Notes to the Consolidated Financial Statements

For the year ended December 31, 2006

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.

2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new standard, amendments and interpretations issued by the International Accounting Standards Board (the "IASB") and the International Financial Reporting Interpretations Committee (the "IFRIC") of the IASB that are either effective for annual accounting periods beginning on or after December 1, 2005 or January 1, 2006. The adoption of the new standards, amendment and interpretations had no material effect on the results and financial position for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

At the date of authorization of these consolidated financial statements, the following new standards, amendment and interpretations were in issue but not yet effective:

IAS 1 (Amendment)	Capital Disclosures[1]
IFRS 7	Financial Instruments: Disclosures[1]
IFRS 8	Operating Segments[2]
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies[3]
IFRIC 8	Scope of IFRS 2[4]
IFRIC 9	Reassessment of Embedded Derivatives[5]
IFRIC 10	Interim Financial Reporting and Impairment[6]
IFRIC 11	IFRS 2: Group and Treasury Share Transactions[7]
IFRIC 12	Service Concession Arrangements[8]

1 Effective for annual periods beginning on or after January 1, 2007.
2 Effective for annual periods beginning on or after January 1, 2009.
3 Effective for annual periods beginning on or after March 1, 2006.
4 Effective for annual periods beginning on or after May 1, 2006.
5 Effective for annual periods beginning on or after June 1, 2006.
6 Effective for annual periods beginning on or after November 1, 2006.
7 Effective for annual periods beginning on or after March 1, 2007.
8 Effective for annual periods beginning on or after January 1, 2008.

The directors anticipate that the adoption of these new standards, amendment and interpretations in future periods will have no material financial impact on the results and the financial position of the Group.

3. PRINCIPAL ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. 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.

The consolidated financial statements have been prepared on the historical cost basis.

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 presented separately from the Group's equity therein. Minority interests in the net assets 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.

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

Business combinations

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 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 Business Combinations are recognized at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as assets and measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the profit or loss.

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.

Acquisition of additional interests in subsidiaries

On acquisition of additional interest in a subsidiary, the difference between the consideration paid and the aggregate of the goodwill (or discount on acquisition) and the carrying values of the underlying assets and liabilities attributable to the additional interests in a subsidiary acquired is debited to reserve on acquisition.

Goodwill

Goodwill arising on acquisition on or after March 31, 2004.

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 initially recognized as assets at cost and is subsequently measured 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. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. 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.

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

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 the consolidated 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 net assets of the associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that 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.

Any excess of the Group's share of the net fair value 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 interests 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.

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 net assets 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, 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 unrealised losses provide evidence of an impairment of the assets transferred, in which case, the full amount of losses is recognised.

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

Revenue recognition

Revenue is measured at the fair values of the consideration received or receivable and represents amounts receivable for goods sold in the normal course of business, net of sales related taxes.

Sales of goods are recognised when goods are delivered and title has passed.

Interest revenue 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.

Property, plant and equipment

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

Depreciation is charged so as to write off the cost of assets, other than construction in progress, over their estimated useful lives and after taking into account of the estimated residual value, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

Construction in progress represents property, plant and equipment in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognised impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the assets is included in the consolidated income statement in the year in which the item is derecognised.

Investment property

On initial recognition, investment properties are measured at cost, including any directly attributable expenditure. Subsequent to initial recognition, investment properties are measured using the fair value model. Gains or losses arising from changes in the fair value of investment property are included in profit or loss for the period in which they arise.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use or no future economic benefits are expected from its disposals. Any gain or loss arising on derecognition of the assets is included in the consolidated income statement in the year in which the item is derecognized.

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

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.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term.

Rental income from operating leases is recognised in the consolidated income statements on a straight-line basis over the term of the relevant leases.

Foreign currencies

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates its functional currency. For the purpose of the consolidated financial statements, the results and financial position of each entity are expressed in RMB, which are the functional currency of the Company and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual entities, transactions in currencies other than the entities' functional currency ("foreign currencies") are recorded at the rates of exchanges prevailing at the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the balance sheet date. 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 which they arise .

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying 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. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

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

Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs. Grants related to expense items are recognised in the same period as those expenses are charged in the consolidated income statement and are reported separately as 'other income'.

Retirement benefits costs

Payments to defined contribution retirement benefits schemes and state-managed retirement benefit schemes are charged as an expense when employees have rendered service entitling them to the contributions.

Share-based payments

Equity-settled share-based payments to employees are measured at fair value of the equity instrument at the grant date. Fair value is measured by using a binomial model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioral considerations.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of share options that will eventually vest.

Taxation

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

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated 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 are accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are generally recognised for all deductible temporary differences 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 taxable profit nor the accounting profit.

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 assets and liabilities are measured 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 on substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

Intangible assets

Intangible assets acquired separately

Intangible assets acquired separately and with finite useful lives are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is charged on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Gains or losses arising from derecognizing of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the assets and are recognized in the consolidated income statement when the asset is derecognized.

Impairment of tangible and intangible assets excluding goodwill

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 any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss exists. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. An impairment is recognised as an expense immediately.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate 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 recognised for the asset in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Inventories

Inventories are stated at the lower of cost and net realizable value. Costs are determined on the weighted average cost method. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Financial assets

Financial assets are classified into loans and receivables or available for sale investments. All regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame estimated by regulation or convention in the marketplace and is recognized and derecognized on a trade date basis. The accounting policies adopted in respect of each category of financial assets are set out below.

Amounts due from related parties, trade and other receivables and bank balances and pledged bank deposits

These financial assets have fixed or determinable payments that are not quoted in an active market and are classified as loans and receivables.

Loans and receivables are measured at initial recognition at fair value, and are subsequently measured at amortized cost using the effective interest method. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

Investments

Available-for-sale investment in equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are carried at cost less impairment. Impairment losses recognised in profit or loss for equity investments classified as available-for-sale are not subsequently reversed through profit or loss.

Financial liabilities and equity

Financial liabilities and equity instruments issued 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 for financial liabilities and equity instruments are set out below.

3. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Bank and other borrowings

Borrowings are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings.

