




## BUSINESS

### OVERVIEW




The Group is principally engaged in the design, manufacture and wholesale of a wide range of home furniture products including mainly wood-based furniture and mattresses in the PRC and overseas markets. Banking on its strong capabilities in furniture design and brand management, the Group also derives licensing fees from granting non-exclusive rights to other furniture manufacturers for use of its own brands and product designs.

The Group's home furniture products are principally categorised into the classic furniture series and the modern furniture series targeting at middle and high price point consumers. Products branded under the classic furniture series are generally larger in size and characterised by elaborate and intricate carving and finishing. The products under the following brand names are classified under the classic furniture series:

Brand name	Target market segment	Recommended retail price range <i>(approximately RMB per set (Note))</i>
 Johnston (self-manufacture)	[Sophisticated middle and high price point consumers who demand grand and luxurious designs]	[20,000 – 76,000]
 New Nobleman (self-manufacture)	[Middle and high price point consumers who have the predilection for Spanish-styled classic furniture]	[19,000 – 26,000]
 Classic Sanroy (under licence)	[High price point consumers who demand luxurious furniture products]	[30,000 – 40,000]


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Products under the modern furniture series are characterised by simple and trendy designs with minimal use of decorative items, targeted at younger and middle price point consumers who look for trendy, functional and affordable home furniture. The products under the following brand names are classified under the modern furniture series:

Brand name	Target market segment	Recommended retail price range <i>(approximately RMB per set (Note))</i>
 PZ-King (self-manufacture)	[Middle price point consumers]	[9,000 – 15,000]
 Mandarin (self-manufacture)	[Middle price point consumers who have the preference for Italian-styled modern furniture]	[7,000 – 12,000]
 Orient (under licence)	[Young aged middle price point consumers]	[5,000 – 13,000]

*Note:* A set of furniture comprises a bed, two bedside cabinets, a wardrobe and a dressing table.

The Group uses its brand “Degas” to market the branded mattresses it manufactures. All the Group’s mattresses are for export only.

Brand name	Target market segment	Recommended retail price range <i>(approximately HK\$ per piece)</i>
 Degas (self-manufacture)	[Middle price point consumers]	[900 – 4,000]

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Set out below is a table showing the breakdown of the Group's turnover by business activities and brand names during the Track Record Period:

	For the year ended 31 December					
	2006		2007		2008	
	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%
<b>Domestic sales</b>						
Johnston	74,921	20.3	106,120	21.5	128,588	24.1
PZ-King	52,764	14.3	48,976	9.9	54,273	10.2
Mandarin	20,745	5.6	55,926	11.4	51,844	9.7
New Nobleman	–	–	–	–	19,382	3.6
	<u>148,430</u>	<u>40.2</u>	<u>211,022</u>	<u>42.8</u>	<u>254,087</u>	<u>47.6</u>
<b>Exports</b>						
Branded						
– Johnston	–	–	36,336	7.4	49,101	9.2
– PZ-King	45,959	12.4	38,003	7.7	34,583	6.5
Mattress	50,393	13.6	58,748	11.9	51,665	9.7
Unbranded	97,445	26.4	120,651	24.5	125,963	23.5
	<u>193,797</u>	<u>52.4</u>	<u>253,738</u>	<u>51.5</u>	<u>261,312</u>	<u>48.9</u>
<b>Licensing fees</b>						
Oriant	19,754	5.3	23,829	4.9	17,546	3.3
New Nobleman	–	–	3,141	0.6	–	–
Classic Sanroy	1,347	0.4	939	0.2	1,401	0.2
Mandarin	6,298	1.7	–	–	–	–
	<u>27,399</u>	<u>7.4</u>	<u>27,909</u>	<u>5.7</u>	<u>18,947</u>	<u>3.5</u>
<b>Total</b>	<u><b>369,626</b></u>	<u><b>100.0</b></u>	<u><b>492,669</b></u>	<u><b>100.0</b></u>	<u><b>534,346</b></u>	<u><b>100.0</b></u>

During the Track Record Period, sales to the five largest customers accounted for approximately 32.6%, 32.3% and [29.8]% of the total turnover of the Group respectively, whilst the sales contribution from the largest customer to the Group's total turnover were [10.9%], [11.2%] and [8.5%] respectively. The five largest customers of the Group during the Track Record Period comprised home furniture retailers, importers and a building contractor.

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### Domestic sales

During the Track Record Period, the Group did not operate any retail shops and relied on domestic distributors to market its furniture products to end-users in the PRC. As at the Latest Practicable Date, the Group contracted with approximately [511] local furniture distributors to market its branded furniture products to end-users in the PRC. Over [75%] of these distributors were operated in the form of sole proprietorship, each operating one to two shops in their respective regions approved by the Group. As at the Latest Practicable Date, these [511] local furniture distributors operated over 600 approved shops covering [22] provinces, [4] municipalities and [4] autonomous regions in the PRC. The number of years of relationship between the Group and these distributors ranged from approximately [1] to [14] years. The Directors confirmed that none of them, the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, and the senior management of the Group, or any of their respective associates had any interest in any of the distributors of the Group during the Track Record Period.

The following table sets out the total number of distributors and approved shops in the PRC as at 31 December 2006, 2007 and 2008, and the average annual turnover per approved shop during the Track Record Period:

	As at 31 December		
	2006	2007	2008
Number of distributors	348	435	[471]
Number of approved shops	380	482	[565]
Average annual turnover per approved shop ( <i>HK\$'000</i> )	390.6	437.8	[449.7]

The relationship between the Group and each of the distributors is governed by a distribution framework agreement, which has a standard term of one year and is subject to renewal by mutual agreement upon expiry. For details of the distribution framework agreement, please refer to the sub-paragraph headed "Distribution framework agreement" in the paragraph headed "Sales and distribution" in this section below.

### Export sales

During the Track Record Period, the Group participated in various furniture trade shows and exhibitions in the PRC and in Europe. These events are usually attended by furniture manufacturers as well as furniture buyers, such as overseas sourcing companies, furniture importers and retailers. The Group has been able to build up business relationships with a number of these overseas customers through attending trade shows and exhibitions over the years. During the Track Record Period, the Group's overseas customers were mainly furniture retailers and importers. The top five largest customers of the Group during the Track Record Period were mainly furniture retailers and importers in the overseas markets. During the three

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years ended 31 December 2008, the Group transacted with over [170], [140] and [90] overseas customers respectively for its export business. Set out below is a table showing the breakdown of the Group's export sales by geographical locations during the Track Record Period:

	For the year ended 31 December					
	2006		2007		2008	
	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%
Asia ( <i>Note 1</i> )	127,850	66.0	172,942	68.2	176,896	67.7
Europe ( <i>Note 2</i> )	24,817	12.8	32,287	12.7	35,370	13.5
Others ( <i>Note 3</i> )	41,130	21.2	48,509	19.1	49,046	18.8
<b>Total</b>	<b><u>193,797</u></b>	<b><u>100.0</u></b>	<b><u>253,738</u></b>	<b><u>100.0</u></b>	<b><u>261,312</u></b>	<b><u>100.0</u></b>

*Notes:*

1. Asia mainly represented Japan, Taiwan, Middle East and Southeast Asia.
2. Europe mainly represented Sweden, Italy, Spain and Germany.
3. Others mainly represented the United States, Canada, Angola and Ivory Coast.

As at the Latest Practicable Date, the number of years of relationship between the Group and its overseas customers ranged from [1] to [15] years. The Directors confirmed that none of them, the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, and the senior management of the Group, or any of their respective associates had any interest in any of the overseas customers of the Group during the Track Record Period.

### Licensing

In addition to its conventional furniture manufacturing and sales business, the Group grants non-exclusive rights to licensees for the use of its certain brand names and product designs in the PRC. During the Track Record Period, the Group received licensing fees amounting to approximately HK\$27.4 million, HK\$27.9 million, and HK\$[18.9] million respectively. Under the licence agreement, the Group is responsible for the nationwide brand promotional activities to boost the market image and brand awareness of the products under the licence. For details of the licence agreement, please refer to the sub-paragraph headed "Licence agreement" in the paragraph headed "Licensing arrangements" in this section below.

The customers of licensees are mainly furniture distributors in the PRC. As at the Latest Practicable Date, the number of years of business relationship between the Group and the licensees ranged from [1] to [13] years. The Directors confirmed that none of them, the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, and the senior management of the Group, or any of their respective associates had any interest in any of these furniture manufacturers during the Track Record Period.

