period.

The functional currency of the Company is United States Dollars. The majority of the operation of the Group is in the People's Republic of China and the financial statements are therefore presented in Renminbi ("RMB").

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

2. CHANGE IN ACCOUNTING POLICIES AND SUMMARY OF THE EFFECTS

In the current year, the Group has applied the new and revised International Financial Reporting Standards ("IFRS"), International Accounting Standards ("IASs") and Interpretations ("IFRIC") (hereinafter collectively referred to as "new IFRSs") issued by International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretation Committee of the IASB that are effective for accounting periods beginning on or after January 1, 2005. The adoption of the new IFRSs has resulted in changes of the Group's accounting policies in the following areas that have an effect on the results for the current or prior accounting periods are prepared and presented.

Business Combinations

IFRS 3 Business Combinations is effective for business combinations for which the agreement date is on or after March 31, 2004 and from the beginning of its first annual period beginning on or after March 31, 2004 (i.e. the financial year beginning on January 1, 2005). The principal effects upon application of the transitional provision of IFRS 3 on January 1, 2005 to negative goodwill arising from business combinations are summarized below:

Excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost (previously known as "negative goodwill")

In accordance with IFRS 3, any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of acquisition ("discount on acquisition") is recognized immediately in profit or loss in the period in which the acquisition takes place. In previous periods, negative goodwill arising on acquisitions was presented as a deduction from assets and released to income based on an analysis of the circumstances from which the balance resulted. In accordance with the relevant transitional provisions in IFRS 3, the Group derecognized all negative goodwill on January 1, 2005. A corresponding adjustment to the Group's retained earnings of approximately RMB4,395,000 has been made.

The impact of the change in accounting policy for the year is an increase in other operating income of approximately RMB4,252,000 and an increase in net assets at January 1, 2005 of approximately RMB4,395,000.

Share-based Payments

In the current year, the Group has applied IFRS 2 *Share-based Payment* which requires an expense to be recognized where the Group buys goods or obtains services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares or rights over shares ("cash-settled transactions"). The principal impact of IFRS 2 on the Group is in relation to the expensing of the fair value of share options granted to directors and employees of the Company, determined at the date of grant of the share options, over the vesting period. Prior to the application of IFRS 2, the Group did not recognize the financial effect of these share options until they were exercised. The Group has applied IFRS 2 to share options granted on or after January 1, 2005. Because there were no unvested share options at January 1, 2005, comparative figures for last year need not to be restated. During the year, no share options have been granted by the Company.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

2. CHANGE IN ACCOUNTING POLICIES AND SUMMARY OF THE EFFECTS *(Continued)***Summary of the effects of the changes in accounting policies**

The effects of the changes in the accounting policies described above are an increase in discounts on acquisition of an additional interest in a subsidiary of approximately RMB4,252,000 for the current year (2004: Nil).

The Group has not early applied the following new standards, amendments and interpretations that have been issued but are not yet effective. The directors of the Company have commenced considering the potential impact of these new standards, amendments and interpretations. Except for IAS 39 & IFRS 4 (Amendments) on financial guarantee contracts (which requires financial guarantees to be initially measured at fair value), which may have potential impact to the financial statements, the directors anticipate that the adoption of these new standards, amendments and interpretations, should not result in any significant changes in the future as to how the results and financial position are prepared and presented. The Group is still not in the position to reasonably estimate the impact that may arise from IAS 39 & IFRS 4 (Amendments).

IAS 1 (Amendment)	Capital Disclosures ¹
IAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures ²
IAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions ²
IAS 39 (Amendment)	The Fair Value Option ²
IAS 39 & IFRS 4 (Amendments)	Financial Guarantee Contracts ²
IFRS 6	Exploration for and Evaluation of Mineral Resources ²
IFRS 7	Financial Instruments: Disclosures ¹
IFRIC 4	Determining whether an Arrangement Contains a Lease ²
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds ²
IFRIC 6	Liabilities arising from Participating in a Specific Market, – Waste Electrical and Electronic Equipment ³
IFRIC 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies ⁴
IFRIC 8	Scope of IFRS 2 ⁵
IFRIC 9	Reassessment of Embedded Derivatives ⁶

¹ Effective for annual periods beginning on or after January 1, 2007.

² Effective for annual periods beginning on or after January 1, 2006.

³ Effective for annual periods beginning on or after December 1, 2005.

⁴ Effective for annual periods beginning on or after March 1, 2006.

⁵ Effective for annual periods beginning on or after May 1, 2006.

⁶ Effective for annual periods beginning on or after June 1, 2006.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with IFRS. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and by the Hong Kong Companies Ordinance.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company and its subsidiaries. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of the subsidiaries to bring the accounting policies used in line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the consolidation. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Business combinations

Other than business combinations involving entities under common control (i.e. the Reorganisation as set out in note 1), the acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognized at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* ("IFRS 5"), which are recognized and measured at fair value less costs to sell.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair values of the assets, liabilities and contingent liabilities recognized.

When the Group increases its interest in an entity that is already a subsidiary, the difference between the consideration paid for the additional interest and the fair value of the net assets of the subsidiary attributable to the additional interest acquired is recognized as goodwill or discount on acquisition.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**Business combinations** (Continued)*Goodwill*

Goodwill arising on the acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the net fair values of the identifiable assets, liabilities and contingent liabilities of the subsidiary recognized at the date of acquisition.

Goodwill is recognized as an asset at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognized for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

The Group's policy for goodwill arising on the acquisition of an associate is described under 'Investments in associates' below.

Excess of an acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost ("discount on acquisition")

A discount on acquisition arising on an acquisition of a subsidiary or an associate for which an agreement date is on or after March 31, 2004 represents the excess of the acquirer's interest in the net fair values of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the business combination and should be recognized immediately in income statement.

In accordance with the transitional rules of IFRS 3, all negative goodwill as at January 1, 2005 has been derecognized.

Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in this financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the associate, less any identified impairment loss. When the Group's share of losses of an associates equal or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognizing its share of further losses. An additional share of losses is provided for and a liability is recognized only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments in associates (Continued)

Any excess of the cost of acquisition over the Group's share of the net fair values of the identifiable assets, liabilities and contingent liabilities of the associate recognized at the date of acquisition is recognized as goodwill. Goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment. Any excess of the Group's share of the net fair values of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognized immediately in profit or loss.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Jointly controlled entities

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

Jointly controlled entities are accounted for using the equity method.

The results and assets and liabilities of jointly controlled entities are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the jointly controlled entities, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognizing its share of further losses. An additional share of losses is provided for and a liability is recognized only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

When a group entity transacts with a jointly controlled entity of the Group, unrealized profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealized losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognized.

Revenue recognition

Revenue is measured at the fair values of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, value-added tax and other sales related taxes.

Sales of goods are recognized when goods are delivered and title has been passed.

Interest income is accrued on a timely basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)***Revenue recognition** *(Continued)*

Dividend income from investments is recognized when the shareholders' rights to receive payment have been established.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases, including interest in land use right, are charged to profit or loss on a straight line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognized as a reduction of rental expense over the lease term on a straight line basis.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognized in profit or loss in the period in which they arise, except for exchange differences arising on a monetary item that forms part of the Group's net investment in a foreign operation, in which case, such exchange differences are recognized in equity in the consolidated financial statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognized directly in equity, in which cases, the exchange differences are also recognized directly in equity.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Company (i.e. RMB) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognized as a separate component of equity (the translation reserve). Such exchange differences are recognized in profit or loss in the period when the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising from an acquisition of a foreign operation are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognized in the translation reserve.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

Government grants

Grants relating to depreciable assets are presented as a deduction from the carrying amount of the relevant asset and released to income over the useful lives of the assets. Grants related to expense items are recognized in the same period as those expenses are charged to the income statement and are reported separately as other operating income.

Where government grants are given for the purposes of immediate financial support to the Group with no further related cost to be incurred, the grants are recognized as income when they become receivable.

Retirement benefits costs

Payments to defined contribution retirement benefits schemes and state-managed retirement benefit schemes are charged as an expense as they fall due.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognized on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences arising on investments in subsidiaries and associates and interest in joint ventures, except where the Group as a parent or a venturer is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)***Taxation** *(Continued)*

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Property, plant and equipment

Property, plant and equipment other than construction in progress are stated at cost less subsequent accumulated depreciation, amortization and accumulated impairment losses.