Trade, bills and other payables and amounts due to related companies

The above financial liabilities are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest method.

Equity instruments

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

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

4. KEY SOURCES OF ESTIMATION UNCERTAINTY

The following are the key assumptions concerning the future, and other key sources of estimation 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.

Impairment of 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.

The carrying amount of goodwill at the balance sheet date was RMB158 million after an impairment loss of RMB23 million was recognized during 2006. Details of the impairment loss calculation are provided in note 14.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include borrowings, trade receivables, trade payables and bank balances and cash. 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.

Market risk

Interest rate risk

The Group's exposure to fair value interest rate risk relates primarily to the fixed rate bank and other borrowings (see Note 27 for detail of these borrowings). The Group has not entered into any interest rate hedging contracts. The directors monitor the Group's exposure on continuing 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 sales and purchase transactions denominated in US dollars and such related receivables and payables arising from time to time. In addition, the Group has short term borrowings 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 continuing basis and will consider hedging the currency risk should the need arise. Balances denominated in foreign currency in the consolidated balance sheet mainly represented trade receivables, bank balances and cash, trade payables and bank borrowings.

Credit risk

As at December 31, 2006, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to perform an obligation by the counterparties is arising from the carrying amount of the respective recognised financial assets as stated in the consolidated balance sheet.

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the consolidated 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.

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.

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

The Group has no significant concentration of credit risk, with exposure spread over a number of counterparties and customers.

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

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

Liquidity risk

In the management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by the management to finance the Group's operations and monitors the level of borrowings on a continuing basis.

6. BUSINESS AND GEOGRAPHICAL SEGMENTS

For management purposes, the Group is currently organized into five 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 (Note); and

– Others (including sale of wooden frame and others)

Note: There was no transaction for leather garments segment in both years.

Segment information about these businesses is presented below:

6. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

Consolidated Income Statement

	Upholstered furniture RMB'000	Furniture leather RMB'000	Automotive leather RMB'000	Others RMB'000	Eliminations RMB'000	Total RMB'000
2006						
Turnover						
External sales	**3,122,953**	**615,104**	**150,141**	**28,315**	**–**	**3,916,513**
Inter-segment sales	**603,005**	**2,249,976**	**–**	**126,818**	**(2,979,799)**	**–**
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)	–

Inter-segment sales are charged at prevailing market prices.

	Year ended December 31, 2006 RMB'000	2005 RMB'000
Result		
Segment result		
- Upholstered furniture	**195,956**	321,955
- Furniture leather	**(17,748)**	44,585
- Automotive leather	**(9,391)**	10,946
- Others	**(246)**	(575)
	168,571	376,911
Unallocated income	**31,361**	18,746
Unallocated expenses	**(10,345)**	(4,338)
Share of profit (loss) of an associate	**937**	(1,114)
Finance costs	**(85,390)**	(111,540)
Profit before taxation	**105,134**	278,665
Taxation	**(21,707)**	(18,311)
Profit for the year	**83,427**	260,354

6. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

Other Information

	Year ended December 31, 2006 RMB'000	2005 RMB'000
Impairment loss recognized in respect of trade and other receivables		
– Upholstered furniture	**5,747**	2,152
– Furniture leather	**10,398**	1,718
– Automotive leather	**1,392**	1,343
– Others	**89**	417
	17,626	5,630
Allowances for inventories		
– Upholstered furniture	**1,480**	306
– Furniture leather	**9,924**	3,226
	11,404	3,532
Capital additions		
– Upholstered furniture	**52,518**	124,801
– Furniture leather	**15,102**	66,600
– Automotive leather	**493**	23,339
– Others	**5,653**	16,728
	73,766	231,468
Depreciation and amortization		
– Upholstered furniture	**47,545**	38,043
– Furniture leather	**43,200**	45,540
– Automotive leather	**3,825**	1,857
– Others	**4,915**	5,695
	99,485	91,135
Goodwill impairment		
– Upholstered furniture	**10,138**	–
– Automotive leather	**12,910**	–
	23,048	–

6. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

Balance Sheets

	As at December 31,	
	2006	2005
	RMB'000	RMB'000
ASSETS		
Segment assets		
– Upholstered furniture	**1,656,269**	1,909,643
– Furniture leather	**1,475,264**	1,600,250
– Automotive leather	**200,962**	190,614
– Others	**128,275**	82,598
Subtotal	**3,460,770**	3,783,105
Investments in associates	**26,728**	9,127
Investment in a jointly controlled entity	**2,614**	811
Unallocated corporate assets	**584,416**	648,647
	4,074,528	4,441,690
LIABILITIES		
Segment liabilities		
– Upholstered furniture	**437,400**	525,898
– Furniture leather	**119,390**	206,128
– Automotive leather	**7,410**	12,204
– Others	**39,836**	39,762
Subtotal	**604,036**	783,992
Unallocated corporate liabilities	**1,287,515**	1,359,832
	1,891,551	2,143,824

Geographical segment

Segment assets are substantively located in the People's Republic of China ("PRC").

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

	2006	2005
	RMB'000	RMB'000
United States	**2,825,773**	2,383,797
PRC, including Hong Kong	**736,138**	727,001
Europe	**160,326**	120,272
Australia	**122,253**	187,543
Others	**72,023**	56,844
	3,916,513	3,475,457

7. OTHER INCOME

Details of other income are as follows:

	2006 RMB'000	2005 RMB'000
Government grants		
Grants for technology development	**2,830**	180
Grants for export sales	**18,362**	6,786
Incentive for business development	**4,274**	4,500
Other grants	**3,456**	928
	28,922	12,394
Net gain from sale of raw materials	**10,947**	11,535
Interest income	**8,905**	7,487
Discounts on acquisition of an additional interest in a subsidiary	**10,279**	5,300
Gain (loss) on disposals of subsidiaries (Note 32)	**8,838**	(1,380)
Others	**3,339**	7,339
	71,230	42,675

8. FINANCE COSTS

	2006 RMB'000	2005 RMB'000
Interest on:		
Bank borrowings wholly repayable within five years	**84,611**	94,245
Other borrowings wholly repayable within five years	**269**	3,536
Other borrowings not wholly repayable within five years	**510**	510
Convertible loan notes	**–**	13,249
	85,390	111,540