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### Procurement and outsourcing

During the Track Record Period, the Group had over [270], [250] and [180] suppliers respectively and the five largest suppliers included suppliers of raw materials and contract manufacturers who handled outsourced manufacturing of certain furniture products. Purchases from the Group's five largest suppliers in aggregate represented approximately [27.7]%, [41.5]% and [49.8]% of the Group's total purchases and purchases from the largest supplier of the Group accounted for approximately [9.7]%, [14.6]% and [14.4]% of the Group's total purchases for the three years ended 31 December 2008 respectively.

In addition to purchases from its raw material suppliers, the Group makes purchases of finished products from contract manufacturers by way of outsourcing the production of certain furniture products with simple designs and minimal decorative features or on the occasions when its production capacity is running close to full utilisation. During the Track Record Period, the Group engaged 16, 11 and [7] contract manufacturers in the PRC respectively to handle the outsourced manufacturing. The Directors confirmed that none of them, the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, and the senior management of the Group, or any of their respective associates had any interest in any of the raw material suppliers and contract manufacturers during the Track Record Period.

### Production facilities

The Group's furniture production facilities are located at Shenzhen and Dongguan, Guangdong Province, the PRC. For details of the Group's production facilities, please refer to the sub-paragraph headed "Production facilities" in the paragraph headed "Production" in the section headed "Business" in the document.

With the intention to increase its production capacity for its modern furniture series and the "CHINATAG" furniture products, which are expected to launch in [2010], the Group is presently constructing new production facilities, Shenzhen Xingli Production Base, on Longgang Land I it acquired in June 2007. The Group has planned to invest approximately RMB[121.2] million (approximately HK\$136.0 million) for the development of the Shenzhen Xingli Production Base.

With a gross floor area of approximately 38,869 sq.m., the construction of the Shenzhen Xingli Production Base is expected to complete in June 2009. The Group expects to commence the trial production in August 2009 and the full scale production in November 2009. Upon its full scale production, the new production facilities at the Shenzhen Xingli Production Base are expected to provide an annual production capacity of approximately 31,800 furniture sets. The Directors consider that the completion of Shenzhen Xingli Production Base would have positive impact on the Group's profitability as the new production base would enable the Group to expand its production capacities and to capture the growing business opportunities brought about by the expansion of the PRC furniture industry.

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### Ownership of the Group

During the Track Record Period, the Group experienced a change in controlling shareholder. Since its incorporation in April 2004 and up to November 2004, the Company was all along jointly controlled by the four Founders or their respective investment vehicles. In August 2004, the investment vehicles of the Founders entered into an agreement with Talent Sino Holdings Limited, a wholly-owned subsidiary of Omnicorp Limited, for the acquisition by the latter of approximately 51.52% of the enlarged issued share capital of the Company. In July 2006, Mr. Fang Shin, who was then holding approximately 2.7% interest in Omnicorp Limited, through his investment vehicle, namely Triple Express, acquired from Talent Sino Holdings Limited its entire interest in the Company together with a shareholder's loan owed by the Company to Talent Sino Holdings Limited.

Despite the change in the controlling shareholder of the Company when Omnicorp Limited disposed of its entire interest in the Company to Mr. Fang Shin in July 2006, the Group's management and business operations were not affected and remained stable throughout the Track Record Period. During the period when Omnicorp Limited was the controlling shareholder of the Company, the Group's management and the daily operations were entirely in the hands of the Founders. None of the Directors nominated by Omnicorp Limited assumed any management role or participated in the day to day operation of the Company and their directorships were merely reflective of the majority shareholding in the Company. Omnicorp Limited only seconded to the Company an accountant to monitor the Group's financial reporting from November 2004 to July 2006. Like Omnicorp Limited, Mr. Fang Shin saw his acquisition of the interest in the Company as an investment and had no intention to take part in its management. Mr. Fang Shin had been a Director since July 2006 and he also nominated his son, Mr. Fang Yan Zau, Alexander, to be a member of the Board as well. Mr. Fang Shin resigned as a Director effective on [29 May] 2009. The Board [was] restructured to consist of two executive Directors, namely Mr. Sung and Mr. Cheung, one non-executive Director, Mr. Fang Yan Zau, Alexander, and three independent non-executive Directors [prior to] [●].

### Non-compliance issues

As a result of its rapid expansion during the Track Record Period, the Group has inadvertently failed to comply with certain laws, rules and regulations of the PRC and Hong Kong. Summarised below are the Group's incidents of non-compliance during the Track Record Period:

- (i) failure to obtain the environmental protection facilities approval for the production facilities prior to the commencement of operations of Shenzhen Xingli and Dongguan Super Furniture;
- (ii) failure to make timely housing provident fund contributions by Shenzhen Xingli, Shenzhen Xingli Zundian and Dongguan Super Furniture and failure to make employee social insurances contributions by Dongguan Super Furniture;

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- (iii) late filings of the Company's subsidiaries in accordance with the Companies Ordinance and Business Registration Ordinance; and
- (iv) failure to notify the IRD by Hing Lee Furniture of its chargeability to tax within the prescribed time frame.

For further details of these non-compliance incidents and the remedial actions taken by the Group to rectify these incidents, please refer to [the paragraph headed "Compliance and litigation" in this section below]. The Directors believe that, given the remedial actions the Group has taken, none of these non-compliance incidents would give rise to any material adverse impact on the Group's operation.

Furthermore, in view of the occurrence of the above mentioned non-compliance incidents, in December 2008, the Group has set up a compliance department, headed by the chief financial officer and staffed by a qualified accountant and an internal audit manager, to ensure that the Group's operations are in compliance with applicable laws, rules and regulations, to strengthen its existing internal control framework, to recommend best practices for corporate governance and to report internal control deficiencies as well as remedial plans from time to time.

### **Indemnities**

Pursuant to the Deed of Indemnity, each of the Founders and their respective investment vehicles has jointly and severally agreed with and undertaken to the Company (for itself and as trustee for other members of the Group) that he/it will fully indemnify the Group and each member of the Group and at all times keep them and each of them fully indemnified from and against all claims, damages, fines, penalties, loss, payments, liabilities, costs and expenses which any member of the Group may incur, suffer and accrue, directly or indirectly, from or in connection with, any failure, delay or defects of corporate or regulatory compliance as mentioned above on or before the date on which [●] save for those already provided by the Group in its accounts.



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### COMPETITIVE STRENGTHS

The Directors consider that the Group's competitive edges lie in its commitment in product design and development and innovation, comprehensive product range, well-established and strong brand names, extensive distribution network, established long-term relationships with distributors and experienced and capable management team. The Directors believe that the Group has the following competitive strengths:

- **Commitment in product design and development and innovation**

The Group places strong emphasis on creating innovative designs and developing new products in order to maintain its competitive edges. The Group has established a strong design and development department which is headed by Mr. Huang, being one of the Founders, who has over [20] years of experience in the home furniture industry. As at the Latest Practicable Date, there were [43] employees in the design and development department of the Group. The Group's product design and development process can be broadly divided into four phases: (i) market assessment; (ii) product development and design; (iii) manufacturing feasibility; and (iv) market feedback. The design and development department sets up designated design teams for each of the classic furniture series and modern furniture series. The design and development department requires its teams to regularly roll out new furniture designs mainly at industry trade fairs held in March and August of each year and introduce enhanced products throughout the year in the PRC. In addition to developing new products, the design and development department takes account of the latest trends and feedback from customers regarding the function, colour or use of raw materials and accessories to enhance the existing products through modifying designs and particulars of existing products, adding new features or using alternative materials or colours. In order to minimise the cost of patent registration, the Group would register those designs which are most commonly used in the Group's products and have higher market potential. As at the Latest Practicable Date, the Group was the registered owner of [6] patented product designs. During the Track Record Period, the Group's product design and development team had been consistently introducing an average of around [350] new or enhanced products every year. Products developed by the Group's product design and development department have won numerous industry awards for product designs such as 第十九屆深圳國際家具展覽會民用書房家具系列金獎 (The 19th Shenzhen International Furniture Exhibition Gold Award of Study Room Home Furniture Series) awarded by SFTA in 2006 and 中國十大家具品牌(2005-2006)－尊典，歐瑞系列產品 (Top 10 Famous Furniture Brands in China (2005-2006) – Johnston and Oriant Brand Furniture Series) awarded by 中華全國工商業聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce) in 2006. In August 2008, the Group has also been awarded 中國十大家具品牌－尊典，歐瑞(2007-2008) (Top 10 Famous Furniture Brands in China – Johnston and Oriant (2007-2008)) by 中華全國工商業聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce).