Construction in progress is stated at cost which includes all construction costs and other direct costs attributable to such projects. It is not depreciated until completion of construction. Costs of completed construction works are transferred to the appropriate categories of property, plant and equipment.

Depreciation is provided to write off the cost of property, plant and equipment other than construction in progress over their estimated useful lives and after taking into account their estimated residual value, using the straight line method.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of asset. Any gain or loss arising from derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognized.

Intangible assets

Costs incurred in the acquisition of computer software are capitalized and amortized on a straight line basis over their estimated useful lives of five years from the date of acquisition.

Internally-generated intangible assets – research and development expenditure

Expenditure on research activities is recognized as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from the Group's development activities is recognized only if all of the following conditions are met:

- an asset is created that can be identified (such as software and new processes);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Internally-generated intangible assets are amortized on a straight line basis over their estimated useful lives. Where no internally-generated intangible asset can be recognized, development expenditure is charged to profit or loss in the period in which it is incurred.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Impairment of tangible and intangible assets with definite useful lives

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimation of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognized as income immediately.

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is calculated using the weighted average cost method.

Financial instruments

Financial assets and financial liabilities are recognized on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

The Group's financial assets are classified into one of the three categories, including financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss including financial assets held for trading. At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognized directly in profit or loss in the period in which they arise.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)***Financial instruments** *(Continued)**Loans and receivables*

Loans and receivables (including trade and other receivables, amounts due from related companies and bank deposits) are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables are carried at amortized cost using the effective interest method, less any identified impairment losses. An impairment loss is recognized in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognized, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated or not classified as any of the other categories. At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognized in equity, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognized in equity is removed from equity and recognized in profit or loss. Any impairment losses on available-for-sale financial assets are recognized in profit or loss. Impairment losses on available-for-sale equity investments will not reverse through profit or loss in subsequent periods. For available-for-sale debt investments, impairment losses are subsequently reversed if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

For available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, they are measured at cost less any identified impairment losses at each balance sheet date subsequent to initial recognition. An impairment loss is recognized in profit or loss when there is objective evidence that the asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount of the asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses will not reverse in subsequent periods.

Financial liability and equity

Financial liabilities and equity instruments by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

Financial liabilities

Financial liabilities including bank and other borrowings, trade, bills and other payables and amounts due to related parties are subsequently measured at amortized cost, using the effective interest rate method.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Convertible loan notes

Convertible loan notes are regarded as compound instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is determined using the prevailing market interest rate of similar non-convertible debts. The difference between the proceeds of issue of the convertible loan notes and the fair value assigned to the liability component, representing the embedded call option for the holder to convert the loan notes into equity of the Company, is included in equity.

In subsequent periods, the liability component of the convertible loan notes is carried at amortized cost using the effective interest method. The equity component, represented by the option to convert the liability component into ordinary shares of the Company, will remain in equity reserve until the embedded option is exercised (in which case the balance stated in equity reserve will be transferred to share premium). Where the option remains unexercised at the expiry date, the balance stated in equity reserve will be released to the retained earnings. No gain or loss is recognized in profit or loss upon conversion or expiration of the option.

Transaction costs that relate to the issue of the convertible loan notes are allocated to the liability and equity components in same proportion of the allocation of the proceeds. Transaction costs relating to the equity component are charged directly to equity. Transaction costs relating to the liability component are included in the carrying amount of the liability portion and amortized over the period of the convertible loan notes using the effective interest method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct costs of issuance.

4. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future and other key sources of uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment loss recognized in respect of trade receivables

The policy for allowance of bad and doubtful debts of the Group based on the evaluation of collectability and aging analysis of accounts and on management's estimate. In determining whether impairment is required, the Group takes into consideration the aging status and likelihood of connection, specific allowance is only made for receivable that are unlikely to be collected and is recognized on the difference between the estimated future cash flow expected to receive discounted using the original effective interest rate and the carrying value.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

4. KEY SOURCES OF ESTIMATION UNCERTAINTY *(Continued)***Impairment loss on goodwill**

Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual cash flows are less than expected, a material impairment loss may arise. As at December 31, 2005, the carrying amount of goodwill is approximately RMB181 million. Details of the recoverable results are disclosed in note 13.

Allowances for inventories

The management of the Group reviews inventories on a product-by-product basis at each balance sheet date, and makes allowance for obsolete and slow-moving inventory items identified that are no longer suitable for use in production. The management estimates the net realizable value for such finished goods and work-in progress based primarily on the latest invoice prices and current market conditions.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include borrowings, trade receivables, trade payables and bank deposits. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Interest rate risk

The Group's exposure to fair value interest rate risk relates primarily to the fixed rate bank and other borrowings. The Group has not entered into any interest rate hedging contracts. This directors monitor the Group's exposure on going basis and will consider hedging interest rate risk should the need arise.

Foreign currency risk

The Group's exposure to foreign currency risk related primarily to the turnover and costs that denominated in US dollars. The Group has not entered into any forward contracts to hedge the exposures. The directors monitor the Group's exposure on going basis and will consider hedging the currency risk should the need arise.

Credit risk

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of impairment loss on trade receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment.

In addition, more than 30% of the Group's sales is attributable to five major customers and therefore the Group has concentration of credit risk arisen from exposure to certain major customers.

The Group trades only with recognized creditworthy third parties. It is Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

Credit risk *(Continued)*

During the year, the Group maintained export credit insurance to protect the Group against the risk that the overseas customers may default settlement.

The credit risk on bank deposits is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies.

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and the flexibility through the use of bank and other borrowings. After the initial public offering of the Company's shares, the cash flow of the Group has been improved.

6. SEGMENT INFORMATION

For management purposes, the Group is currently organized into four operating divisions. These divisions are the basis on which the Group reports its primary segment information.

Business segment

During the year, the Group has presented its business by the following segments:

- Upholstered furniture, comprising leather and fabric upholstered furniture and furniture covers;
- Furniture leather;
- Automotive leather;
- Leather garments; and
- Others (including sale of wooden frame and others)

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

6. SEGMENT INFORMATION (Continued)

Segment information about these business is presented below:

Consolidated Income Statement

	Upholstered furniture	Furniture leather	Automotive leather	Leather garments	Others	Eliminations	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
2005							
Turnover							
External sales	2,755,003	593,121	126,907	-	426	-	3,475,457
Inter-segment sales	640,091	1,599,461	-	-	98,347	(2,337,899)	-
2004							
Turnovers							
External sales	2,033,173	491,839	127,451	130,811	69,117	-	2,852,391
Inter-segment sales	434,550	1,238,044	73	4,087	519,465	(2,196,219)	-

Inter-segment sales are charged at prevailing market prices.

	Year ended December 31,	
	2005	2004
	RMB'000	RMB'000
Result		
Segment result		
- Upholstered furniture	317,237	255,551
- Furniture leather	41,993	47,263
- Automotive leather	9,200	11,005
- Leather garments	-	13,044
- Others	(2,477)	10,141
	365,953	337,004
Unallocated corporate income	49,891	24,634
Unallocated corporate expenses	(23,145)	(12,056)
(Loss) gain on disposals of subsidiaries	(1,380)	3,013
Share of loss of an associate	(1,114)	-
Finance costs	(111,540)	(95,419)
Profit before taxation	278,665	257,176
Taxation	(18,311)	(22,646)
Profit for the year	260,354	234,530

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

6. SEGMENT INFORMATION (Continued)**Other Information**

	Year ended December 31,	
	2005	2004
	RMB'000	RMB'000
Impairment loss recognized in respect of trade and other receivables		
– Upholstered furniture	2,152	7,742
– Furniture leather	1,718	140
– Automotive leather	1,343	1,271
– Leather garments	–	454
– Others	417	361
	5,630	9,968
Allowances for inventories		
– Upholstered furniture	306	1,489
– Furniture leather	3,226	30,659
– Leather garments	–	125
	3,532	32,273
Capital additions		
– Upholstered furniture	124,801	446,823
– Furniture leather	66,600	195,300
– Automotive leather	23,339	555
– Leather garments	–	1,480
– Others	16,728	579
– Unallocated corporate items	–	94,821
	231,468	739,558
Depreciation and amortization		
– Upholstered furniture	37,235	16,179
– Furniture leather	43,024	30,333
– Automotive leather	1,857	64
– Leather garments	–	345
– Others	5,583	3,805
– Unallocated corporate items	–	10,542
	87,699	61,268