9. PROFIT BEFORE TAXATION

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

	2006 RMB'000	2005 RMB'000
Amortization of intangible assets (included in administrative expenses)	**350**	225
Amortization of prepaid lease payments	**3,277**	3,436
Depreciation of property, plant and equipment	**95,858**	87,474
Total depreciation and amortization	**99,485**	91,135
Auditors' remuneration	**4,619**	3,620
Cost of inventories recognised as expense	**3,477,732**	2,923,662
Impairment loss recognized in respect of trade and other receivables	**17,626**	5,630
Impairment of goodwill	**23,048**	–
Loss (gain) on disposal of property, plant and equipment	**2,161**	(26)
Operating lease rentals in respect of land and buildings	**1,892**	1,878
Net foreign exchange losses	**17,836**	15,263
Expenses of sampling and products upgrading	**8,048**	26,399
Allowances for inventories	**11,404**	3,532
Total employee benefit expenses	**286,659**	237,063

10. DIRECTORS AND EMPLOYEES' REMUNERATION

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

2006

	Zhu Zhangjin ("Mr. Zhu") RMB'000	Zhou Xiaosong RMB'000	Zhu Jianqi RMB'000	Li Hui RMB'000	Lu Yungang RMB'000	Chow Joseph RMB'000	Zhang Huaqiao RMB'000	Shi Zhengfu RMB'000	Sun Qiang Chang RMB'000	Total RMB'000
Fees	–	–	–	–	–	–	–	–	–	–
Other emoluments										
Salaries and other benefits	340	238	238	–	150	150	75	75	–	1,266
Contributions to retirement benefits schemes	2	2	2	–	–	–	–	–	–	6
Share based payment expense	1,039	1,039	1,039	–	208	208	–	–	–	3,533
Total emoluments	1,381	1,279	1,279	–	358	358	75	75	–	4,805

2005

	Mr. Zhu RMB'000	Zhou Xiaosong RMB'000	Zhu Jianqi RMB'000	Li Hui RMB'000	Lu Yungang RMB'000	Chow Joseph RMB'000	Zhang Huaqiao 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

Notes:

(1) Mr. Li Hui, David was appointed as non-executive director and Mr. Sun Qiang Chang resigned as non-executive director on May 30, 2006.

(2) Mr. Zhang Huaqiao, Joe was appointed as independent non-executive director and Mr. Shi Zhengfu resigned as independent non-executive director on July 3, 2006.

10. DIRECTORS AND EMPLOYEES' REMUNERATION *(Continued)*

Of the five individuals with the highest emoluments in the Group, three (2005: three) were directors of the Company whose emoluments are included in the disclosures as above. The emoluments of the remaining two (2005: two) individuals was as follows:

	2006 **RMB'000**	2005 RMB'000
Basic salaries and other benefits	**854**	650
Contributions to retirement benefits schemes	**14**	14
Share based payment expense	**1,247**	–
	2,115	664

The emoluments of the two individuals with the highest emoluments are within the following bands:

HK$	**2006** **Number of individuals**	2005 Number of individuals
1,000,000 or below	**1**	2
1,000,001-1,500,000	**1**	-

During the year, no emoluments were paid by the Group to the directors and the 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

	2006 **RMB'000**	2005 RMB'000
Hong Kong Profits Tax		
– current year	**1,027**	718
– underprovision in previous year	**58**	425
PRC enterprise income tax		
– current year	**18,717**	19,504
– under(over)provision of income tax	**1,905**	(2,336)
	21,707	18,311

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 years of 2006 and 2005 ("Tax Holidays"). The maximal of Tax Holiday is 5 years from the first taxable profit year.

11. TAXATION *(Continued)*

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

	2006 RMB'000	2005 RMB'000
Profit before taxation	**105,134**	278,665
Tax rate applicable to the major operation of the Group	**26.4%**	26.4%
Tax at the applicable rate	**27,755**	73,568
Tax effect of income not taxable for tax purpose	**(1,210)**	(1,460)
Tax effect of expenses/losses not deductible for tax purpose	**6,052**	3,129
Tax effect of deferred tax assets not recognized	**1,693**	147
Tax effect of tax losses not recognized	**9,519**	6,406
Tax effect of share of result of associates	**(247)**	294
Utilization of tax loss previously not recognized	**–**	(1,464)
Tax effect of Tax Holidays and concessions	**(27,988)**	(61,184)
Tax effect of different tax rates of subsidiaries operating with different tax regulations in the PRC and in Hong Kong	**4,170**	786
Overprovision in previous years	**–**	(2,336)
Underprovision in previous years	**1,963**	425
Taxation for the year	**21,707**	18,311

At December 31, 2006, the Group has unused tax losses of approximately RMB43,761,000 (2005: RMB32,041,000) available to offset against future profits, of which losses of RMB5,527,000 (2005: RMB32,041,000) will expire in year 2010, losses of RMB38,234,000 (2005: Nil) will expire in year 2011. No deferred tax asset has been recognized in respect of unused tax losses due to the unpredictability of future profit streams.

12. DIVIDEND

Dividends recognised as distributions during the year:

	2006 RMB'000	2005 RMB'000
Final 2005, HK7.59 cents per share	**79,575**	–
Interim 2006, HK3.45 cents per share	**34,683**	–
	114,258	–

13. 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

	2006 **RMB'000**	2005 RMB'000
Earnings for the purposes of basic earnings per share, being profit attributable to equity holders of the Company	**64,143**	265,699
Effect of dilutive potential ordinary shares:		
Interest on convertible loan notes	–	13,249
Earnings for the purposes of diluted earnings per share	**64,143**	278,948

Number of shares

	2006	2005
Weighted average number of ordinary shares for the purposes of basic earnings per share	**1,004,410,969**	645,419,597
Effect of dilutive potential ordinary shares:		
Convertible loan notes	–	179,512,056
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**1,004,410,969**	824,931,653

The share options granted to the employees of the Group has no effect to the diluted earnings per share because the exercise price of the Company's share options was higher than average market price for shares during the share option outstanding period.