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- **Comprehensive product range**

The Group offers a wide range of high quality and sophisticated home furniture products. The Group’s home furniture products are principally categorised into classic and modern series for use in bedrooms, living rooms, dining rooms and home offices, covering mid to high price points consumers. In order to further diversify its product lines and expand its market share in both the PRC and the overseas markets, the Group soft launched a brand new furniture product line under the brand “CHINATAG” in early 2008. [It is contemplated by the Directors that the brand “CHINATAG” would be promoted as “*contemporary Italian design with traditional Chinese furniture style*”, targeting at high price point consumers in both the PRC and the overseas markets.]

- **Well-established and strong brand names**

The Group currently owns a number of brands, among which the Directors consider the brands “Johnston”, “Orient” and “PZ-King” are particularly well established and popular in the PRC. As at the Latest Practicable Date, the Group was the owner of [36] trademarks. Two of the Group’s brands “Johnston” and “Orient” were awarded 中國十大家具品牌 (2005-2006) – 尊典 · 歐瑞系列產品 (Top 10 Famous Furniture Brands in China (2005-2006) – Johnston and Orient Brand Furniture Series) by 中華全國工商業聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce) in 2006. The Group was also recognised for its contributions to the PRC wood-based home furniture industry, and was awarded 突出貢獻獎 (Exceptional Contributions Award) in 2004 by SFTA, and 2000-2004年度廣東省優秀家具出口企業 (Certificate of Excellent Export-Oriented Furniture Enterprise in Guangdong Province (2000-2004)) in 2005 by 廣東省家具商會 (Guangdong Furniture Chamber of Commerce). In August 2008, the Group was also awarded 中國十大家具品牌 – 尊典 · 歐瑞 (2007-2008) (Top 10 Famous Furniture Brands in China – Johnston and Orient (2007-2008)) by 中華全國工商業聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce).

- **Extensive distribution network**

The Group’s home furniture products are marketed through an extensive distribution network in the PRC. As at the Latest Practicable Date, the Group contracted with [511] distributors who operated over [600] approved shops, forming a prominent distribution network covering [22] provinces, [4] municipalities and [4] autonomous regions in the PRC. In addition, home furniture products of the Group are also exported to [overseas countries mainly in Asia and Europe].

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- **Established long-term relationships with distributors**

Over the years, the Group has established strong and close working relationships with its distributors through delivery of comprehensive range of high quality and innovative home furniture products and after-sales service support which includes provision of in-house and on-site staff training, timely market information and store layout consultancy advice. During the Track Record Period, sales to the top five distributors in aggregate accounted for approximately [8.8]%, [5.5]% and [7.2]% of the Group's turnover and approximately [22.0]%, [14.3]% and [15.2]% of the Group's domestic sales.

The top five distributors of the Group for the year ended 31 December 2008 have maintained business relationships with the Group for periods ranging from 2 to 8 years. Such long-term relationships with the major distributors are key to the Group's success in expanding its market share in the PRC.

- **Experienced and capable management team**

The growth and success of the Group's business are attributed to its experienced and dedicated management team with extensive furniture industry knowledge. The management team is led by one of the Founders and an executive Director, Mr. Sung, who has over [15] years of experience in the home furniture industry, and has been instrumental in spearheading the Group's growth. In addition, the other three Founders, Mr. Cheung, Mr. Chan and Mr. Huang, have over [15], [15] and [20] years of experience in the home furniture industry respectively. The intimate knowledge and dedication of such key management are critical to the success of the business of the Group.

## STRATEGIES

The Directors believe that there are promising prospects in the home furniture industry in the PRC. In order to further expand its business, the Group intends to adopt the following strategies:

- **Increasing brand recognition and enhancing corporate profile**

The furniture industry in the PRC comprises mostly small to medium-sized enterprises. There are approximately 50,000 enterprises in the furniture industry in the PRC with no apparent brands dominating the market. Under such operating environment, the Directors consider that consumers' awareness and recognition of the Group's brands are crucial to the Group's success and growth. The Company intends to strengthen public awareness of its brands, in particular, "Johnston", "Orient", "PZ-King" and "CHINATAG", as well as to enhance corporate profile through employing multi-faceted advertising strategies. The Group will continue to promote its corporate image and brands through advertising on a variety of media

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channels including billboards, buses and bus-stops, magazines, trade publications and newsletters in the PRC. In addition, the Group will put more efforts in promoting its "CHINATAG" products in the PRC through sending out product brochures and participating in trade fairs.

- **Strengthening design and development capabilities and expanding product range**

The Group intends to strengthen its design and development capabilities through the deployment of advanced design technology and equipment. The Group also intends to recruit additional four to five designers from domestic leading design institutes in 2010 and provide continuous training to its design and development staff. Training includes (i) in-house training by senior designers in relation to product knowledge and characteristics of the Group's products; (ii) inviting renowned furniture design and development experts to conduct professional courses covering use of materials, color, latest product development and use of technology; and (iii) sending designers to participate in furniture trade fairs in the PRC and abroad to gain firsthand knowledge of international furniture trend and development. The Group also intends to engage international renowned furniture designers to act as its consultants. It is the Group's objective to focus its design and development initiatives on the expansion of product range and to create quality products with innovative designs to meet the changing tastes of consumers. In addition, the Group intends to set up a testing centre at Shenzhen Xingli Production Base in 2010. The testing centre will be equipped with new machineries and staffed with two employees with furniture-related quality control experience for testing newly designed products, raw materials used in production and finished products. The Group plans to commence trial run of the testing centre in around September 2010 and normal operations as from October 2010.

- **Increasing market penetration in the PRC**

The Directors believe that there is substantial growth potential for the home furniture industry in the PRC. Therefore, the Group plans to put more efforts in marketing activities and customer service support to enhance its market penetration and expand the distribution network of the Group's branded furniture products in the PRC. The Group will continue its present practice of providing training to the existing distributors on sales and marketing skills and customer services as well as holding seminars to brief distributors on shop design and product display at retail outlets. The Group intends to conduct the training and seminars by in-house senior

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sales officers and industry experts. At the same time, by establishing close contacts with the distributors, the Group will be able to keep abreast of market information and consumer preference and take appropriate measures to meet consumers’ tastes and preferences. The Group will rely on the above strategies to maintain its competitive position and together with the extensive efforts put in marketing and advertising activities as mentioned in the sub-paragraph headed “Increasing brand recognition and enhancing corporate profile” above, the Directors are confident that the Group will be able to increase its market share and attract new customers.

- **Increasing production capacity and improving production efficiency by deployment of new production equipment**

In view of the continuous growth of the home furniture industry, the Group has planned to increase its production capacity in a timely and cost-effective manner. The Group has acquired Longgang Land I and Longgang Land II for the construction of new production facilities. In addition, the Group intends to improve its production efficiency by deployment of new production equipment in the Shenzhen Xingli Production Base. The Group has ordered advanced woodworking machineries from local and overseas suppliers.

- **Growth through value-accretive acquisition strategies**

To further expand its business, the Group may enter into strategic alliances, joint ventures or mergers and acquisitions with companies in the PRC. The Group will select the alliance or joint venture partners or merger or acquisition targets based on their sales network, product portfolio, quality of products and services and production capacities which are complementary to the Group’s existing operations or growth plans. Moreover, as the PRC’s furniture market is a fragmented industry, the Directors believe that there will be opportunities for consolidation.

