

Chairman's Statement

Dear Shareholders,

On behalf of the Board of Directors ("the Board"), I am pleased to report the annual results of the Company and its subsidiaries ("the Group") for the year ended December 31, 2006.

BUSINESS REVIEW

For the year ended December 31, 2006, the Group's turnover amounted to RMB3,916,513,000, representing an increase of 12.7% as compared to RMB3,475,457,000 for the previous year. Profit attributable to equity holders of the Company was RMB64,143,000, representing a decrease of 75.9% as compared to RMB265,699,000 for the previous year. The Board did not recommend the payment of a final dividend.

2006 has been a tough year for the Group. As a major original equipment manufacturer ("OEM") partner for the US upholstered furniture industry, our sales were adversely impacted by the slow down in the US housing market which had led to a much weaker demand for household furniture. Amid declining retail sales, our major customers in the US cut down their orders in the second half of 2006 in order to clear stocks.

Our profit margin was impacted mainly by a continued hike of raw material prices throughout the year. The prices of raw cowhides, which account for approximately 44% of our cost of sales, went up by approximately 20-30% during the year. This was combined by the soaring prices of other major raw materials such as chemicals, timber and foam. During the year under review, the accelerated appreciation of the Chinese RMB against the US dollar had also led to a further squeeze on our profit margin as most of our revenue is denominated in the US dollars.

I would like to express my gratitude to my fellow management team. With their dedication, hard work and innovation, we have been able to mitigate a substantial amount of these adverse factors through aggressive cost cutting initiatives. We were also able to add some major customers while retaining existing customers during these difficult times.

PROSPECTS

During the year under review, the Chinese government introduced a quota system for duty-free raw cowhide imports in order to regulate and consolidate the leather industry. This will bring stricter controls on new entrants to the leather tanning industry as hide import duties will be levied on new players. As an industry leader, we were allocated the largest duty-free quota, representing more than 15% of the whole nation. We are confident that our leading position in China's leather industry will be maintained and strengthened in years to come.

Over the past five years, leveraging on our success as a leather manufacturer, we have grown into a major OEM partner for the world's upholstered furniture manufacturers. We believe that there are still tremendous potential in this sector as the penetration rate of Chinese made sofas is still relatively low. Therefore, we will continue to explore the outsourcing market in the US and Europe to achieve further growth with more emphasis on profitability.

However, China's huge trade surplus has led to a series of measures being implemented by the government to contain the export industry. It is also clear that the RMB will appreciate further against the other major currencies, in particular the US dollar. Therefore, we have to prepare ourselves for an even more unfavorable macro environment in the future. In addition to continued efficiency improvement and market expansion of our existing core businesses, the Group is planning to establish a presence in the domestic market in order to tap into the growth potential of China's consumption boom.

Chairman's Statement (cont'd)

The Group has carried out an extensive research on the Chinese domestic market for upholstered furniture. In 2007, the Group is planning to open two to three independent flagship furniture stores with a combined floor space of approximately 10,000 square meters. These stores will be located in Shanghai and Hangzhou, two of the largest and richest metropolis in Eastern China all within 90 minutes from our major manufacturing base. As we will not own these premises, the capital expenditure requirement for these stores is expected to be below RMB20 million.

On March 15, 2007, the Group entered into a framework agreement to form a joint venture with Haining Leather Market and another strategic investor to develop leather product shopping malls in major Chinese cities. Haining Leather Market, a well-known and successful developer and operator of large leather product shopping malls, will allow the joint venture to use its trade name “海寧中國皮革城” and to share its management resources and customer base. The Group will take a 51% equity interest in the joint venture which will have a registered capital of RMB360 million. The first project to be developed is expected to be in Changsha, the capital city of Hunan province, where the joint venture has successfully tendered a land of approximately 145,078 square meters. The Changsha project, which will include a flagship store for our own products, is an integral part of our broad domestic retail strategy. It is experimental in nature and we will strive to limit our risk exposures.

The Group is also planning to carry out an asset consolidation process. During 2003/04, the Group acquired large plots of land at relatively cheap prices for factory expansions. Currently our total land area is 2,586,000 square meters, of which 844,137 square meters have not been developed. For the existing production space, our utilization is approximately 50-60%. We plan to sell some of these lands if there are reasonable bids. In addition, we have two fully built factories available for sale as we have relocated their manufacturing to other facilities. Selling these lands and factories will not affect our production capability. The proceeds from these asset sales will be used to finance our leather product shopping mall investments in Haining.

The Board and management remain committed to the prosperity of the Group. Even with the setbacks during this transition period, we are bullish on the Group's long term outlook. We are confident that our position as China's leading leather and furniture producer will be maintained and strengthened, and our domestic retail strategy will enable the Group to benefit from China's growth prospects.

Chairman

ZHU Zhangjin, Kasen

Hong Kong, April 16, 2007