14. GOODWILL

	2006 RMB'000	2005 RMB'000
COST		
At January 1 and December 31	**181,006**	181,006
ACCUMULATED IMPAIRMENT LOSSES		
At January 1	–	–
Impairment losses recognized in the year	**23,048**	–
At December 31	**23,048**	–
CARRYING AMOUNTS		
At December 31	**157,958**	181,006

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

During the financial year of 2006, the Group assessed the recoverable amount of goodwill, and determined that goodwill associated with the Group's upholstered furniture operation and automotive leather operation was impaired by RMB23 million. The recoverable amount of the upholstered furniture operation and automotive leather operation was assessed by reference to value in use model.

The main factor contributing to the impairment of the cash-generating units was the failure of generating sufficient cash as previously expected. In 2006, the Group lost some orders from customers, thus leading to less cash generated as expected. No write-down of the carrying amounts of other assets in the cash-generating unit was necessary.

Allocation of goodwill to cash-generating units

Before recognition of impairment losses, the carrying amount of goodwill allocated to cash-generating units that are significant individually or in aggregate is as follows:

	2006 RMB'000	2005 RMB'000
Haining Kareno Furniture Co., Ltd. ("Kareno")	**60,287**	60,287
Haining Kasen Leather Co., Ltd. ("Haining Kasen")	**97,671**	97,671
Haining Schinder Tanning Co., Ltd.	**12,910**	12,910
Haining Home Direct Furniture Co., Ltd. ("Home Direct")	**10,138**	10,138
	181,006	181,006

14. GOODWILL *(Continued)*

IMPAIRMENT TESTING ON GOODWILL

Goodwill has been allocated to the following cash-generating units (CGUs). The carrying amount of goodwill (net of accumulated impairment losses) as at December 31, 2006 is allocated as follows:

	2006	2005
	RMB'000	RMB'000
Upholstered furniture operation		
– Kareno	**60,287**	60,287
– Home Direct	**–**	10,138
– Haining Kasen	**97,671**	97,671
Automotive leather operation		
Haining Schinder Tanning Co., Ltd.	**–**	12,910
	157,958	181,006

The recoverable amount of the CGUs is determined based on a value in use calculation which uses cash flow projections based on financial budgets approved by management covering a five-year period, and a discount rate of 11.78% per annum (2005: 5% per annum). The cash flows beyond that five year period have been extrapolated using a steady 3% per annum growth rate.

The key assumptions used in the value in use calculations for the above operations are as follows:

Budgeted sales growth rate — The values assigned to the assumptions reflect the past experiences, overall industry situation in PRC, as well as the marketing staff's best estimate for the sales in the next five years. The growth factor is consistent with management development strategies. Management believes that the planned sales growth per year for the next five years is reasonably achievable.

Budgeted gross margin — The average gross margins achieved in the three years immediately before the budget period, normalized with the effect of increased raw material prices and the sudden currency appreciation. This reflects past experience, with Management expects that the company can fully absorb the adverse effects of increased raw material prices and the risk from the appreciation of RMB against US dollars.

Raw materials price inflation — The forecast takes into account of major raw materials' prices during the budget period for the countries from which raw materials are purchased. The values assigned to the key assumption are consistent with external sources of information.

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, 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)
Reclassification	190,571	17,186	162	18	(207,937)	–
At January 1, 2006	883,689	475,158	26,828	47,765	72,636	1,506,076
Additions	5,224	28,941	5,808	5,168	27,734	72,875
Disposals of subsidiaries	(72,242)	(8,839)	(1,672)	(2,568)	(4,029)	(89,350)
Disposals	–	(545)	(133)	(501)	(1,617)	(2,796)
Reclassification	74,970	1,439	1,006	329	(77,744)	–
At December 31, 2006	**891,641**	**496,154**	**31,837**	**50,193**	**16,980**	**1,486,805**
DEPRECIATION						
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 January 1, 2006	78,244	115,917	13,327	17,358	–	224,846
Provided for the year	42,085	41,773	3,990	8,010	–	95,858
Elimination on disposals of subsidiaries	(4,937)	(1,241)	(406)	(529)	–	(7,113)
Elimination on disposals	–	(149)	(44)	(192)	–	(385)
At December 31, 2006	**115,392**	**156,300**	**16,867**	**24,647**	**–**	**313,206**
CARRYING AMOUNTS						
At December 31, 2006	**776,249**	**339,854**	**14,970**	**25,546**	**16,980**	**1,173,599**
At December 31, 2005	805,445	359,241	13,501	30,407	72,636	1,281,230

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 after consideration of residual value 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

The Group has pledged its buildings with a carrying amount of approximately RMB469 million (2005: RMB487 million) to secure general banking facilities granted to the Group.

As at December 31, 2006, the title deeds of the buildings in amount of RMB45 million (2005: RMB49 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.

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. An amount of approximately RMB82,125,000 (2005: RMB87,144,000) had been pledged to banks to secure the borrowings of the Group granted by the banks.

	2006 RMB'000	2005 RMB'000
Analyzed for reporting purposes as:		
Non-current asset	**131,860**	142,812
Current asset	**2,904**	3,543
	134,764	146,355

	2006 RMB'000	2005 RMB'000
Without title deeds	**23,189**	17,911
With temporary title deeds	**–**	9,500
With formal title deeds	**111,575**	118,944
	134,764	146,355

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

17. INVESTMENT PROPERTIES

	2006 RMB'000	2005 RMB'000
Carrying amount		
– Land in PRC	**32,901**	–

The fair value of the Group's investment properties at December 31, 2006 was arrived at by reference to a valuation carried out by Sallmanns (Far East) Limited, an independent qualified professional valuers not connected with the Group. Sallmanns (Far East) Limited are qualified valuers and have appropriate qualifications and recent experiences in the valuation of similar properties in the relevant locations. The valuation was arrived at by reference to market evidence of transaction prices for similar properties.

The land held is for capital appreciation purpose under medium-term lease in the PRC.