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

6. SEGMENT INFORMATION (Continued)**Balance Sheets**

	As at December 31,	
	2005	2004
	RMB'000	RMB'000
ASSETS		
Segment assets		
– Upholstered furniture	1,741,547	1,111,436
– Furniture leather	1,600,250	1,635,120
– Automotive leather	177,704	110,428
– Leather garments	–	28,676
– Others	82,598	34,227
Unallocated corporate assets	839,591	1,117,057
	4,441,690	4,036,944
LIABILITIES		
Segment liabilities		
– Upholstered furniture	525,898	227,827
– Furniture leather	206,128	236,496
– Automotive leather	12,204	71,684
– Leather garments	–	6,328
– Others	39,762	19,149
Unallocated corporate liabilities	1,359,832	2,274,084
	2,143,824	2,835,568

Geographical segments

Most of the identifiable assets of the Group are located in the PRC.

The following table provides an analysis of the Group's sales by geographical market:

	2005	2004
	RMB'000	RMB'000
United States	2,383,797	1,915,701
PRC, including Hong Kong	727,001	637,763
Russia	563	131,742
Europe	119,709	89,659
Australia	187,543	70,427
Others	56,844	7,099
	3,475,457	2,852,391

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

7. OTHER INCOME

Details of other income are as follows:

	2005 RMB'000	2004 RMB'000
Government grants		
Grants for technology development	180	5,918
Grants for export sales	6,786	3,031
Incentive for business development in Zhejiang Province	4,500	15,444
Other grants	928	2,000
	12,394	26,393
Sales of raw materials	29,765	138,868
Interest income	7,487	4,106
Discounts on acquisition of an additional interest in a subsidiary/Release of negative goodwill on acquisition of subsidiaries	5,300	518
Value added tax refund	-	13,903
Others	7,339	6,107
	62,285	189,895

During the year, the Group received government grants of RMB717,117 (2004: RMB25,007,000) which are related to the prepaid lease payment made by the Group for interest in land use rights. The amounts have been deducted from the prepaid lease payment.

8. FINANCE COSTS

	2005 RMB'000	2004 RMB'000
Interest on:		
Bank borrowings wholly repayable within five years	94,245	77,340
Other borrowings wholly repayable within five years	3,536	2,975
Other borrowings not wholly repayable within five years	510	205
Convertible loan notes	13,249	14,899
	111,540	95,419

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

9. PROFIT BEFORE TAXATION

Profit before taxation has been arrived at after charging (crediting):

	2005	2004
	RMB'000	RMB'000
Amortization of intangible assets (included in administrative expenses)	225	113
Depreciation of property, plant and equipment	87,474	61,155
Total depreciation and amortization	87,699	61,268
Auditors' remuneration	3,620	2,255
Cost of sales of raw materials (included in other expenses)	18,230	128,163
Impairment loss recognized in respect of trade and other receivables	5,630	9,968
(Gain) loss on disposal of property, plant and equipment	(26)	833
Operating lease rentals in respect of land and buildings	1,878	1,290
Net foreign exchange losses	15,263	3,018
Release of prepaid lease payment	3,436	3,201
Research, design and product development	26,399	10,630
Allowances for inventories	3,532	32,273
Total employee benefit expenses	237,063	190,221

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

10. DIRECTORS AND EMPLOYEES' REMUNERATION

The emoluments paid or payable to the directors were as follows:

2005

	Zhu Zhangjin ("Mr. Zhu") RMB'000	Zhou Xiaosong RMB'000	Zhu Jianqi RMB'000	Sun Qiang Chang RMB'000	Lu Yungang RMB'000	Chow Joseph RMB'000	Shi Zhengfu RMB'000	Jiang Jianzhong RMB'000	Total RMB'000
Fees	-	-	-	-	-	-	-	-	-
Other emoluments									
Salaries and other benefits	220	196	196	-	-	-	-	95	707
Contributions to retirement benefits schemes	2	2	2	-	-	-	-	11	17
Total emoluments	222	198	198	-	-	-	-	106	724

2004

	Mr. Zhu RMB'000	Zhou Xiaosong RMB'000	Zhu Jianqi RMB'000	Sun Qiang Chang RMB'000	Lu Yungang RMB'000	Chow Joseph RMB'000	Shi Zhengfu RMB'000	Jiang Jianzhong RMB'000	Total RMB'000
Fees	-	-	-	-	-	-	-	-	-
Other emoluments									
Salaries and other benefits	100	88	88	-	-	-	-	74	350
Contributions to retirement benefits schemes	2	2	2	-	-	-	-	26	32
Total emoluments	102	90	90	-	-	-	-	100	382

Note: Mr. Jiang Jianzhong was resigned as director on June 17, 2005.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

10. DIRECTORS AND EMPLOYEES' REMUNERATION (Continued)

Of the five individuals with the highest emoluments in the Group, three (2004: four) were directors of the Company whose emoluments are included in the disclosures as above. The emoluments of the remaining individuals was as follows:

	2005 RMB'000	2004 RMB'000
Basic salaries and other benefits	650	169
Contributions to retirement benefits schemes	14	8
	664	177

The emoluments of each of the five highest paid individuals are less than HK\$1,000,000 (equivalent to approximately RMB1,040,000) for the year.

During the year, no emoluments were paid by the Group to the directors and five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

11. TAXATION

	2005 RMB'000	2004 RMB'000
Hong Kong Profits Tax		
– current year	718	–
– under-provision in previous year	425	–
PRC enterprise income tax		
– current year	19,504	22,646
– over-provision of income tax	(2,336)	–
	18,311	22,646

Hong Kong Profits Tax is calculated at 17.5% of estimated assessable profit for the year.

PRC enterprise income tax is calculated at the applicable rates to the PRC subsidiaries. Certain subsidiaries of the Company operating in the PRC are eligible for certain tax holidays and concessions and were exempted from PRC income taxes for the year ("Tax Holidays").

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

11. TAXATION (Continued)

The taxation for the year can be reconciled to the profit before taxation per the consolidated income statement as follows:

	2005 RMB'000	2004 RMB'000
Profit before taxation	278,665	257,176
Tax rate applicable to the major operation of the Group	26.4%	26.4%
Tax at the applicable rate	73,568	67,894
Tax effect of income not taxable for tax purpose	(1,460)	(138)
Tax effect of expenses/losses not deductible for tax purpose	3,129	3,931
Tax effect of deferred tax assets not recognized	147	–
Tax effect of tax losses not recognized	6,406	9,897
Tax effect of share of result of an associate	294	–
Utilization of tax loss previously not recognized	(1,464)	–
Effect of Tax Holidays	(61,184)	(57,463)
Tax effect of different tax rates of subsidiaries operating with different tax regulations in the PRC and in Hong Kong	786	(1,475)
Over-provision in previous years	(2,336)	–
Under-provision in previous years	425	–
Taxation for the year	18,311	22,646

At December 31, 2005, the Group has unused tax losses of approximately RMB32,041,000 (2004: RMB45,432,000) available to offset against future profits. The unrecognized tax losses can be utilized to offset against future profits within five years from the date of incurrence.

In the opinion of the directors of the Company, no deferred tax asset has been recognized in 2005 and 2004 as the effect to the Group's financial statement was immaterial.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

12. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share attributable to the equity holders of the Company is based on the following data:

Earnings

	2005	2004
	RMB'000	RMB'000
Earnings for the purposes of basic earnings per share, being profit attributable to equity holders of the Company	265,699	225,701
Effect of dilutive potential ordinary shares: Interest on convertible loan notes	13,249	14,899
Earnings for the purposes of diluted earnings per share	278,948	240,600

Number of shares

	2005	2004
Weighted average number of ordinary shares for the purposes of basic earnings per share	645,419,597	476,675,977
Effect of dilutive potential ordinary shares: Convertible loan notes	179,512,056	207,951,216
Weighted average number of ordinary shares for the purposes of diluted earnings per share	824,931,653	684,627,193

The weighted average number of ordinary shares for the purpose of calculating basic and diluted earnings per share attributable to the equity holders of the Company for the year has been retrospectively adjusted for the effect of the share consolidation completed during the year.

