Management Discussion and Analysis

Business Review

Turnover and Profit

To overcome the market challenges and competitions in last year, we committed to delivering excellent value for our customers by offering more product categories and enhancing the logistics services and inventory management. Turnover was approximately US$568.4 million, an increase of US$51.4 million from US$517.0 million compared with 2005. We weathered the softening U.S. economic environment and maintained the sales growth through organic growth and acquisition.

Gross profit margin decreased to 32.4% from 34.2% in 2005, mainly due to the change in product mix and increase in production costs.

Total operating expenses increased to US$84.4 million from US$81.5 million in 2005. The increase was primarily due to an increase in one-off legal and professional fee for handling the appeal on the U.S. Antidumping Duty Order.

Profit for the year increased to US$103.1 million from US$89.0 million in 2005. Net profit margin increased to 18.1% from 17.2% in 2005.

Acquisition

During the year, Craftmaster Furniture, Inc., a wholly-owned subsidiary of the Company, acquired the net operating assets of Craftmaster Furniture Corporation. The purchase of assets establishes the U.S. upholstery manufacturing facility for the Group, supplementing the Group's successful fully assembled imported upholstery program under Universal Furniture International, Inc. With the Group's expertise in sourcing upholstery products in China, the Group has the ability to enhance the upholstery product line by taking advantage of the benefits that China offers to U.S. upholstery manufacturing. The Group will also benefit from the acquisition by providing the Group's upholstery division with expanded special order capabilities through the acquired facilities.

Liquidity, Financial Resources and Capital Structure

As at 31 December 2006, the Group's cash and cash equivalents was US$135.6 million (31 December 2005: US$110.6 million), the bank borrowing was US$46.9 million (31 December 2005: nil) and the gearing ratio (total bank borrowings/shareholders' equity) was 10.7% (31 December 2005: nil).

Cash and cash equivalents held by the Group are mainly denominated in United States dollars, Renminbi and Hong Kong dollars. The bank borrowings are denominated in United States dollars, carry interest at floating rates and are repayable within five years.

Our sources of liquidity include cash and cash equivalents, cash from operations and general banking facilities granted to the Group. The Group intends to maintain strong and prudent liquidity for day-to-day operations and business development.

As substantially all of our turnover and most of our cost of sales are denominated in US dollars, we have not had any material foreign exchange gains or losses in connection with our operations.

The Group's current assets increased 8.9% to US$348.8 million compared with US$320.3 million in 2005 and the Group's current liabilities increased 43.3% to US$111.6 million compared with US$77.9 million in 2005.

The current ratio (current assets/current liabilities) was 3.1 times (2005: 4.1 times).

Management Discussion and Analysis (Cont'd)

Pledge of Assets

As at 31 December 2006, the Group's inventories of approximately US$10.8 million (2005: US$10.8 million) and trade and other receivables of approximately US$52.8 million (2005: US$57.0 million) had been pledged to banks to secure the general banking facilities granted to the Group.

Capital Expenditure

Capital expenditures increased to US$65.2 million from US$19.1 million in 2005 comprised of the purchase of property, plant and equipment. The increase was mainly due to the expansion of our production and warehouse capacity at our Dongguan and Jiashan facilities during the year 2006.

Dividends

The Board has recommended the payment of a final dividend for the year ended 31 December 2006 of HK$0.058 per share.

Employees and Emolument Policy

As at 31 December 2006, the Group employed approximately 13,700 full-time employees in China, U.S. and Taiwan.

The Company believes that the ability to grow as a successful business depends on the quality of our management and employees. The Company is committed to recruiting, training and retaining skilled and experienced people throughout our operations globally to better serve our customers. The Company intends to do this through our remuneration packages, including discretionary bonuses and share option scheme, as well as an emphasis on employee training. The emolument of the employees of the Group is on the basis of their merit, qualifications and competence. The emoluments of the directors and senior management of the Company are decided by the Remuneration Committee, having regard to the Company's operating results, individual performance and comparable market statistics.