18. INTANGIBLE ASSETS

	RMB'000
COST	
At January 1, 2005	1,077
Additions	397
At January 1, 2006	1,474
Additions	891
Disposals of subsidiaries	(147)
At December 31, 2006	**2,218**
ACCUMULATED AMORTIZATION	
At January 1, 2005	172
Provided for the year	225
At January 1, 2006	397
Provided for the year	350
Elimination on disposals of subsidiaries	(14)
At December 31, 2006	**733**
CARRYING AMOUNT	
At December 31, 2006	**1,485**
At December 31, 2005	1,077

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

19. INVESTMENTS IN ASSOCIATES

The interests in associates 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, and a 30% interest in 海寧市斜橋森博水務有限公司 (Haining Xieqiao Senbo Water Co., Ltd.) ("Senbo Water"), an associate changed from a subsidiary through additional capital injection by minority shareholders, and a 35% interest in Sichuan Longteng Leather Co., Ltd. ("Longteng"), an equity joint venture established in the PRC in 2006.

	2006 **RMB'000**	2005 RMB'000
Cost of unlisted investment in associates	**26,905**	10,241
Share of post-acquisition losses	**(177)**	(1,114)
	26,728	9,127

	2006 **RMB'000**	2005 RMB'000
Summarised financial information relating to the associates		
Total assets	**130,734**	59,664
Total liabilities	**(52,275)**	(23,156)
Net assets	**78,459**	36,508
Group's share of net assets of associates	**26,728**	9,127
Revenue	**96,309**	6,639
Profit (loss) for the year	**4,048**	(4,456)
Group's share of associates' profit (loss) for the year	**937**	(1,114)

20. INVESTMENT 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 Kasen-Melx Leather Co., Ltd.) ("Kasen-Melx"), an equity joint venture established in the PRC which commenced business in August 2005. The jointly controlled entity was established for the principal purpose of trading in leather and other furniture products.

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

	2006 **RMB'000**	2005 RMB'000
Cost of unlisted investment in jointly controlled entity	**2,614**	811
The summarized financial information in respect of the Group's jointly controlled entities which are accounted for using the equity method is set out below:		
Total assets	**8,131**	1,672
Total liabilities	**(2,778)**	(91)
Net assets	**5,353**	1,581
Group's share of net assets of jointly controlled entity	**2,614**	811
Revenue	**2,103**	–
Profit (loss) for the year	**164**	(40)
Group's share of jointly controlled entity's profit (loss) for the year	**–**	–

21. AVAILABLE-FOR-SALE INVESTMENTS

The amount represents investments in unlisted equity securities issued by private entities incorporated in the PRC. As the range of fair value estimates vary significantly, the directors of the Company are of the opinion that it may not be meaningful to disclose the fair values.

22. INVENTORIES

	2006 **RMB'000**	2005 RMB'000
Raw materials	**348,878**	389,974
Work in progress	**806,913**	823,296
Finished goods	**170,425**	165,572
	1,326,216	1,378,842

23. TRADE AND OTHER RECEIVABLES

	2006 RMB'000	2005 RMB'000
Trade receivables	**535,961**	549,341
Less: allowance for doubtful debts	**(45,494)**	(34,908)
	490,467	514,433
Prepayments	**64,917**	154,247
Other receivables	**92,890**	136,490
Less: allowance for doubtful debts	**(14,426)**	(9,505)
	633,848	795,665

Movement in the allowance for doubtful debts

	2006 RMB'000	2005 RMB'000
Balance at beginning of the year	**44,413**	38,783
Amounts written off during the year	**(496)**	–
Amount relating to disposal of subsidiaries	**(1,623)**	–
Increase in allowance recognised in profit or loss	**17,626**	5,630
Balance at end of the year	**59,920**	44,413

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

	2006 RMB'000	2005 RMB'000
Aged:		
Within 60 days	**345,725**	355,407
61 – 90 days	**53,892**	51,342
91 – 180 days	**47,468**	63,429
181 – 365 days	**35,546**	43,139
1 – 2 years	**7,836**	1,116
	490,467	514,433

The directors consider that the carrying amount of trade and other receivables at December 31, 2006 approximates their fair value.

24. AMOUNTS DUE FROM (TO) RELATED COMPANIES

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

	Name of related companies	Notes	2006 RMB'000	2005 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)	**3,783**	2,705
	伊犁霍爾果斯皮革有限公司 Yili Horgos Leather Co., Ltd. ("Yili Horgos")	(i), (ii)	**(29)**	(47,219)
	白銀卡森皮革有限公司 Baiyin Kasen Leather Co., Ltd. ("Baiyin Kasen")	(i), (ii)	**–**	(2,130)
	克孜勒蘇新蓉皮革有限公司 Kezilesu Xinrong Leather Co., Ltd. ("Kezilesu Xinrong")	(i), (ii)	**–**	(848)
	Starcorp Corporation Pty. Ltd. ("Starcorp")	(i), (ii)	**28,496**	17,963
	海寧萬盛絲綢噴織有限公司 Haining Wansheng Silk Weaving Co., Ltd. ("Wansheng Silk")	(ii), (v)	**–**	(5,960)
	海寧美景海綿有限公司 Future Foam	(ii), (viii)	**(13,438)**	(3,532)
	Kasen-Melx	(ii), (ix)	**3,080**	(339)
	上海思達傢俱有限公司 Shanghai Star Furniture Co., Ltd.	(i), (ii)	**–**	(259)
	North Pole Ltd.	(ii), (vii)	**313**	–
	澳林家具(上海)有限公司 AoLin Furniture (Shanghai) Co., Ltd.	(i), (ii)	**196**	–
	海寧長虹進出口有限公司 Haining Changhong Import and Export Co., Ltd. ("Changhong I&E")	(ii), (v)	**193**	–
	海派皮業有限公司 Haining Haipai Leather Industry Co., Ltd.	(ii), (v)	**29**	–
(b)	**Non-operating in nature**			
	周慧敏	(iv), (vi)	**–**	59
	孫時良	(iv), (vi)	**–**	526
	海寧市斜橋森博水務有限公司 Haining Senbo Water Co., Ltd. ("Senbo Water")	(iii), (vi)	**506**	–
	海寧獵馬皮革服裝有限公司 Haining Liema Leather Garments Co., Ltd.	(v), (x)	**(6,000)**	–
			17,129	(39,034)
	Represented by:			
	Amounts due from related companies, included in current assets		**36,596**	21,253
	Amounts due to related companies, included in current liabilities		**(19,467)**	(60,287)
			17,129	(39,034)

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

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

	2006		2005	
	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	**10,421**	**(12,621)**	4,588	(14,484)
60 – 90 days	**5,619**	**(6,105)**	3,900	(544)
91 – 180 days	**12,067**	**(706)**	12,100	(45,259)
181 – 365 days	**6,303**	**(35)**	665	–
1 – 2 years	**2,186**	**–**	–	–
	36,596	**(19,467)**	21,253	(60,287)

Details of the operating transactions with the related parties are set out in note 37.