13. GOODWILL

	RMB'000
GROSS AMOUNT	
At January 1, 2004	–
Arising on acquisition of an additional interest in subsidiaries during the year ended December 31, 2004	181,006
At December 31, 2004 and December 31, 2005	181,006

Goodwill arose from the Group's acquisition of SFT International Pty. Ltd. ("SFT") in September 2004 (see note 32).

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. Before recognition of impairment losses, the carrying amount of goodwill had been allocated under 'upholstered furniture' segment and 'automotive leather' segment.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

13. GOODWILL (Continued)

	2005 RMB'000	2004 RMB'000
Upholstered furniture	176,899	176,899
Automotive leather	4,107	4,107
	181,006	181,006

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next three years and extrapolates cash flows for the following five years based on an estimated growth rate of 10%. This rate does not exceed the average long-term growth rate for the relevant markets. The rate used to discount the forecast cash flows is 5%.

The directors considered no impairment loss on goodwill is necessary at December 31, 2005.

14. NEGATIVE GOODWILL

	RMB'000
GROSS AMOUNT	
At January 1, 2004 and at December 31, 2004	5,186
RELEASED TO INCOME	
At January 1, 2004	273
Released to income	518
At December 31, 2004	791
CARRYING AMOUNT	
At December 31, 2004	4,395
Derecognized upon the application of IFRS	(4,395)
At January 1, 2005	-

Prior to January 1, 2005, the negative goodwill was released to income on a straight line basis over ten years.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

15. PROPERTY, PLANT AND EQUIPMENT

	Buildings RMB'000	Plant and equipment RMB'000	Motor vehicles RMB'000	Furniture, fixtures and equipment RMB'000	Construction in progress RMB'000	Total RMB'000
COST						
At January 1, 2004	253,181	237,159	16,509	21,970	269,320	798,139
Additions	37,007	174,098	9,503	11,700	506,489	738,797
Disposals	(13)	(4,512)	(17)	(192)	(17,632)	(22,366)
Disposal of subsidiaries	(139,539)	(48,306)	(3,611)	(1,298)	(35,541)	(228,295)
Transfers	540,821	22,002	206	1,380	(564,409)	–
At January 1, 2005	691,457	380,441	22,590	33,560	158,227	1,286,275
Additions	12,923	77,539	4,076	14,187	122,346	231,071
Disposals	(11,262)	(8)	–	–	–	(11,270)
Transfers	190,571	17,186	162	18	(207,937)	–
At December 31, 2005	883,689	475,158	26,828	47,765	72,636	1,506,076
DEPRECIATION						
At January 1, 2004	26,525	55,661	6,941	5,578	–	94,705
Provided for the year	22,567	30,900	3,321	4,367	–	61,155
Disposal of subsidiaries	(6,990)	(7,751)	(769)	(222)	–	(15,732)
Eliminated on disposals	–	(644)	(4)	(117)	–	(765)
At January 1, 2005	42,102	78,166	9,489	9,606	–	139,363
Provided for the year	38,133	37,751	3,838	7,752	–	87,474
Eliminated on disposals	(1,991)	–	–	–	–	(1,991)
At December 31, 2005	78,244	115,917	13,327	17,358	–	224,846
CARRYING AMOUNTS						
At December 31, 2005	805,445	359,241	13,501	30,407	72,636	1,281,230
At December 31, 2004	649,355	302,275	13,101	23,954	158,227	1,146,912

The buildings are located on the land leased under medium-term land use rights in the PRC.

The above items are depreciated on a straight line basis at the following rates per annum:

Buildings	shorter of the lease term or useful life
Plant and machinery	10-15 years
Motor vehicles	5 years
Furniture, fixtures and equipment	5-10 years

Construction in progress are not depreciated until completion of construction and are ready for their intended use.

The Group has pledged its buildings with a net book value of approximately RMB486,878,000 (2004: RMB209,150,000) to secure general banking facilities granted to the Group.

As at December 31, 2005, the title deeds of the buildings in amount of RMB49 million (2004: RMB475 million) has not been obtained. The directors believe that the relevant title deeds will be granted in the due course and the absence of official certificate does not impair the value of the relevant properties of the Group.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

16. PREPAID LEASE PAYMENTS

The prepaid lease payments made by the Group are interest in land use rights under medium-term lease in the PRC and an amount of approximately RMB87,144,000 (2004: RMB27,575,000) had pledged to banks to secure the borrowings of the Group granted by the banks.

	2005 RMB'000	2004 RMB'000
Analysed for reporting purposes as:		
Non-current asset	142,812	140,801
Current asset	3,543	3,436
	146,355	144,237
	2005 RMB'000	2004 RMB'000
Without title deeds	17,911	30,864
With temporary title deeds	9,500	86,433
With formal title deeds	118,944	26,940
	146,355	144,237

The directors believe that the relevant title deeds will be granted to the Group in due course.

17. INTANGIBLE ASSETS

	RMB'000
COST	
At January 1, 2004	316
Additions	761
At January 1, 2005	1,077
Additions	397
At December 31, 2005	1,474
ACCUMULATED AMORTIZATION	
At January 1, 2004	59
Provided for the year	113
At January 1, 2005	172
Provided for the year	225
At December 31, 2005	397
CARRYING AMOUNT	
At December 31, 2005	1,077
At December 31, 2004	905

Intangible assets represent expenditure incurred for development of computer softwares and are amortized over five years.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

18. INTEREST IN AN ASSOCIATE

The interest in an associate represents a 25% interest in 海寧美景海綿有限公司(Future Foam Asia, Inc.) ("Future Foam"), an equity joint venture established in the PRC in 2004. The associate was established for the principal purpose of manufacturing foam used in sofa production and has commenced business in 2005.

	2005 RMB'000	2004 RMB'000
Cost of investment in associates	10,241	5,173
Share of post-acquisition loss	(1,114)	–
	9,127	5,173
Summarized financial information relating to the associate		
Total assets	59,664	28,455
Total liabilities	(23,156)	(5)
Net assets	36,508	28,450
Group's share of net assets of associates	9,127	5,173
Revenue	6,639	–
Loss for the year	(4,456)	–
Group's share of associate's loss for the year	(1,114)	–

19. INTEREST IN A JOINTLY CONTROLLED ENTITY

The interest in a jointly controlled entity represents a 50% interest in 海寧市卡森 - 美如可思皮革有限公司 (Haining City Kasen-Melx Leather Co., Ltd.) ("Kasen-Melx"), an equity joint venture established in the PRC. The jointly controlled entity was established for the principal purpose of trading leather and other furniture products and has commenced business in August 2005.

Jointly controlled entity is accounted for using the equity method of accounting:

	2005 RMB'000	2004 RMB'000
Cost of unlisted investments in jointly controlled entities	811	–

The jointly controlled entity had a loss of approximately RMB8,000 since date of incorporation to December 31, 2005.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

20. AVAILABLE-FOR-SALE INVESTMENTS

The amount represents investments in unlisted equity securities issued by private entities incorporated in the PRC. As a range of reasonable fair value estimates is so significant, the directors of the Company are of the opinion that the fair value of these investments cannot be measured reliably. The amount is measured at cost less impairment at each balance sheet date.

During the year, an amount of approximately RMB2,100,000 of investments had been disposed of by the Group and the gain on disposal was approximately RMB305,000.