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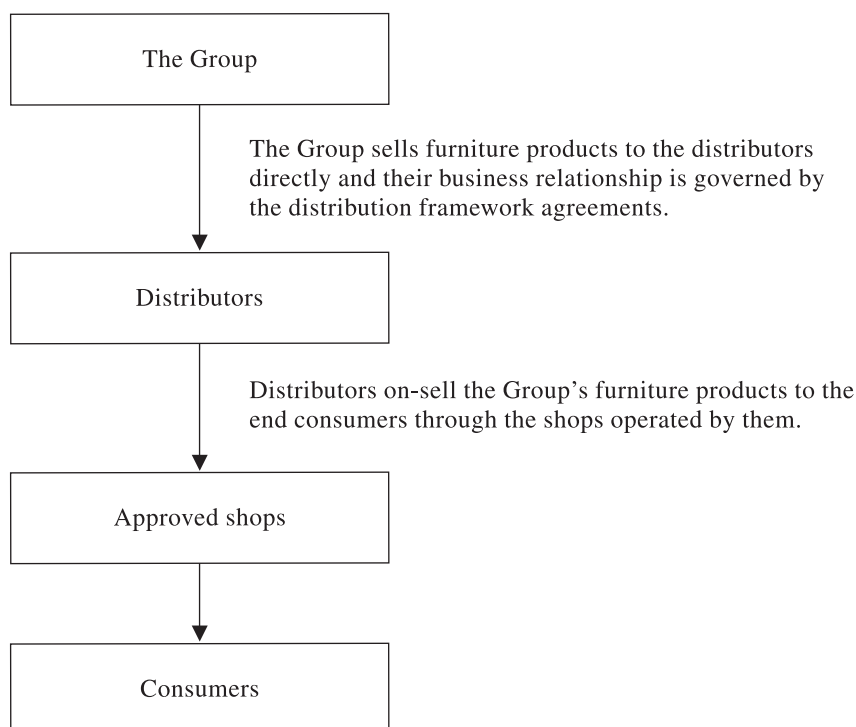
### SALES AND DISTRIBUTION

#### Distribution network

The Group has established an extensive distribution network to market its products in the PRC and developed business relationships with over [90] overseas customers. The branded wood-based furniture products manufactured by the Group are distributed in the PRC through approved shops operated by third party distributors. During the Track Record Period, the Group contracted with [348], [435] and [471] distributors in the PRC respectively. As at the Latest Practicable Date, the Group contracted with [511] distributors in the PRC. The branded and unbranded wood-based furniture and mattress products of the Group are marketed abroad by its overseas customers which include mainly furniture retailers and importers. Both the distributors in the PRC and the overseas customers are regarded as the final customers of the Group. The Group does not own nor operate any approved shops itself as the Directors believe that through the extensive distribution network operated by the distributors instead, the Group will be able to penetrate into the mass market in the PRC at a faster pace.

*The following chart illustrates the relationship among the Group, the distributors and the end consumers for the Group’s domestic sales:*

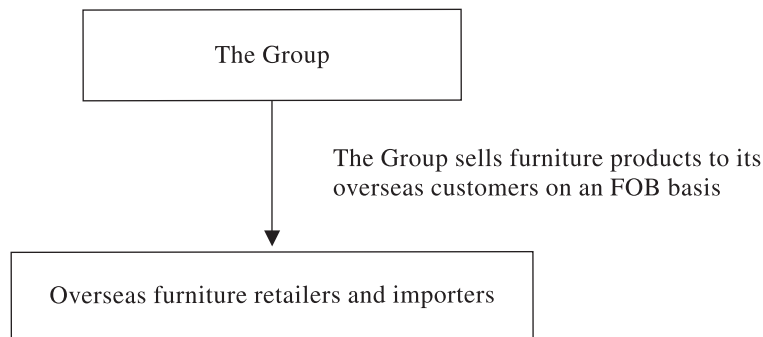
#### Domestic market



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The following chart illustrates the relationship among the Group and its overseas customers for its export sales:

### Export market



### Domestic sales

As at the Latest Practicable Date, the Group had contracted with [511] local furniture distributors, who operated over 600 approved shops to market the Group's branded home furniture products to end-users in the PRC. All of these distributors are home furniture retailers and the approved shops are operated by them. The distributors are usually located in the same cities as the approved shops.

### Selection of the distributors

When appointing the distributors, the Group assesses the suitability of a potential distributor based on (i) its sufficiency of financial resources amounting to approximately RMB[500,000] in order to settle the initial rental deposit and decoration expenses for opening the retail shop as well as to purchase a meaningful amount of furniture products from the Group for its initial operation; (ii) the feedback on the distributor's reputation and integrity obtained from the reference check conducted by the Group; and (iii) its relevant experience in the management and operation of furniture retail shop though this is not a compulsory requirement.

The following table sets out the total number of distributors and approved shops in the PRC as at 31 December 2006, 2007 and 2008 and the average annual turnover per approved shop during the Track Record Period:

	As at 31 December		
	2006	2007	2008
Number of distributors	348	435	[471]
Number of approved shops	380	482	[565]
Average annual turnover per approved shop (HK\$'000)	390.6	437.8	[449.7]

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The Group does not have any requirement on the number of shops operated by each distributor and it is not the Group's strategy to appoint distributors who operate one approved shop only. However, it is the Group's strategy to ensure no approved shop is located and operated in the close proximity of one another in order to avoid competition. The Directors mainly consider the distributor's experience and credit worthiness before determining the number of shops to be operated by the relevant distributor.

The distributors are required to obtain the Group's prior approval before opening any new approved shops, although it is not specifically required to do so in the distribution framework agreement. In opening a new shop, the distributor works closely with the Group's sales staff who advise the distributor in selecting shop location, provide the distributor with shop layout design to follow and consent the distributor to use the Group's relevant brand name to name the approved shop. The name of each approved shop generally starts with the name of the city where it operates and is followed by the brand name of products that the shop is selling. The Group sets the minimum floor area of each approved shop for selling the Group's classic series furniture to be no less than 200 sq.m. and for selling the modern series furniture to be no less than 120 sq.m..

The following table sets forth the movements in the number of distributors for the three years ended 31 December 2006, 2007 and 2008:

	As at 31 December		
	2006	2007	2008
Number of distributors at the beginning of the year	431	348	435
Number of existing distributors not appointed	(99)	(5)	(19)
Number of new distributors appointed	<u>16</u>	<u>92</u>	<u>55</u>
Number of distributors at the end of the year	<u><u>348</u></u>	<u><u>435</u></u>	<u><u>471</u></u>

[After Shenzhen Xingli Zundian had taken over the operation originally conducted by Shenzhen Dahao], the Directors undertook steps as described below to regroup its distributors in order to better promote its products in the domestic market, resulting in a reduction of the number of distributors and approved shops in 2006.]

In 2006, the Group laid down the policy of minimum floor area of each approved shop as described above. Therefore, the Group did not renew the distribution framework agreements with those distributors whose shops did not meet the minimum floor area requirement upon their expiry during 2006. Besides, the Group stopped selling its mattress products in the domestic market since the beginning of 2006 and did not renew the distribution framework agreements with approximately 30 distributors who were solely selling the Group's mattress products upon their expiry during the year. In 2007, the Group launched various marketing



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activities through channels like advertisement broadcasting on the [CCTV], roadside billboards, trade publications and newspapers as well as participation in trade fairs and exhibitions. As a result, new distributors were engaged to market the Group's products in the domestic market in 2007 and 2008.

As at the Latest Practicable Date, there were [434] distributors each operating 1 approved shop, [62] distributors each operating 2 approved shops, [13] distributors each operating 3 approved shops and [2] distributors each operating 4 approved shops.

The Directors confirmed that none of them, the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, and the senior management of the Group, or any of their respective associates had any interest in any of the distributors of the Group or the approved shops for each of the three years ended 31 December 2008.

### **Distribution framework agreement**

The relationship between the Group and each of the distributors is governed by a distribution framework agreement, which has a standard term of one year. Upon expiry, the Group mainly considers the past payment records of the distributors in deciding whether to renew the respective distribution framework agreements.

Pursuant to the distribution framework agreement, the Group is required to:

- (i) provide the distributor with advice on shop design and layout guidance and sales training;
- (ii) assign a designated sales person to assist the distributor in marketing the Group's products;
- (iii) exchange products with quality defects;
- (iv) serve at least 15-day notice to the distributor in case of any price adjustment; and
- (v) undertake to sell products to all distributors at the same price,

whilst the distributor is required:

- (a) to operate in the region as approved by the Group;
- (b) to decorate the shop in accordance with the advice provided by the Group;
- (c) not to sell products not manufactured or approved by the Group in the shop; and
- (d) to undertake confidentiality towards any information relating to the Group's operation and products.

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Under the distribution framework agreements, if problems arise in relation to the quality of the Group's products, the Group is required to replace the relevant spare parts unconditionally within the maintenance period. However, if the products are damaged by the distributors, the Group will only replace the relevant spare parts at the costs of the distributors. There is no provision in the distribution framework agreement entitling the distributors to return the Group's products under any other conditions, nor is there provision relating to product liability or quality warranty provided by the Group to the distributors or the end customers. During the Track Record Period, the sales returned by the distributors amounted to approximately HK\$[0.2] million, HK\$[0.3] million and HK\$[0.5] million respectively. Pursuant to the relevant laws and regulations in the PRC, consumers may claim the seller or the manufacturer for any personal injury or other damages due to the defect of the products purchased. Up to the Latest Practicable Date, [the Group had not received any claims from its distributors or end customers against it in respect of product liability.] There is no provision in the distribution framework agreement entitling the Group to charge its distributors any fees for the sales and marketing campaigns launched by the Group or any other supporting services provided by the Group. The distribution framework agreement also sets out the transportation charges for products delivered to the locations within the Guangdong Province, the PRC. For areas outside the Guangdong Province, the relevant distributor has to arrange its own transportation of products from the Group's premises to the shops. The Directors confirmed that the Group had no arrangement with the distributors in relation to sales incentives and rebate, and arrangement of warehousing. The Group recognises its revenue upon the signing of the delivery notes by the distributors or their respective authorised agents.