Notes:

(i) Mr. Zhu has influence and beneficial interests in these companies through Sunbridge Industrial Group Co., Ltd.

(ii) The amounts are unsecured, interest-free and repayable according to the credit terms.

(iii) Senbo Water ceased to be subsidiary and became associate of the Group since May 2006.

(iv) The individuals ceased to be directors of the non-wholly owned subsidiaries of the Company since October 24, 2006.

(v) A director of a non-wholly owned subsidiary has influence and beneficial interests in the company.

(vi) The amounts are unsecured, interest-free and recoverable within one year.

(vii) The company is the subsidiary of one major shareholder of the Company.

(viii) Associate of the Company.

(ix) Jointly controlled entity of the Company.

(x) The amounts are unsecured, carried annual interest rate of 6.696% and repayable on demand.

The directors consider that the carrying amount of amounts due from (to) related companies at December 31, 2006 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% (2005: 0.72%). The pledged bank deposits will be released upon the settlement of relevant bill payables and bank borrowings. The fair value of the pledged bank deposits at December 31, 2006 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, 2006 approximates the carrying amount.

26. TRADE, BILLS AND OTHER PAYABLES

The aging analysis of trade payables is as follows:

	2006	2005
	RMB'000	RMB'000
Aging:		
Within 60 days	**286,950**	321,512
60 – 90 days	**20,807**	33,685
91 – 180 days	**13,080**	49,869
181 – 365 days	**10,907**	15,974
1 – 2 years	**8,719**	6,643
Over 2 years	**6,445**	3,206
Total trade payables	**346,908**	430,889
Bills payables (Note)	**142,479**	183,403
Other payables and accrued liabilities	**114,649**	169,700
	604,036	783,992

26. TRADE, BILLS AND OTHER PAYABLES *(Continued)*

Note:

The aging analysis of bills payable is follows:

	2006 **RMB'000**	2005 RMB'000
Aging:		
Within 60 days	**61,156**	81,026
60 – 90 days	**26,937**	58,959
91 – 180 days	**54,386**	43,418
	142,479	183,403

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, 2006, the Group recorded a balance of approximately RMB14 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 36.

The directors consider that the carrying amount of trade, bills and other payables at December 31, 2006 approximates their fair value.

27. BANK AND OTHER BORROWINGS

	2006 RMB'000	2005 RMB'000
Bank borrowings	**1,246,689**	1,281,338
Other borrowings	**10,400**	10,400
Total	**1,257,089**	1,291,738
Analysed as:		
Secured	**475,936**	502,038
Unsecured	**781,153**	789,700
	1,257,089	1,291,738
Denominated in United States Dollars (foreign currency)	**124,998**	94,246
Denominated in Renminbi (functional currency)	**1,132,091**	1,197,492
	1,257,089	1,291,738
The bank and other borrowings are repayable as follows:		
Within one year or on demand	**1,246,689**	1,191,246
In the one to second year	**–**	90,092
After five years	**10,400**	10,400
	1,257,089	1,291,738
Less: Amount due within one year shown under current liabilities	**(1,246,689)**	(1,191,246)
Amount due after one year	**10,400**	100,492

Bank borrowings are substantively fixed-rate borrowings and carry interests ranging from 4.65% to 8.78% (2005: from 4.00% to 8.35%) per annum.

Other borrowings represent loans advanced by independent third parties and carry at a fixed interest rate of 2.55% (2005: 2.55%) per annum.

Parts of 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 34 and 37(d).

The directors consider that the carrying amount of bank and other borrowings at December 31, 2006 approximates their fair value.

28. 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, 2005	399,682,608,696	217,391,304	100,000,000	40,000
Shares consolidation	(133,227,536,232)	–	–	–
Shares re-designation and reclassification	211,594,202	(217,391,304)	(100,000,000)	–
At December 31, 2005 & December 31, 2006	266,666,666,666	–	–	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, 2005	829,894,730	–	–	82,990	689
Share consolidation	(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	257,973,142	(176,693,933)	(81,279,209)	–	–
Issued on public floatation	202,809,074	–	–	30,421	246
At December 31, 2005	1,014,045,369	–	–	152,107	1,256
Share repurchase	(23,997,000)	–	–	(4)	(29)
At December 31, 2006	**990,048,369**	**–**	**–**	**152,103**	**1,227**

Pursuant to the general mandate granted by the shareholders of the Company, the Board of Directors resolved on July 31, 2006 to repurchase the Company's shares of up to 10% of the issued shares of the Company as at the date of May 30, 2006. The repurchase was made at the discretion of the Board. Up to December 31, 2006, 23,997,000 shares were repurchased.

28. SHARE CAPITAL *(Continued)*

During the year, the Company repurchased its own shares through the Stock Exchange of Hong Kong Limited as follows:

Month of repurchase	No. of ordinary share	Price per share Highest	Price per share Lowest	Aggregate consideration paid
	'000	HK$	HK$	RMB'000
August 2006	23,997	1.05	0.99	25,891

The above shares were cancelled upon repurchase. None of the Company's subsidiaries repurchased, sold or redeemed any of the Company's listed shares during the year.

29. SHARE OPTION

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 option issued pursuant to the Scheme will expire with 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.

The Company granted a total of 29,800,000 share options to the directors and other eligible employees on March 9, 2006. The exercise price of the options is fixed at HK$2.38 (the share price immediately before grant date was HK$2.24). The fair value of the options determined at the date of grant using the Binomial Model was approximately RMB21 million and the Company recorded a share based payment expense of RMB15,486,000 in the year ended December 31, 2006 (2005: Nil).