21. INVENTORIES

	2005 RMB'000	2004 RMB'000
Raw materials	389,974	377,089
Work in progress	823,296	866,750
Finished goods	165,572	148,899
	1,378,842	1,392,738

22. TRADE AND OTHER RECEIVABLES

	2005 RMB'000	2004 RMB'000
Trade receivables	549,341	296,908
Less: accumulated impairment loss	(34,908)	(26,360)
	514,433	270,548
Prepayments	154,247	108,018
Other receivables	136,490	163,323
Less: accumulated impairment loss	(9,505)	(12,423)
	795,665	529,466

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

22. TRADE AND OTHER RECEIVABLES (Continued)

The Group grants a credit period predominantly ranging from 30 days to 90 days to their trade customers. The aging analysis of trade receivables is as follows:

	2005 RMB'000	2004 RMB'000
Aged:		
Within 60 days	355,407	226,629
60-90 days	51,342	12,903
91-180 days	63,429	18,189
181-365 days	43,139	11,344
1-2 years	1,116	1,483
Total trade receivables, net of impairment loss	514,433	270,548

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

23. HELD FOR TRADING INVESTMENTS

	2005 RMB'000	2004 RMB'000
Equity securities listed in the PRC, at fair value	-	3,505

The fair values have been determined by reference to bid prices quoted in active markets.

The equity securities had been disposed of in 2005.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

24. AMOUNTS DUE FROM (TO) RELATED COMPANIES

Details of the amounts due from (to) related companies are as follows:

Name of related companies	Notes	2005 RMB'000	2004 RMB'000
(a) Operating in nature			
海寧宇潔物資回收有限公司 Haining Yujie Material Recycling Co., Ltd. ("Yujie")	(i), (ii)	2,705	14,355
伊犁霍爾果斯皮革有限公司 Yili Horgos Leather Co., Ltd. ("Yili Horgos")	(i), (ii), (iii)	(47,219)	1,521
白銀卡森皮革有限公司 Baiyin Kasen Leather Co., Ltd. ("Baiyin Kasen")	(i), (ii), (iii)	(2,130)	(37,118)
克孜勒蘇新蓉皮革有限公司 Kezilesu Xinrong Leather Co., Ltd. ("Kezilesu Xinrong")	(i), (ii), (iii)	(848)	3,832
白銀白利斯皮革有限公司 Baiyin Palace Leather Co. Ltd. ("Baiyin Palace")	(i), (iii)	-	591
Starcorp Corporation Pty. Ltd ("Starcorp")	(i), (ii)	17,963	3,083
Kasen UK Co. Ltd.	(iv)	-	2,985
海寧萬盛絲綢噴織有限公司 Haining Wansheng Silk Weaving Co., Ltd. ("Wansheng Silk")	(ii), (vi)	(5,960)	(9,971)
上海森橋皮業有限公司 Shanghai Sunbridge Leather Industry, Co., Ltd. ("Sunbridge Leather")	(i)	-	5,431
Future Foam	(ii)	(3,532)	-
Kasen-Melx	(ii)	(339)	-
上海思達傢俱有限公司(Shanghai Star Furniture Co., Ltd)	(i), (ii)	(259)	-
(b) Non-operating in nature			
周慧敏	(v), (vii)	59	-
孫時良	(v), (vii)	526	-
浙江森橋實業集團有限公司 Zhejiang Sunbridge Industrial (Group) Co., Ltd. ("Sunbridge")	(iv)	-	141,997
海寧富華皮件有限公司 Haining Fuhua Leather Co., Ltd. ("Haining Fuhua")	(vi)	-	(13,000)
海寧長虹進出口有限公司 Haining Changhong Import and Export Co., Ltd. ("Changhong I&E")	(vi)	-	(5,620)
海寧長虹皮件有限公司 Haining Changhong Leather Co., Ltd. ("Changhong Leather")	(vi)	-	(8,580)
		(39,034)	99,506
Represented by:			
Amounts due from related companies, included in current assets		21,253	173,795
Amounts due to related companies, included in current liabilities		(60,287)	(74,289)
		(39,034)	99,506

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

24. AMOUNTS DUE FROM (TO) RELATED COMPANIES (Continued)

(c) Aging of amounts due from (to) related companies in operating nature is as follows:

	2005		2004	
	Amounts due from related companies RMB'000	Amounts due to related companies RMB'000	Amounts due from related companies RMB'000	Amounts due to related companies RMB'000
Aging:				
Within 60 days	4,588	(14,484)	24,310	(12,661)
60 – 90 days	3,900	(544)	1,084	(10,680)
91 – 180 days	12,100	(45,259)	3,944	(18,138)
181 – 365 days	80	–	2,460	(5,610)
	20,668	(60,287)	31,798	(47,089)

Details of the operating transactions with the related parties are set out in note 39.

Notes:

- (i) Mr. Zhu has influence and beneficial interests in these companies through Sunbridge.
- (ii) The amounts are unsecured, interest-free and repayable according to the credit terms.
- (iii) The companies ceased to be subsidiaries of the Company since December 2004.
- (iv) Mr. Zhu has influence and beneficial interests in these companies.
- (v) The individuals are directors of the non-wholly owned subsidiaries of the Company.
- (vi) A director of a non-wholly owned subsidiary has influence and beneficial interests in these companies.
- (vii) The amounts are unsecured, interest-free and repayable on demand.

The directors consider that the carrying amount of amounts due from (to) related companies approximates their fair value.

25. BANK BALANCES AND CASH**(a) Pledged bank deposits**

The amount mainly represents deposits pledged 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%. The pledged bank deposits will be released upon the settlement of relevant bills payables and bank borrowings. The fair value of the bank deposits at December 31, 2005 approximates the carrying amount.

(b) Bank balances and cash

Bank balances and cash comprised of bank deposits with short maturity at market interest rate and cash on hand.

The fair value of the bank balances and cash at December 31, 2005 approximates the carrying amount.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

26. TRADE, BILLS AND OTHER PAYABLES

The aging analysis of trade payables is as follows:

	2005 RMB'000	2004 RMB'000
Aged:		
Within 60 days	321,512	339,688
60-90 days	33,685	61,320
91-180 days	49,869	40,140
181-365 days	15,974	12,032
1-2 years	6,643	6,160
Over 2 years	3,206	630
Total trade payables	430,889	459,970
Bills payables (note)	183,403	214,838
Other payables and accrued liabilities	169,700	198,574
	783,992	873,382

Note:

The aging analysis of bills payable is follows:

	2005 RMB'000	2004 RMB'000
Aged:		
Within 60 days	81,026	214,838
60-90 days	58,959	–
91-180 days	43,418	–
	183,403	214,838

During the year of 2003, the local government paid approximately RMB53 million to the Group for the construction of certain infrastructure and public facilities on local government's behalf in a location which is under-developed. The Group applied the amount received from the government to the construction of such facilities and entered into various construction contracts. Up to December 31, 2005, the Group recorded a balance of approximately RMB21 million which had not been utilized in the constructions and was included in other payables and accrued liabilities. Details of the capital commitments of the Group relating to the construction contracts at the balance sheet dates are set out in note 38.

The directors consider that the carrying amount of trade, bills and other payables approximates their fair value.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

27. BANK AND OTHER BORROWINGS

	2005 RMB'000	2004 RMB'000
Bank borrowings	1,281,338	1,564,917
Other borrowings	10,400	10,400
Total	1,291,738	1,575,317
Analyzed as:		
Secured	502,038	202,470
Unsecured	789,700	1,372,847
	1,291,738	1,575,317
Denominated in United States Dollars ("US dollars")	94,246	53,383
Denominated in Renminbi ("RMB")	1,197,492	1,521,934
	1,291,738	1,575,317
The bank and other borrowings are repayable as follows:		
Within one year or on demand	1,191,246	1,472,825
In the one to second year	90,092	2,000
In the second to third year	–	90,092
After five years	10,400	10,400
	1,291,738	1,575,317
Less: Amount due within one year shown under current liabilities	(1,191,246)	(1,472,825)
Amount due after one year	100,492	102,492

All the bank borrowings of the Group are fixed-rate borrowings and carry interests ranging from 4% to 8% per annum.

Other borrowings represent loans advanced by independent third parties and carry fixed interests of 2.55% per annum.

The borrowings were guaranteed by group companies, related parties and independent third parties and were also secured by the assets owned by the Group. Details of the assets pledged by the Group and the corporate guarantees given by related parties in favour of the Group's borrowings are set in notes 36 and 39(b), respectively.

The directors consider that the carrying amount of bank and other borrowings approximates their fair value.