As advised by the PRC Legal Advisers, if a party to the distribution framework agreement is in breach of the terms thereof, the defaulting party is liable for the breach [and the non-defaulting party shall be entitled to claim compensation from the defaulting party]. If both parties are at fault, they shall bear their respective liabilities according to the actual circumstances. In addition, in the event that any distributor breaches any major terms of the relevant distribution framework agreement, such as failure to undertake the confidentiality obligation and sale by the distributor of counterfeit products, the Group is entitled to terminate the distribution framework agreement unilaterally and to claim damages from such distributor. The Directors confirmed that there was no breach of the major terms of the distribution framework agreements by the Group or any distributor and the Group did not terminate any of the distribution framework agreements [prior to its expiry date] during the Track Record Period.

### **After-sales support to the domestic distributors**

The Group employs an active after-sales support strategy. Sales persons of the Group regularly visit the approved shops to ensure that they are operated in accordance with the terms of the distribution framework agreements. As at the Latest Practicable Date, the Group employed [42] sales persons in its domestic sales divisions and divided the sales persons into 6 teams. Headed by a regional sales manager, each team has been assigned to monitor the sales activities, solicit orders from and provide after sales services to a group of designated distributors and their respective approved shops within the same region. Due to the large number of distributors and approved shops located across the nation, the Directors considered that it would post significant burden on the Group in terms of manpower and costs to set up and maintain an electronic system linked with the distributors and approved shops to monitor

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their sales activities. Each team is required to visit the distributors and their respective approved shops once every two months and through phone calls, on a regular basis, to solicit restocking orders and gather information about the sales performance of the approved shops, the marketability of the Group's furniture products from the distributors and consumers' opinion on the Group's products. The sales persons did not record any of the sales information of the approved shops gathered through phone calls, but used such data as a general reference on the marketability of the Group's furniture products when soliciting restocking orders from the distributors. The Directors confirmed that none of the personnel working in the approved shops were employed by the Group during the Track Record Period.

In order to create a unified theme and brand image across the nation, the Group provides the approved shop operators with:

- guidelines and layouts in relation to the display of the Group's branded products;
- operation manuals with the objective of standardising the operations and logistics of approved shops; and
- training and guidebooks for strengthening the sales techniques and product understanding of the staff of the approved shops.

The map below shows the geographic distribution of the approved shops in the PRC.



*Note:* The number in the relevant province, municipality, autonomous region in the above map denotes the number of approved shops in that region as at the Latest Practicable Date.

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### Export sales

In order to expand its business outside the PRC market, the Group also actively developed the overseas markets by exporting its branded and unbranded wood-based furniture and mattress products to overseas countries mainly in Asia, Europe, North America and Africa.

Unlike domestic sales, the Group does not engage any overseas distributor for its export sales. Through participation in trade fairs and exhibitions in the PRC and overseas, the Group has been able to keep itself abreast of the market demands of different regions around the globe, increase the international exposure of the Group's brands and product designs, and establish and maintain relationship with overseas furniture importers, wholesalers, retailers and suppliers. The Group has an export sales and marketing team responsible for organising its participation in such trade fairs and exhibitions, which included 中國廣州國際傢俱博覽會 (China International Furniture Fair (Guangzhou)), 深圳國際家具展覽會 (Shenzhen International Furniture Exhibition), Imm Cologne – the International Furnishing Show, Salone Internazionale Del Mobile Di Milano and Ligna Hannover.

Moreover, the Group has endeavored to nurture its customer-focused corporate culture through close collaboration with different functional departments in fulfilling customer orders on a timely basis. All these factors helped the Group in establishing a strong overseas client base. The new markets opened up by the Group during the Track Record Period included [Angola], [Congo], [Saudi Arabia], [Belgium] and [Sweden] in 2006, [Oman] and [Vietnam] in 2007 and [Thailand] and [Kazakhstan] in 2008. During the Track Record Period, the Group's overseas customers were located in about [49], [57] and [49] countries respectively.

Set out below is a table showing the breakdown of the Group's export sales by geographical locations during the Track Record Period:

	<b>For the year ended 31 December</b>					
	<b>2006</b>		<b>2007</b>		<b>2008</b>	
	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%
Asia ( <i>Note 1</i> )	127,850	66.0	172,942	68.2	176,896	67.7
Europe ( <i>Note 2</i> )	24,817	12.8	32,287	12.7	35,370	13.5
Others ( <i>Note 3</i> )	41,130	21.2	48,509	19.1	49,046	18.8
<b>Total</b>	<b><u>193,797</u></b>	<b><u>100.0</u></b>	<b><u>253,738</u></b>	<b><u>100.0</u></b>	<b><u>261,312</u></b>	<b><u>100.0</u></b>

*Notes:*

1. Asia mainly represented Japan, Taiwan, Middle East and Southeast Asia.
2. Europe mainly represented Sweden, Italy, Spain and Germany.
3. Others mainly represented the United States, Canada, Angola and Ivory Coast.

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The Group's overseas customers mainly include furniture retailers and importers. To the best knowledge of the Directors, the target customers of the Group's overseas customers are furniture retailers (in the case of furniture importers) and end consumers (in the case of furniture retailers). During the Track Record Period, the Group had transacted business with over [170], [140] and [90] overseas customers respectively. In 2006, in order to expand its export business, the Group developed business relationships with a large number of new overseas customers, without requiring a minimum order size. As the export business continued to expand, the Group stopped selling products to those small customers as it was not economical to do so. Instead, the Group focused on expanding trading volume with the remaining customers, and substantially reduced the number of overseas customers with whom the Group transacted business in 2007 and 2008.

The following table sets out the average number and size of sales orders placed by the Group's overseas customers for each of the three years in the Track Record Period:

	For the year ended 31 December		
	2006	2007	2008
Average number of sales orders per overseas customer ( <i>approximately</i> )	5	6	8
Average size of sales orders ( <i>approximately HK\$'000</i> )	205.5	298.2	352.6

The Directors confirmed that none of them, the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, and the senior management of the Group, or any of their respective associates had any interest in any of the overseas customers of the Group during the Track Record Period.

When accepting orders from the overseas customers, the Group (i) assesses its ability to meet the craftsmanship required; (ii) confirms the production capacities of the Group or the contract manufacturers sufficient to handle these orders; and (iii) requires a minimum order value of HK\$[20,000]. The Group did not enter into any form of distribution arrangement with its overseas customers. The transactions with the Group's overseas customers are conducted on a deal by deal basis. The product pricing was subject to arm's length negotiation between the Group and the respective overseas customers. The Directors confirmed that the Group had no arrangement with the overseas customers in relation to goods return policy, sales incentives and rebate, product liability and warranty provision and arrangement of warehousing, or with any overseas end consumers in relation to any product warranty. Certain major overseas customers sometimes attend the Group's production premises to inspect the quality of the products before shipment. The Group does not maintain any insurance to cover the product liability risk in its exporting markets. The Directors confirmed that the overseas customers were responsible for product liability in respect of the Group's products sold in the respective overseas countries. It is the Directors' understanding that any product liability claim brought by the end consumer in the overseas markets would be handled by the relevant overseas customer locally. However, the Group cannot assure that it would not be named as a defendant in any lawsuit or proceeding brought by the end consumer in respect of the product liability claim. Furthermore, if the relevant overseas customer can prove that the product quality deficiency which gives rise to the

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product liability claim is caused by the Group's fault, the relevant overseas customer may claim against the Group. Up to the Latest Practicable Date, [the Group had not received any claims regarding product liability from its overseas customers or their end customers.] The Directors also confirmed that there had not been any products returned by the overseas customers during the Track Record Period.