The following assumptions were used in the Binomial model:

	2006 Options to Employees
Average risk-free rate of return	**4.44%**
Weighted average expected option life	**7.58 years**
Volatility rate	**49%**
Dividend yield	**5.95%**
Average share price at the grant date	**HK$2.35**

29. SHARE OPTION *(Continued)*

Expected volatility was determined by using the historical volatility of the price return of the ordinary shares of the Company over the period starting from its listing date on October 20, 2005 to March 9, 2006.

The Binomial Model has been used to estimate the fair value of the options. The variables and assumptions used in computing the fair value of the share options are based on the director's best estimate. The value of an option varies with different variables of certain subjective assumptions.

The share options could be exercised during the following periods:

Date	**Percentage of share options**
From January 1, 2007 to March 8, 2016	50%
From January 1, 2008 to March 8, 2016	50%

Details of the share options outstanding during the current year are as follows:

	Number of share options
Granted on March 9, 2006 and outstanding as at December 31, 2006	29,800,000

No share option has been exercised during the year.

30. 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.

(c) The Company suffered loss of RMB53,104,000 for the year ended December 31, 2006 (2005: loss of RMB281,732,000).

31. ACQUISITION OF ADDITIONAL INTERESTS IN SUBSIDIARIES

In June 2006, the Group acquired 44.55% and 49.5% additional interests in its subsidiaries, Haining Hainix Sofa Co., Ltd. ("Hainix Sofa") and Haining Hidea Furniture Co., Ltd. ("Hidea Furniture"), respectively, from their minority shareholders.

In April 2005, the Group acquired 4.416% additional interest in its subsidiary, Haining Kareno Furniture Co., Ltd. ("Kareno") from its minority shareholder.

The acquisition prices were agreed through negotiation between the Group and the minority shareholders.

	2006			
	Hainix Sofa RMB'000	**Hidea Furniture RMB'000**	**Total carrying amount RMB'000**	2005 Carrying amount RMB'000
Net assets acquired	**17,251**	**11,937**	**29,188**	6,621
Reserve on acquisition (Note)	**16,935**	**14,033**	**30,968**	–
Discounts on acquisition of an additional interest in a subsidiary	**–**	**(10,279)**	**(10,279)**	(5,300)
	34,186	**15,691**	**49,877**	1,321
Satisfied by:				
Cash consideration	**34,186**	**15,691**	**49,877**	1,321

Note: This represents the portion of the revaluation difference that arose since the original acquisition date that is attributable to the increase of the Group's interests.

32. DISPOSAL OF SUBSIDIARIES

During the year, the Group entered into an agreement to dispose of an non-wholly owned subsidiary, 海寧萬盛沙發有限公司 ("Haining Wansheng Furniture Co., Ltd.") ("Wansheng Furniture"), which carried out upholstered furniture manufacturing operations. The disposal was completed on June 29, 2006, on which date the control of Wansheng Furniture passed to the acquirer.

Senbo Water ceased to be a subsidiary of the Group from May 2006 due to the additional capital injections of its minority shareholder.

During the year of 2005, the Group disposed of its interests in SFT.

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

	2006			
	Wansheng Furniture RMB'000	**Senbo Water RMB'000**	**Total RMB'000**	2005 RMB'000
Property, plant and equipment	**70,727**	**11,510**	**82,237**	–
Prepaid lease payment	**8,928**	**–**	**8,928**	–
Amounts due from related companies	**650**	**–**	**650**	–
Inventories	**50,319**	**–**	**50,319**	–
Trade and other receivables	**75,582**	**5**	**75,587**	1,381
Intangible assets	**133**	**–**	**133**	–
Bank balances and cash	**21,421**	**5,562**	**26,983**	–
Trade and other payables	**(106,690)**	**(6,049)**	**(112,739)**	–
Amount due to related companies	**(11,345)**	**(250)**	**(11,595)**	–
Bank borrowings	**(85,000)**	**(800)**	**(85,800)**	–
	24,725	**9,978**	**34,703**	1,381
Minority interests	**(12,237)**	**(6,993)**	**(19,230)**	–
Gain (loss) on disposal	**8,823**	**15**	**8,838**	(1,380)
	21,311	**3,000**	**24,311**	1
Satisfied by:				
Cash consideration received	**21,311**	**–**	**21,311**	1
Transferred to interests in associates	**–**	**3,000**	**3,000**	–
Net cash outflow arising on disposal of subsidiaries:				
Cash consideration	**21,311**	**–**	**21,311**	–
Cash and cash equivalents disposed of	**(21,421)**	**(5,562)**	**(26,983)**	–
	(110)	**(5,562)**	**(5,672)**	–

Wansheng Furniture and Senbo Water did not make any significant contributions to the results and cash flows of the Group during the current year.

33. 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 scheme's 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 RMB8,844,000 (2005: RMB8,273,000) represents contributions payable to the above schemes by the Group in respect of the current accounting period. As at December 31, 2006, contributions of approximately RMB2,589,000 (2005: RMB7,873,000) due in respect of the reporting period had not been paid to the above schemes.

34. 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:

	2006	2005
	RMB'000	RMB'000
Buildings (note 15)	**468,517**	486,878
Prepaid lease payments (note 16)	**82,125**	87,144
Bank deposits (note 25)	**163,221**	240,112
	713,863	814,134

35. LEASE ARRANGEMENTS

As lessee

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

	2006	2005
	RMB'000	RMB'000
Within one year	**1,502**	1,543
In the second to fourth year inclusive	**3,169**	1,440
	4,671	2,983

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.