According to the loan agreement with Citic Ka Wah Bank Limited, Orix Asia Limited and China Citic Bank, Hangzhou Branch (hereinafter refer to as "the Lenders") dated on December 30, 2005, the Lenders provide a subsidiary of the Company a loan facility of up to an aggregate principal amount of HK\$125,000,000 with an annual interest rate of HIBOR plus 2%. The loan facility of HK\$125,000,000 has been fully drawn down in January 2006.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

28. CONVERTIBLE LOAN NOTES

In 2003 and 2004, the Company issued convertible loan notes and details of the notes are set out as follows:

Date of issue	Loan amount	Conversion price	Number of ordinary shares for conversion	Terms
July 2, 2003	US\$21,739,130.43	US\$0.1	217,391,304 ordinary shares (equivalent to 144,927,536 Consolidated Shares)	Due within one year
January 9, 2004	US\$15,000,000.00	US\$0.15	100,000,000 ordinary shares (equivalent to 66,666,667 Consolidated Shares)	Due within one year

The loan notes are converted into an aggregate of 317,391,304 Preferred Shares and ultimately to convert into an aggregate of 317,391,304 ordinary shares (equivalent to 211,594,203 Consolidated Shares) of the Company.

If the above loan notes have not been converted, they will be redeemed on the assigned date according to the agreements at par. The loan notes bear interest at a prime lending rate charged by a bank until repayment or the conversion of the entire loan amount.

Upon the maturity dates of the above loan notes, the Company and the loan notes holder had entered into supplemental extension agreements to extend the maturity dates.

On August 5, 2005, the Group and the loan notes holder entered into the supplemental agreement and the number of shares for conversion was changed from an aggregate of 317,391,304 ordinary shares (equivalent to 211,591,203 Consolidated Shares) to an aggregate of 386,959,713 ordinary shares (equivalent to 257,973,142 Consolidated Shares).

On October 20, 2005, the Company completed the loans notes conversion and were converted into an aggregate of 257,973,142 Consolidated Shares of US\$0.00015 each and credited as fully paid. (see note 29(ix))

According to the terms of the loan notes, upon conversion of the loan amount, any accrued but unpaid interest on the loan notes shall cease to be payable. Upon conversion, the accrued but unpaid interest, included in the other payables, amounted to approximately US\$3,942,000 (equivalent to approximately RMB32,823,000) and had credited as share premium of the Company.

The convertible loan notes contain two components, liability and equity elements. The convertible loan notes were split between the liability and equity elements upon issue. The equity element is presented in equity heading "equity reserve".

The movement of the liability component of the convertible loan notes for the year is set out below:

	2005 RMB'000	2004 RMB'000
Liability component at the beginning of the year	304,934	304,934
Converted into ordinary shares	(304,934)	-
	-	304,934

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

29. SHARE CAPITAL

	Number of ordinary shares	Number of series A preferred shares	Number of series B preferred shares	US\$'000
Authorized share capital of the Company				
At January 1, 2004	399,782,608,696	217,391,304	–	40,000
Changes during the year ended December 31, 2004 (note vi)	(100,000,000)	–	100,000,000	–
At January 1, 2005	399,682,608,696	217,391,304	100,000,000	40,000
Shares consolidation (note vii)	(133,227,536,232)	–	–	–
Shares re-designation and re-classification (note x)	211,594,202 ^{2/3}	(217,391,304)	(100,000,000)	–
At December 31, 2005	266,666,666,666^{2/3}	–	–	40,000

	Number of ordinary shares	Number of series A preferred shares	Number of series B preferred shares	Equivalent to
				US\$ RMB'000
Issued and fully paid ordinary shares of the Company				
At January 1, 2004	231,095,052	–	–	23,110 192
Issued during the year ended December 31, 2004	598,799,678	–	–	59,880 497
At January 1, 2005	829,894,730	–	–	82,990 689
Shares consolidation (note vii)	(276,631,577)	–	–	– –
Issued upon conversion of convertible loan notes	–	176,693,933	81,279,209	38,696 321
Conversion of preference shares to ordinary shares (note ix)	257,973,142	(176,693,933)	(81,279,209)	– –
Issued on public floatation (note x)	202,809,074	–	–	30,421 246
At December 31, 2005	1,014,045,369	–	–	152,107 1,256

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

29. SHARE CAPITAL (Continued)

During the year, the changes in share capital of the Company are as follows:

- (i) On January 21, 2004, 16,666,666 ordinary shares of US\$0.0001 each were allotted and issued to investors for US\$2,500,000.
- (ii) On September 16, 2004, 362,319 ordinary shares of US\$0.0001 were allotted and issued to a then employee for US\$36,232.
- (iii) On September 16, 2004, 144,025,170 ordinary shares of US\$0.0001 were allotted and issued to Mr. Zhu for acquisition of a subsidiary.
- (iv) On September 16, 2004, 16,666,667 ordinary shares of US\$0.0001 were allotted and issued to Mr. Zhu for assumption of a loan of US\$2,500,000 which was originally owed by the Group to SFT which Mr. Zhu has beneficial interests.
- (v) On September 16, 2004, 421,078,856 ordinary shares of US\$0.0001 were issued to the shareholders of Zhejiang Kasen Industrial Co., Ltd., a subsidiary of the Company at an aggregate consideration of US\$20,485,160 for the purpose of the group reorganization that completed at the same date.
- (vi) On September 28, 2004, the authorized share capital of the Company was further amended by adoption of the second amended and restated memorandum of association through special resolution of members to US\$40,000,000 divided into 399,682,608,696 ordinary shares of US\$0.0001 each and 217,391,304 series A Preferred Shares of US\$0.0001 each and 100,000,000 series B Preferred Shares of US\$0.0001 each ("collectively termed as "Preferred Shares").
- (vii) On September 24, 2005, every 1.5 ordinary shares in the capital of the Company of US\$0.0001 each were consolidated into 1 ordinary share of US\$0.00015 each ("Consolidated Share"). Such that the authorized share capital of the Company consisted of 266,455,072,464 ordinary shares of US\$0.00015 each, 217,391,304 series A Preferred Shares of US\$0.0001 each and 100,000,000 series B Preferred Shares of US\$0.0001 each.
- (viii) On September 26, 2005, a total of $5\frac{1}{3}$ ordinary shares of US\$0.00015 each arising from the share consolidation stated in (vii) above were transferred for free to an employee, of which $\frac{1}{3}$ share was immediately repurchased by the Company from that employee and then cancelled.
- (ix) On October 20, 2005, loans in the aggregate amount of US\$36,739,130.43 owing by the Company were converted into an aggregate of 317,391,304 Preferred Shares which were allotted to the loan notes holder conditionally upon the listing of Company's share in the Stock Exchange. All such Preferred Shares had been converted in full into an aggregate of 257,973,142 Consolidated Shares on the same date.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

29. SHARE CAPITAL *(Continued)*

- (x) On October 20, 2005, 202,809,074 Consolidated Shares were issued to the public at a price of approximately US\$0.327 (equivalent to HK\$2.55) for cash. The excess of the issued price over the par value of the Consolidated Shares was credited to share premium account of the Company. The authorized share capital of the Company was re-designated by the adoption of the third amended and restated memorandum of association through special resolution of members passed on September 24, 2005 as US\$40,000,000 divided into 266,666,666,666^{2/3} ordinary shares of US\$0.00015 each.

30. SHARE OPTION SCHEME

A share option scheme was adopted by the Company pursuant to a resolution passed on September 26, 2005 (the "Scheme") for the primary purpose of providing incentives to directors and eligible employees. The Scheme became effective on October 20, 2005 and the options issued pursuant to the Scheme will expire no later than 10 years from the date of grant of the option. Under the Scheme, the board of directors of the Company may grant options to any employees of the Company or any of its subsidiaries to subscribe shares of the Company.

For any options granted to directors, chief executives or substantial shareholders of the Company, options to be granted shall be approved by the independent non-executive directors (excluding any independent non-executive director who is the proposed grantee of options).

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company on October 20, 2005 (representing 101,404,536 shares of the Company) without prior approval from the Company's shareholders. The number of shares issued and to be issued in respect of options granted and may be granted to any individual in any one year is not permitted to exceed 1% of the total shares of the Company in issue at any point in time, without prior approval from the Company's shareholders.

The amount payable on acceptance of an option is HK\$1.00. The exercise price is determined by the directors of the Company, and will not be less than the higher of (i) the closing price of the Company's shares on the date of grant, (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share.