The Group recognises its revenue in respect of the sales to overseas customers upon the issuance of the bills of lading after the goods are loaded on board. All the Group's sales to overseas customers are on an FOB basis. For the three years ended 31 December 2008, in case there were any trade restriction levies such as anti-dumping duties, tariffs and quota fees imposed by the countries to which the Group exported its products, the relevant overseas customers were responsible to settle such costs. During the Track Record Period, so far as the Directors are aware, among the overseas markets where the Group exported its products, only the U.S. imposed anti-dumping duties on wooden bedroom furniture products imported from the PRC, and the anti-dumping duties imposed on the Group's wooden bedroom furniture products ranged from [7.24% to 32.23%]. For the three years ended 31 December 2008, the Group's export sales which were subject to U.S. anti-dumping duties amounted to approximately HK\$16.8 million, HK\$21.0 million and HK\$13.7 million, representing approximately 8.7%, 8.3% and 5.2% of the Group's export sales respectively.

### Customers

The Group's customers are mainly home furniture retailers in the PRC and furniture retailers and importers in the overseas markets.

For its licensing business, the Group's licensees are furniture manufacturers in the PRC.

For the three years ended 31 December 2008, sales to the Group's single largest customer accounted for approximately [10.9]%, [11.2]% and [8.5]% of its turnover respectively and sales to the Group's top five customers together accounted for approximately [32.6]%, [32.3]% and [29.8]% of its turnover respectively. The five largest customers of the Group during the Track Record Period have maintained business relationships with the Group for a period ranging from [1] to [15] years.

The following tables set out the background and locations of the top five customers during Track Record Period:

*The top five customers for the year ended 31 December 2006*

<b>Customers</b>	<b>Location</b>	<b>Background</b>
The top 1 customer	Japan	Home furniture retailer
The top 2 customer	The Middle East and India	Home furniture retailer
The top 3 customer	PRC	Home furniture retailer
The top 4 customer	Taiwan	Home furniture importer
The top 5 customer	The United States	Home furniture retailer

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*The top five customers for the year ended 31 December 2007*

<b>Customers</b>	<b>Location</b>	<b>Background</b>
The top 1 customer	Taiwan	Home furniture importer
The top 2 customer	Japan	Home furniture retailer
The top 3 customer	The United States	Home furniture retailer
The top 4 customer	PRC	Home furniture retailer
The top 5 customer	The Middle East and India	Home furniture retailer

*The top five customers for the year ended 31 December 2008*

<b>Customers</b>	<b>Location</b>	<b>Background</b>
The top 1 customer	Japan	Home furniture retailer
The top 2 customer	The Middle East and India	Home furniture retailer
The top 3 customer	Taiwan	Home furniture importer
The top 4 customer	The United States	Home furniture retailer
The top 5 customer	Qatar	Building contractor

The Directors confirmed that none of them and their respective associates and the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, had any interest in any of the five largest customers of the Group during the Track Record Period.

### *Credit terms*

The Group's credit terms differ according to the types of customers.

For domestic sales, all the new customers are required to pay in cash upon delivery or place a deposit when ordering, which amount depends on the Group's assessment of the credit risk associated with these new customers. For existing customers, depending on the Group's assessment of their credit worthiness, the Group generally requires partial settlement upon delivery of its products and the remaining balance is subject to credit terms of 30 to 60 days. The exact amount of the credit limits and the terms of the credit period are determined based on the length of business relationship between the relevant customer and the Group, credit history, size of purchase orders, sales performance history and past collection history. During the Track Record Period, the approximate range of credit limits granted by the Group to customers in relation to the domestic sales was from RMB[10,000] to RMB[1 million] and the methods of settlement by the local customers are either bank transfer or cash payment.

For licensing fees payable by the licensees under the licensing arrangements, the Group grants its licensees a standard credit term of 60 days.

For export sales, all customers, except a few long-established customers to whom credit terms of 30 to 90 days are offered, are required to place up front cash deposit with or to obtain letters of credit in favour of the Group when placing purchase orders.

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The credit terms and limits for each distributor and overseas customer are approved by the chief executive officer of the Company and are subject to regular review by the Group's senior management. The Group may amend the credit terms from time to time in light of changing market conditions and industry norms. The Group's chief financial officer monitors the outstanding trade receivables and instructs the sales and marketing department to follow up on the payment status of any overdue trade receivables.

The Group has adopted a policy of making specific impairment for doubtful debts, based on its quarterly review of the Group's trade receivables. The Group would consider the customers' payment history, ordering pattern, and length of the business relationship with the Group to determine the amount of impairment for the accounts which are past due.

The table below sets forth the impairment for doubtful debts as well as trade receivables turnover for the three years ended 31 December 2008:

	For the year ended 31 December		
	2006	2007	2008
Impairment/(reversal) for doubtful debts made during the year ( <i>HK\$'000</i> )	[4,441]	[(913)]	[1,509]
Trade receivables turnover days <sup>(Note)</sup>	[60]	[41]	[25]

*Note:* Trade receivables turnover days equals to the average of the opening and ending trade receivables balances of the year divided by the turnover during the year and then multiplied by 365 days.

### Seasonality

During the Track Record Period, the Group had generally recorded higher domestic sales in the months of April, August, September, October and December. The sales generated in these months in aggregate accounted for approximately [57.5]%, [49.3]% and [48.8]% respectively of the total domestic sales during the Track Record Period. The Directors attribute the higher sales recorded during these months to the consumers' tendency to spend during the shopping seasons in summer and the months leading to the extended Chinese holidays in May, October and Chinese New Year.

The Group's export sales were normally higher in the periods from March to April and from August to September and in December during the Track Record Period. Sales generated in these periods in aggregate accounted for approximately [51.5]%, [47.6]% and [46.5]% respectively of the total sales from the overseas markets during the Track Record Period. The Directors believe that the higher sales were mainly due to increases in purchases driven by shopping seasons in particular the summer and the holiday seasons of Christmas and New Year.



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For both the domestic and overseas markets, the time around the month of February was generally regarded as the slowest season in the Track Record Period. In response to this seasonal decrease in sales, the Group reduced its scale of operation as the slow down coincided generally with the Chinese New Year when majority of the Group's employees would take their holiday leave. During the slow seasons, the Group would focus on product development, sales staff training, customer visits and solicitation of new customers.

### LICENSING ARRANGEMENTS

Banking on its strong capabilities in furniture design and brand management, the Group started to grant initially to the furniture distributors, and subsequently to the furniture manufacturers the rights to use its certain brand names and product designs in the furniture products they marketed in 2004. Through the licensing arrangements with the licensees, the Group is able to secure alternative income source other than from its conventional manufacture and sales business. Besides, the Group can also enhance the brand awareness of its own brands through the distribution network of the licensees. The Directors consider that such business model of licensing enables the Group to continue expanding its revenue base without being subjected to production capacity and working capital constraints.

For the three years ended 31 December 2008, the licensing fees earned by the Group amounted to approximately HK\$[27.4] million, HK\$[27.9] million and HK\$[18.9] million respectively, representing approximately [7.4]%, [5.7]% and [3.5]% of the Group's turnover respectively. For the two years ended 31 December 2006 and 2007, the Group contracted with nine domestic furniture distributors in the PRC, who were also the Group's distributors for domestic sales. The Group granted these nine licensees the licence to use certain brand names and product designs of the Group in the furniture products they marketed under their sales network. These distributors were required to place manufacturing orders with the manufacturers designated by the Group for the furniture products under the licence. Under the licence agreements with the distributors, the distributors paid licensing fees to the Group based on the quantity of furniture products ordered by them and manufactured by the designated furniture manufacturers, but not conditional on the sale of products by the relevant distributors to their customers. After the expiration of the two-year term under the licence agreements with these distributors at the end of 2007, the Group did not renew the licence agreements with the above nine furniture distributors. Instead, the Group entered into licence agreements with four furniture manufacturers in the PRC, [two] of which were also contract manufacturers of the Group. All of these licensees are Independent Third Parties. As these four licensees were located in the close proximity to the Company's PRC subsidiaries, the Directors believed it would be more efficient to communicate with these licensees and conduct quality inspection. These four licensees do not have their own distribution network. They sell their products to their respective customers, who are mainly furniture retailers in the PRC. As far as the Directors were aware, a small number of the licensees' customers, namely furniture retailers, were also the Group's distributors. However, the Group did not discover that any of its distributors was selling the Group's branded products together with the licensed products in the same shop during the Track Record Period.

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The licensing fees payable by the licensees are calculated based on a certain percentage of the invoiced value of the furniture products under licence at which the licensees sell to their customers. The unit prices for calculating the invoiced value of the furniture products are pre-determined by the Group and the licensees after arms' length negotiation and taking into account the costs incurred by the Group in product design and brand building as well as the potential production costs. In the event that a licensee sells its products to customers at prices different from those as the pre-determined, the licensing fees will be calculated based on the actual invoiced value. [So far as the Directors are aware, up to the Latest Practicable Date, none of the licensees had sold their products to customers at prices that differ from the Group's pre-determined prices.]