36. CAPITAL COMMITMENTS

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

	2006	2005
	RMB'000	RMB'000
Capital expenditure contracted for but not provided in the consolidated financial statements in respect of acquisition of property, plant and equipment	**1,464**	6,656
Capital expenditure contracted for but not provided in the consolidated financial statements in respect of construction of certain infrastructure and public facilities in the PRC on behalf of the government (note 26)	**14,135**	20,991
	15,599	27,647

37. 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 connected and related parties during the year:

	Nature of transactions	Notes	2006 RMB'000	2005 RMB'000
Connected and related parties				
Yili Horgos	Purchase by the Group		**34,242**	108,522
白銀白利斯皮革有限公司 Baiyin Palace Leather Co., Ltd. ("Baiyin Palace")	Sales by the Group		–	10,273
	Sales of production wastes by the Group	(i)	–	151
Yujie	Sales of production wastes by the Group		**8,975**	11,369
Baiyin Kasen	Purchase by the Group		**68,854**	148,680
	Sales of production wastes by the Group		–	2,259
Kezilesu Xinrong	Purchase by the Group		**60,220**	35,981
Wansheng Silk	Purchase by the Group		**9,541**	9,895
	Interest expense charged to the Group		–	282
Starcorp	Sales by the Group		**49,209**	57,443
North Pole Ltd.	Sales by the Group		**10,830**	–
Related parties				
上海森橋皮業有限公司 Shanghai Sunbridge Leather Industry Co., Ltd. ("Sunbridge Leather")	Sales by the Group	(i)	–	2,531
海寧長虹皮件有限公司 Haining Changhong Leather Co., Ltd. ("Changhong Leather")	Interest expense charged to the Group	(ii)	–	436
	Sales by the Group		–	269

Notes to the Consolidated Financial Statements (cont'd)

For the year ended December 31, 2006

37. CONNECTED AND RELATED PARTY DISCLOSURES *(Continued)*

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

	Nature of transactions	Notes	2006 RMB'000	2005 RMB'000
Related parties *(Continued)*				
Changhong I&E	Sales by the Group		**259**	–
	Interest expense charged to the Group		**–**	299
海寧富華皮件有限公司 Haining Fuhua Leather Co., Ltd. ("Haining Fuhua")	Interest expense charged to the Group	(ii)	**–**	420
浙江森橋實業(集團)有限公司 Zhejiang Sunbridge Industrial (Group) Co., Ltd. ("Sunbridge")	Disposal of property, plant and equipment	(iii)	**–**	4,255
Future Foam	Purchase by the Group		**81,374**	4,946
Kasen-Melx	Sales by the Group		**3,759**	–
	Expense charged to the Group		**–**	403
	Rental income charged by the Group		**–**	6
Shanghai Star Furniture Co., Ltd.	Purchase by the Group		**–**	852
Haining Liema Leather Garments Co., Ltd.	Interest expense charged to the Group		**115**	–
Haining Haipai Leather Industry Co., Ltd.	Sales by the Group		**74**	–
Senbo Water	Provision sewage treatment service to the Group		**22**	–
AoLin Furniture (Shanghai) Co., Ltd.	Sales by the group		**196**	–

Notes:

(i) Mr. Zhu has influence and beneficial interests in the company through Sunbridge.

(ii) A director of a non-wholly owned subsidiary has significant influence and beneficial interests in the company.

(iii) Mr. Zhu has influence and beneficial interests in the company.

37. CONNECTED AND RELATED PARTY DISCLOSURES *(Continued)*

(b) Share options granted to the directors

	2006	2005
Number of share options granted to the directors	**6,800,000**	–

(c) In April 2005, the Group acquired 4.416% additional interest in its subsidiary of Kareno from Ausen International Pty. Ltd. In June 2006, the Group acquired 44.55% and 49.5% additional interests in its subsidiaries of Hainix Sofa and Hidea Furniture, respectively, from following minority shareholders (see note 31).

(d) Corporate guarantees given by the related companies in favor of the Group's borrowings:

	2006 **RMB'000**	2005 RMB'000
Wansheng Silk	–	8,000
孫建新(Note)	–	30,000
	–	38,000

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

(e) Details of the balances with the related parties are set out in note 24.

(f) Key management of the Group are all directors whose remunerations were disclosed in Note 10.

38. CONTINGENT LIABILITIES

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

	2006 **RMB'000**	2005 RMB'000
Guarantees given to banks in respect of banking facilities extended to – Independent third parties	–	67,897

39. PRINCIPAL SUBSIDIARIES

The following table lists major subsidiaries of the Company as at December 31, 2006 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 Direct %	Indirect %	Principal activities
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. 海寧漢林沙發有限公司 (Notes b)	PRC	US$6,000,000	–	95.05	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	–	100	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. 海寧卡雷諾傢俬有限公司 (Note b)	PRC	US$3,600,000	–	100	Production and sale of upholstered furniture

39. 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 Direct %	Indirect %	Principal activities
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
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
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) The company is wholly foreign owned enterprise.

None of the subsidiaries had issued any debt securities at the end of the year.

40. POST BALANCE SHEET EVENTS

(1) A tender submitted by Haining Higher Point Investment Development Co., Ltd. ("Haining Higher Point"), a wholly-owned subsidiary of the Company for the acquisition of a piece of land (the "Land") for an aggregate consideration of RMB253.75 million was accepted on January 29, 2007. The Group, Haining Zhejiang Leather and Garment Market Investment and Development Company Limited ("Haining Leather Market"), and Haining Zhengyang Trading Co., Ltd. ("Haining Zhengyang Trading"), collectively the "Joint Venture Partners", will form a Joint Venture to hold and develop the Land into a leather product retail mall. On February 5, 2007, Haining Higher Point paid the total consideration of RMB203.75 million to Changsha Municipal Bureau of State Land and Resources, 80% of the land price and the total amount of the transaction levy, which was funded from the internal resources of the Group and the remaining 20% of the land price, being RMB50 million, was funded by Haining Leather Market. The cash payments by the Group were from the fund generated from the Group's operating activities.

On March 15, 2007, the Joint Venture Partners, entered into a preliminary joint venture agreement, the total registered capital of which is RMB360 million. The Group will hold 51% interest of the proposed joint venture with an investment amount of approximately RMB184 million.

(2) Pursuant to a board resolution on January 29, 2007, the Company disposed of a subsidiary, Haining Home Craft Furniture Co., Ltd. (海寧家藝家具有限公司) to an independent third party for RMB44.7 million. The net asset value of the subsidiary amounted to RMB41 million as at December 31, 2006.