No share option has been granted during the year since the date of adoption of the Scheme.

Subsequent to the balance sheet date, 30,200,000 share options granted to certain directors and employees of the Group.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

31. STATUTORY AND SPECIAL RESERVES

- (a) The statutory reserve represents amounts appropriated from the profits after tax of certain subsidiaries of the Company established in the PRC to comply with the PRC laws and regulations.
- (b) The special reserve represents the difference between the nominal value of the share capital issued by the Company and the nominal value of the share capital of Zhejiang Kasen acquired pursuant to the reorganization completed in 2004.

32. PURCHASE OF SUBSIDIARIES

On September 16, 2004, the Group acquired a 100% interest in SFT from Mr. Zhu. SFT owned a number of equity investments in the subsidiaries of the Company and these subsidiaries are engaged in the business segment of upholstered furniture and automotive leather. These transactions have been accounted for by purchase method of accounting:

	2004 Fair value and carrying amount RMB'000
<hr/>	
Net assets acquired:	
Amount due from a related company	20,750
Trade and other payables	(81)
	<hr/>
	20,669
Minority interests, representing acquisition of additional interests in subsidiaries	85,613
Goodwill arising on acquisition	181,006
	<hr/>
	287,288
<hr/>	
Satisfied by:	
Issue of shares, at fair value (Note)	287,288
	<hr/>

Note: In connection with the acquisition of SFT from Mr. Zhu, the Company issued Mr. Zhu an aggregate of 160,691,837 ordinary shares, of which 16,666,667 ordinary shares were issued to exchange a loan of US\$2,500,000 which was originally owed by the Group to SFT. In determining the fair value of the 160,691,837 ordinary shares issued, an analysis of other publicly traded companies that are comparable to the Company was performed by the management. The estimation of fair value was primarily based on a market approach where prevailing market conditions as at of the date of issuance of the ordinary shares and in particular quoted prices for the shares of those comparable publicly traded companies were considered.

The subsidiaries acquired during the year ended December 31, 2004 contributed the profits attributable to equity holders of the Company of approximately RMB8,097,000.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

33. DISPOSAL OF SUBSIDIARIES

On November 11, 2004, the Group disposed of certain subsidiaries to Sunbridge. During the year, the Group disposed of its interests in SFT.

The net assets of the disposed subsidiaries at the date of disposal were as follows:

	2005	2004
	RMB'000	RMB'000
Property, plant and equipment	–	212,563
Prepaid lease payment	–	3,167
Amounts due from related companies	–	268
Inventories	–	98,311
Trade and other receivables	1,381	214,252
Bank balances and cash	–	71,587
Trade and other payables	–	(166,994)
Bank borrowings	–	(232,930)
	1,381	200,224
Minority interests	–	(7,690)
(Loss) gain on disposal	(1,380)	3,013
Total consideration	1	195,547
Satisfied by:		
Consideration receivable	1	195,547
Net cash outflow arising on disposal of subsidiaries:		
Cash consideration	–	–
Cash and cash equivalents disposed of	–	(71,587)
	–	(71,587)

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

34. MAJOR NON-CASH TRANSACTIONS

- (a) During the year ended December 31, 2005, the convertible loan notes holder exercised its rights to convert the entire convertible loan notes into preferred shares and immediately converted to ordinary shares of the Company. Details of the transaction are set out in note 28.
- (b) During the year ended December 31, 2004, the Company had issued an aggregate of 160,691,837 ordinary shares of US\$0.0001 to Mr. Zhu for the consideration of the acquisition of a 100% interest in SFT (see note 32).
- (c) During the year ended December 31, 2004, the Company had issued 362,319 ordinary shares of US\$0.0001 to a then employee at a consideration of approximately RMB301,000 as an employee benefit. The amount had included in the staff costs of the Group.

35. RETIREMENT BENEFITS PLAN

The Group contributes to a local municipal government retirement scheme for all qualifying employees in the PRC. The employer and its employees are each required to make contributions to the scheme at the rates specified in the rules. The only obligation of the Group with respect to the retirement scheme is to make the required contributions under the scheme.

In addition, the Group operates a Mandatory Provident Fund ("MPF") Scheme for its qualifying employees in Hong Kong. The assets of the MPF Scheme are held separately from those of the Group, in funds under the control of trustees. The Group contributes at the lower of HK\$1,000 or 5% of relevant payroll costs monthly to the MPF Scheme, which contribution is matched by employees.

The total cost charged to the consolidated income statement of approximately RMB8,273,000 (2004: RMB5,925,000) represents contributions payable to the above schemes by the Group in respect of the current accounting period. As at December 31, 2005, contributions of approximately RMB7,873,000 (2004: RMB4,774,000) due in respect of the reporting period had not been paid over to the above schemes.

36. PLEDGE OF ASSETS

At the balance sheet date, certain of the Group's assets have been pledged to secure the borrowings of the Group. The aggregate carrying amount of the assets of the Group at the balance sheet date is as follows:

	2005 RMB'000	2004 RMB'000
Prepaid lease payment	87,144	27,575
Buildings	486,878	209,150
Bank deposits	240,112	239,185
	814,134	475,910

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

37. LEASE ARRANGEMENTS**As lessee**

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2005 RMB'000	2004 RMB'000
Within one year	1,543	1,053
In the second to fifth year inclusive	1,440	188
	2,983	1,241

The lease payments represent rentals payable by the Group for certain of its office properties. Leases are negotiated for an average term of three years and rentals are fixed for an average of three years.

38. CAPITAL COMMITMENTS

At the balance sheet date, the Group had capital commitments as follows:

	2005 RMB'000	2004 RMB'000
Capital expenditure contracted for but not provided in the financial statements in respect of acquisition of property, plant and the equipment	6,656	108,365
Capital expenditure contracted for but not provided in the financial statements in respect of construction of certain infrastructure and public facilities in the PRC on behalf of the government (note 26)	20,991	33,200
	27,647	141,565

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

39. CONNECTED AND RELATED PARTY DISCLOSURES

Transactions between group companies have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below.

(a) The Group had the following significant transactions with the related parties during the year:

Related parties	Nature of transactions	Notes	2005 RMB'000	2004 RMB'000
Yili Horgos	Purchase by the Group		108,522	8,806
Baiyin Palace	Sales by the Group		10,273	1,130
	Sales of production wastes by the Group		151	–
Yujie	Sales of production wastes by the Group		11,369	8,739
Baiyin Kasen	Purchase by the Group		148,680	9,525
	Sales of production wastes by the Group		2,259	–
	Sales by the Group		–	1,976
Wansheng Silk	Interest expense charged to the Group		282	114
	Purchase by the Group		9,895	267
Starcorp	Sales by the Group		57,443	3,256
Sunbridge Leather	Sales by the Group		2,531	5,952
SFT	Interest expense charged to the Group		–	225
Changhong Leather	Interest expense charged to the Group		436	126
	Sales by the Group		269	–
Changhong I&E	Interest expense charged to the Group		299	65
Haining Fuhua	Interest expense charged to the Group		420	423
Sunbridge	Disposal of subsidiaries	(i)	–	181,997
	Disposal of property, plant and equipment		4,255	–

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

39. CONNECTED AND RELATED PARTY DISCLOSURES (Continued)

Related parties	Nature of transactions	Notes	2005 RMB'000	2004 RMB'000
Kezilesu Xinrong	Purchase by the Group		35,981	–
Future Foam	Purchase by the Group		4,946	–
Kasen-Melx	Expense charged to the Group Rental income charged by the Group		403 6	– –
Mr. Zhu	Acquisition of additional interests in subsidiaries	(ii)	–	287,288
Shanghai Star Furniture Co., Ltd.	Purchase by the Group	(iii)	852	10
浙江吉恩仕服装集團 進出口有限公司 Zhejiang Jeans Clothing Group Import & Export Co., Ltd.	Purchase by the Group Sales by the Group	(iv)	– –	32,242 5,149
海寧獵馬皮革服裝有限公司 Haining Liema Leather Garments Co., Ltd.	Purchase by the Group Sales by the Group	(v)	– –	159 4,833
上海捷恩傢俱有限公司 JCH Home Furnishings Co., Ltd.	Sales by the Group	(iv)	–	3,415
浙江森橋進出口有限公司 Zhejiang Sunbridge Import and Export Co., Ltd. ("Sunbridge IPE")	Sales by the Group	(iii)	–	4,769
Kasen UK Co. Ltd.	Sales by the Group	(iii)	–	8,293
上海星塋傢俱有限公司 Shanghai Xingying Furniture Co., Ltd.	Sales by the Group	(iii)	–	2,134

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

39. CONNECTED AND RELATED PARTY DISCLOSURES (Continued)

Notes:

- (i) Details of the transaction are set out in note 33.
 - (ii) Details of the transaction are set out in note 32.
 - (iii) Mr. Zhu has beneficial interests in these companies through Sunbridge.
 - (iv) During the year, the company ceased to be a related party of the Group.
 - (v) Director of a subsidiary of the Group has beneficial interest in this company.
- (b) Corporate guarantees given by the related companies in favour of the Group's borrowings:

	2005 RMB'000	2004 RMB'000
Wansheng Silk	8,000	2,500
孫建新 (Note)	30,000	–
Mr. Zhu and his spouse	–	30,000
	38,000	32,500

Note: 孫建新 is a director of a non-wholly owned subsidiary of the Group.