Set out below are the types of licensees and the licensed brands during the Track Record Period:

	<b>For the year ended 31 December</b>		
	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Types of licensees</b>	Distributors	Distributors	Manufacturers
<b>Licensed brands</b>	Orient, Classic Sanroy, Mandarin	Orient, Classic Sanroy, New Nobleman	Orient, Classic Sanroy

### **Selection of licensees**

As at the Latest Practicable Date, the Group maintained licensing arrangements with four licensees which were furniture manufacturers operating in the PRC. The Group selects its licensees based on, among others, the following major criteria:

- its operating history in the production of wood-based furniture products;
- its production capacity, ability in delivering products in a timely manner, and standards and techniques of product quality assurance;
- its production floor area of a minimum GFA of not less than 4,000 sq.m.;
- its management capabilities, reputation and integrity; and
- its financial resources.

As at the Latest Practicable Date, the Group had maintained business relationships with these licensees for approximately [1] to [13] years. The Group does not have contractual relationships with the customers of the licensees, or any control over the operations of the shops owned by them. The Directors believe that neither the target markets nor the styles of products under the licence substantially overlap with those of the Group's branded products manufactured and sold by the Group and there should not be any major degree of product competition and cannibalisation between the distributors of the Group's branded products and the licensees.

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The Directors confirmed that none of them and their respective associates and the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, had any interest in any of the licensees of the Group during the Track Record Period.

### **Licence agreement**

Pursuant to the licence agreement between the Group and each of its licensees, the Group (i) grants non-exclusive rights to the licensee for the use of its certain brand names and product designs; and (ii) is responsible for the nationwide brand promotional activities to boost the market image and brand awareness of the products manufactured, whilst the licensee shall (a) pay to the Group the licensing fees with respect to the furniture products it manufactured and sold under the licence; (b) give feedback to the Group on detection of any sale of counterfeit products or any sort of infringement of intellectual property rights with respect to the products under the licence in the market; and (c) ensure that the quality of products manufactured under the licence conforms to the standards required by the Group during the term of the licence agreement. Each licence agreement has a fixed term of two years and is subject to renewal by mutual agreement upon expiry. The Group can terminate the agreement unilaterally and reserve the right to claim compensation or damages in the event that any licensee breaches any major term of the relevant licence agreement or is found to act in a manner severely affecting the image of the Group. The Director confirmed that, during the Track Record Period, neither the Group nor any of the licensees had breached the terms of the respective licence agreements and no licence agreement had been terminated by the Group during its term.

Under the present licensing arrangement with the furniture manufacturers, the Group does not provide the licensees or their customers with any sales incentives, product liability and warranty provision, and warehousing arrangement or the end consumers with any product warranty. Pursuant to the relevant laws and regulations in the PRC, consumers may claim the seller or the manufacturer for any personal injury or other damages due to the defect of the products purchased. Therefore, based on the advice of the PRC Legal Advisers, the Directors consider that the Group will not be liable for any claims in respect of product liability. Up to the Latest Practicable Date, [the Group had not received any claims from end consumers against it in respect of product liability in relation to the products manufactured under the licensing arrangements.]

### **Management of licensees**

In order to maintain the quality and the standard of the products manufactured under the licence, staff members from the production department and the quality assurance department of the Group are seconded to the production facilities of the licensees to monitor the production process and conduct product quality inspections. They also attend the licensees' warehouses to conduct random inspections on the quality of the finished products. In case the finished products do not meet the required quality standard, the Group can either request the licensee to take necessary remedial measures, to recall the defective products from the market, or to terminate the licence agreement unilaterally. The Directors confirmed that no products manufactured under the licence were recalled from the markets other than the replacement of certain minor spare parts during the Track Record Period.

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The Group’s ERP system is linked to those of the licensees. The Group can have instant access to the management information of the licensees, such as purchase orders placed by the customers of the licensees, the production status and the sales and fulfillment information of the licensees. Inspection of delivery notes issued by the licensees against the data retrieved from the licensees’ ERP system is performed by the accounting staff of the Group on a monthly basis prior to the issue of invoices to the licensees in respect of the licensing fees. In addition, monthly confirmations are sent to the licensees for ensuring the correctness of the month end balance of licensing fee receivables.

The Group has registered or has applied for registration of all the trademarks and brand names of the branded products under the licence in the PRC. During the Track Record Period, the Group did not encounter any incident of infringement of intellectual property rights in respect of the trademarks and brand names under licence.


### BRANDS AND PRODUCTS

#### Branded products



The Group seeks to distinguish its home furniture products from its competitors by nurturing strong brand recognition of the Group’s products among the consumers and developing wide range of product designs. With the goal of becoming a leading home furniture provider in both the PRC and overseas markets, the Group has put significant efforts to build up and strengthen its brand portfolio.

The Group’s home furniture products are principally categorised into the classic furniture series and the modern furniture series targeting at middle and high price point consumers.




Products branded under the classic furniture series are generally larger in size and characterised by elaborate and intricate carving and finishing. Due to their distinctive designs and good craftsmanship, home furniture products under the classic furniture series are targeted at middle and high price point consumers who have the consumption power and the predilection for grand and luxurious designs. The Group’s brands classified under the classic furniture series include “Johnston”, “New Nobleman” and “Classic Sanroy”, among which “Johnston” and “New Nobleman” are used for marketing the Group’s self-manufactured products while “Classic Sanroy” is used for marketing the products manufactured by third party furniture manufacturers under the licensing arrangement.

Brand name	Characteristics	Location at home	Target market segment	Recommended retail price range <i>(approximately RMB per set (Note))</i>
 Johnston (self-manufacture)	<ul style="list-style-type: none"> <li>• High grade wooden and upholstered furniture</li> <li>• Classical European luxury with exquisite craftsmanship</li> </ul>	<ul style="list-style-type: none"> <li>• Bedroom</li> <li>• Living room</li> <li>• Dining room</li> <li>• Home office</li> </ul>	[Sophisticated middle and high price point consumers who demand grand and luxurious designs]	[20,000 – 76,000]

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Brand name	Characteristics	Location at home	Target market segment	Recommended retail price range (approximately RMB per set (Note))
 New Nobleman (self-manufacture)	<ul style="list-style-type: none"> <li>Simplified classical furniture</li> <li>Spanish style</li> </ul>	<ul style="list-style-type: none"> <li>Bedroom</li> <li>Living room</li> <li>Dining room</li> </ul>	[Middle and high price point consumers who have the predilection for Spanish-styled classic furniture]	[19,000 – 26,000]
 Classic Sanroy (under licence)	<ul style="list-style-type: none"> <li>Solid wooden furniture</li> <li>Combination of traditional craftsmanship and modern production techniques</li> </ul>	<ul style="list-style-type: none"> <li>Bedroom</li> <li>Living room</li> <li>Dining room</li> </ul>	[High price point consumers who demand luxurious furniture products]	[30,000 – 40,000]


Products under the modern furniture series are characterised by simple and trendy designs with minimal use of decorative items, targeted at younger and middle price point consumers who look for trendy, functional and affordable home furniture. The Group’s brands under modern furniture series include “PZ-King”, “Mandarin” and “Orient”, among which “PZ-King” and “Mandarin” are used for marketing the Group’s self-manufactured products while “Orient” is used for marketing the products manufactured by third party furniture manufacturers under the licensing arrangement.

Brand name	Characteristics	Location at home	Target market segment	Recommended retail price range (approximately RMB per set (Note))
 PZ-King (self-manufacture)	<ul style="list-style-type: none"> <li>Neo-modern</li> <li>Simple, stylish and multi-functional</li> </ul>	<ul style="list-style-type: none"> <li>Bedroom</li> <li>Living room</li> <li>Dining room</li> <li>Home office</li> </ul>	[Middle price point consumers]	[9,000 – 15,000]
 Mandarin (self-manufacture)	<ul style="list-style-type: none"> <li>Italian style with combination of quality and comfort</li> <li>Colourful and dynamic</li> <li>Mix and match to suit individual style</li> </ul>	<ul style="list-style-type: none"> <li>Bedroom</li> <li>Living room</li> <li>Dining room</li> <li>Home office</li> </ul>	[Middle price point consumers who have the preference for Italian-styled modern furniture]	[7,000 – 12,000]
 Orient (under licence)	<ul style="list-style-type: none"> <li>Refreshing collections for the younger generation, children and modern families living in urban areas</li> <li>Modern, fashionable and sleek designs</li> <li>Mix and match to suit the personality of younger generation</li> </ul>	<ul style="list-style-type: none"> <li>Bedroom</li> <li>Living room</li> <li>Dining room</li> <li>Home office</li> <li>Kids workshop</li> </ul>	[Young aged middle price point consumers]	[5,000 – 13,000]

*Note:* A set of furniture comprises a bed, two bedside cabinets, a wardrobe and a dressing table.