- (c) Details of the balances with the related parties are set out in note 24.
- (d) Details of guarantees given by the Group in favour of banking facilities extended to the third parties are set out in note 40.

40. CONTINGENT LIABILITIES

At the balance sheet date, the Group had the following contingent liabilities:

	2005 RMB'000	2004 RMB'000
Guarantees given to banks in respect of banking facilities extended to		
– Independent third parties	67,897	261,663
– Sunbridge I&E	–	33,000
– Yili Horgos	–	80,000
	67,897	374,663

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

41. BALANCE SHEET OF THE COMPANY

The balance sheet of the Company as at December 31, 2005 is as follows:

	Note	2005 RMB'000	2004 RMB'000
Non-current assets			
Property, plant and equipment		99	79
Investments in subsidiaries		377,038	654,350
Loans to subsidiaries		596,401	78,850
		973,538	733,279
Current assets			
Trade and other receivables		495	1,216
Amounts due from subsidiaries		–	61,193
Bank balances and cash		45,267	7,694
		45,762	70,103
Current liabilities			
Trade and other payables		10,499	19,605
Amounts due to subsidiaries		3,261	16,029
Convertible loan notes		–	304,934
Tax payable		425	–
		14,185	340,568
Net current assets (liabilities)		31,577	(270,465)
		1,005,115	462,814
Equity			
Share capital	(a)	1,256	689
Share premium	(a)	1,147,408	308,191
Contributed surplus	(a)	169,684	169,684
Exchange reserve	(a)	(14,460)	–
Equity reserve	(a)	–	1,291
Accumulated losses	(a)	(298,773)	(17,041)
		1,005,115	462,814

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

41. BALANCE SHEET OF THE COMPANY (Continued)

Note:

(a) Statement of movements in equity

	Share capital RMB'000	Share premium RMB'000	Contributed surplus RMB'000	Exchange reserve RMB'000	Equity reserve RMB'000	Accumulated losses RMB'000
At January 1, 2004	192	–	7	–	1,291	(5,856)
Issue of shares	15	21,036	–	–	–	–
Increase in share issue for Reorganization	349	–	169,677	–	–	–
Acquisition of a subsidiary	133	287,155	–	–	–	–
Loss for the year	–	–	–	–	–	(11,185)
At January 1, 2005	689	308,191	169,684	–	1,291	(17,041)
Issue of shares on public flotation	246	539,000	–	–	–	–
Transaction costs attributable to issue of new shares	–	(38,511)	–	–	–	–
Issue upon conversion of convertible loan notes	321	337,437	–	–	–	–
Transfer to share premium upon conversion of convertible loan notes	–	1,291	–	–	(1,291)	–
Exchange differences arising from translation of functional currency to presentation currency of the Company	–	–	–	(14,460)	–	–
Loss for the year	–	–	–	–	–	(281,732)
At December 31, 2005	1,256	1,147,408	169,684	(14,460)	–	(298,773)

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

42. PRINCIPAL SUBSIDIARIES

The following table lists the subsidiaries of the Company as at December 31, 2005 which, in the opinion of the directors, principally affected the results or net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

Name of the company	Country of incorporation/ establishment and operations	Issued and fully paid share capital/ registered capital	Attributable equity interest of the Company		Principal activities
			Direct %	Indirect %	
Haining Gaosheng Leather Co., Ltd. 海寧高盛皮革有限公司 (Note a)	PRC	RMB60,000,000	–	89	Production and processing of leather and tailored products
Haining Hainix Sofa Co., Ltd. 海寧吉恩仕沙發有限公司 (Note b)	PRC	US\$6,000,000	–	50.5	Production and sale of sofas, dining chairs and other furniture products
Haining Hengsen Furniture Co., Ltd. 海寧恒森傢俱有限公司 (Note a)	PRC	RMB30,000,000	–	100	Production of furniture and glass fiber reinforced plastic products; wood processing
Haining Hidea Furniture Co., Ltd. 海寧慧達傢俱有限公司 (Note b)	PRC	US\$5,000,000	–	50.5	Production and sale of sofas, dining chairs and other furniture products
Haining Higher Point Investment Development Co., Ltd. 海寧高點投資發展有限公司 (Note a)	PRC	RMB100,000,000	–	100	Investment holding
Haining Home Impression Furniture Co., Ltd. 海寧家美傢俱有限公司 (Note b)	PRC	US\$2,000,000	–	100	Production and sale of upholstered furniture
Haining Home Point Furniture Co., Ltd. 海寧家典傢俱有限公司 (Note b)	PRC	US\$5,000,000	–	100	Production and sale of upholstered furniture
Haining Kareno Furniture Co., Ltd. 海寧卡雷諾傢俱有限公司 (Note b)	PRC	US\$3,600,000	–	100	Production and sale of upholstered furniture
Haining Kasen Leather Co., Ltd. 海寧卡森皮革有限公司 (Note b)	PRC	US\$3,000,000	–	100	Production and sale of upholstered furniture

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

42. PRINCIPAL SUBSIDIARIES (Continued)

Name of the company	Country of incorporation/ establishment and operations	Issued and fully paid share capital/ registered capital	Attributable equity interest of the Company		Principal activities
			Direct %	Indirect %	
Haining Oyi May Sofa Co., Ltd. 海寧歐意美沙發有限公司 (Note b)	PRC	US\$5,000,000	–	50.5	Production and sale of upholstered furniture
Haining Schinder Tanning Co., Ltd. 海寧森德皮革有限公司 (Note b)	PRC	US\$1,000,000	–	100	Production and sale of automotive leather
Haining Wansheng Furniture Co., Ltd. 海寧萬盛沙發有限公司 (Note b)	PRC	US\$5,000,000	–	50.5	Production and sale of upholstered furniture
Haining Xieqiao Senbo Water Co., Ltd. 海寧市斜橋森博水務有限公司 (Note a)	PRC	RMB4,500,000	–	66.67	Collection and transportation of waste water
Richmond International Trading Limited 富華國際貿易有限公司 (Note a)	Hong Kong	HK\$100	–	100	Trading of leather and other furniture products
Shanghai La Kassa Furniture Co., Ltd. 上海禾美傢俱有限公司 (Note b)	PRC	US\$4,000,000	–	100	Production and sale of upholstered furniture
Zhejiang Kasen Industrial Co., Limited 浙江卡森實業有限公司 (Note c)	PRC	RMB896,240,000	–	100	Research, development, production and sales of furniture leather
Zhejiang Liema Furniture Co., Ltd. 浙江獵馬傢俬有限公司 (Note b)	PRC	US\$7,000,000	–	50.5	Production and sale of upholstered furniture

Notes:

- (a) The companies are limited liability companies.
- (b) The companies are Sino-foreign owned enterprises.
- (c) Zhejiang Kasen was established on June 12, 1995 in China as a domestic limited liability company, and was converted into a company limited by shares on August 24, 2001. On July 1, 2004, Zhejiang Kasen was converted to a sino-foreign joint venture enterprise. On August 9, 2004, Zhejiang Kasen became a sino-owned subsidiary of Kasen International Company Limited pursuant to the Reorganization.