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The Group uses its brand “Degas” to market the branded mattresses it manufactures. All the Group’s mattresses are for export only.

Brand name	Characteristics	Location at home	Target market segment	Recommended retail price range <i>(approximately HK\$ per piece)</i>
 Degas (self-manufacture)	<ul style="list-style-type: none"> <li>Provide a variety of mattresses with different degrees of firmness</li> <li>Provide good spinal support</li> </ul>	<ul style="list-style-type: none"> <li>Bedroom</li> </ul>	[Middle price point consumers]	[900 – 4,000]


The table below summarises the turnover contribution of the branded and unbranded products of the Group during the Track Record Period:

	For the year ended 31 December					
	2006		2007		2008	
	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%
Johnston	74,921	20.3	142,456	28.9	[177,689]	[33.3]
PZ-King	98,723	26.7	86,980	17.6	[88,856]	[16.7]
Oriant	19,754	5.3	23,829	4.9	[17,546]	[3.3]
Mandarin	27,043	7.3	55,925	11.4	[51,844]	[9.7]
New Nobleman	–	–	3,141	0.6	[19,382]	[3.6]
Classic Sanroy	1,347	0.4	939	0.2	[1,401]	[0.2]
Mattress	50,393	13.6	58,748	11.9	[51,665]	[9.7]
Unbranded	97,445	26.4	120,651	24.5	[125,963]	[23.5]
<b>Total</b>	<b><u>369,626</u></b>	<b><u>100.0</u></b>	<b><u>492,669</u></b>	<b><u>100.0</u></b>	<b><u>[534,346]</u></b>	<b><u>[100.0]</u></b>

In order to further diversify its product lines and expand its market share in the PRC and overseas markets, the Group introduces new or enhanced version of existing products to the market each year. Based on market feedback on design, pricing and market acceptability, the Group modifies and improves the design so as to ensure that the new products are able to meet consumers’ tastes and preferences.

The Group soft launched a new product line under the brand “CHINATAG” (中國印) at 深圳國際家具展覽會 (Shenzhen International Furniture Exhibition) held in March 2008 in Shenzhen, the PRC and International Design Week held in Milan, Italy in April 2008. Products branded under “CHINATAG” are designed to target at the market segment of high price point consumers in both the PRC and overseas markets. [It is contemplated by the Directors that the brand “CHINATAG” would be promoted as “contemporary Italian design with traditional Chinese furniture style”.]

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Brand name	Characteristics	Location at home	Target market segment
 CHINATAG	<ul style="list-style-type: none"> <li>• Top grade wooden furniture</li> <li>• Contemporary Italian design with traditional Chinese furniture style</li> </ul>	<ul style="list-style-type: none"> <li>• Living room</li> <li>• Dining room</li> <li>• Home office</li> <li>• Bedroom</li> </ul>	Mature and high price point consumers

### Unbranded products

Apart from exporting its branded furniture products, at the request of the overseas customers, the Group manufactures unbranded furniture products for its overseas customers based on either the Group's own product designs or those provided by the overseas customers. In some cases, the product designs provided by the overseas customer involves special features requiring tailor-made manufacturing process from the Group. Such tailor-made manufacturing processes may involve extensive use of certain colour or special craftsmanship or wood panel milling into special shapes which are distinctive to that particular product and may entail longer production lead time at certain stage of the manufacturing process depending on the product design.

The Group in general prices its branded and unbranded products for overseas sales (including those designed by the overseas customers) with reference to a number of factors including direct labour costs, overheads, cost of raw materials, the complexity of design and the expected profit margin. The Group does not provide any guidelines on the retail price of its branded or unbranded products to the overseas customers.

### DESIGN AND DEVELOPMENT

The Directors believe that strong product design and development capability is one of the Group's competitive edges. Therefore, the Group is committed to creating innovative designs and developing new products in order to keep itself ahead of its competitors and to cater for consumers' ever changing tastes. Products developed by the Group's design and development department have won numerous industry awards for product designs such as 第十九屆深圳國際家具展覽會民用書房家具系列金獎 (The 19th Shenzhen International Furniture Exhibition Gold Award of Study Room Home Furniture Series) awarded by SFTA in 2006 and 中國十大家具品牌(2005-2006)－尊典·歐瑞系列產品 (Top 10 Famous Furniture Brands in China (2005-2006) – Johnston and Oriant Brand Furniture Series) awarded by 中華全國工商業聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce) in 2006. In August 2008, the Group has also been awarded 中國十大家具品牌－尊典·歐瑞(2007-2008) (Top 10 Famous Furniture Brands in China – Johnston and Oriant (2007-2008)) by 中華全國工商業聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce).

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The Group's design and development department is headed by Mr. Huang, one of the Founders, who has over [20] years of experience in the furniture industry. As at the Latest Practicable Date, there were [43] employees in the design and development department of the Group. [34] of them possessed tertiary education qualifications among which [6] were specialised in furniture design. Moreover, 21 employees of the design and development department had over 5 years relevant product design and development experience. The Group regularly sends its design and development staff to participate in domestic and international trade exhibitions and fairs and provides them with training by internal senior designers and external experts to keep them abreast of the latest market trends and product development technologies. The Group's design and development costs comprised primarily in-house staff costs and fees paid to external design houses which were engaged on a case by case basis. During the Track Record Period, the staff costs paid to the employees of the design and development department amounted to approximately HK\$1,270,000, HK\$1,760,000 and HK\$2,046,000 respectively and the costs paid to external design houses amounted to approximately HK\$779,000, HK\$755,000 and HK\$[2,544,000] respectively. The increase in the costs paid to external design houses in 2008 was mainly due to the payment in the amount of €176,000 (approximately HK\$1.9 million) to an independent design house based in Milan, Italy, namely May Day Design. Please refer to the sub-paragraph headed "May Day Design" below for details. The design and development costs are expensed in the year in which the costs are incurred. The Group monitors its design and development costs mainly through control of head count in the design and development department. All such expenses including the payroll are charged to the profit and loss account in the same year as they are incurred.

The Group regularly rolls out new furniture designs every season mainly at the industry trade fairs held in March and August each year in the PRC and introduces enhanced version of the existing products throughout the year. The design and development department sets up designated design teams to be responsible for each of the classic furniture series and modern furniture series product design and development.

The staff of the design and development department work closely with the sales and marketing department, the production department and the procurement department during the product design and development process which takes place every 6 months and which can be broadly divided into four phases: (i) market assessment; (ii) product development and design; (iii) manufacturing feasibility; and (iv) market feedback.

**(i) Market assessment**

Staff of the design and development department collaborate closely with the sales and marketing department in order to keep themselves informed about the latest consumers' preferences, market development and sales strategies. They also attend domestic and international trade exhibitions and fairs to gain first hand information of the latest market trend. During this phase, the department comes up with product concept design, which covers the product images, the expected target customers, product pricing, production process and the choice of raw materials. It usually takes around two to three weeks to complete this process.



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### **(ii) Product development and design**

Based on the result of market assessment, the design and development department commences to develop detailed idea outline and blueprint of the new product, which may be a brand new design or an improvement of an existing model. The Group strives to keep abreast of the changing trends in the furniture industry so that the Group can better anticipate and meet the expectations and preferences of the target consumers. It usually takes around two to three weeks to complete this process.

### **(iii) Manufacturing feasibility**

After developing the preliminary design blueprint, the Group will examine the feasibility of manufacturing the product based on the blueprint. The design and development department will discuss the design and specifications with the production department for the purpose of producing prototype of the new product. The prototype is then inspected and tested for compliance with relevant national product safety requirements. Any flaws or inadequacies detected in the prototype will be rectified. When all relevant tests have been passed, a trial production run will commence. The finished product and the production process will be reviewed by the design and development department, the sales and marketing department and the production department to assess the market prospects of the new product and the feasibility of carrying out mass production. It usually takes around one to two months to complete this process.

### **(iv) Market feedback**

The Group conducts soft launches of prototype of its new design to key customers. It also exhibits such new design at furniture exhibitions or industry trade fairs to obtain market feedback on design, pricing and market acceptability. Based on these responses, the Group will modify and improve the design so as to ensure that the new products are able to meet consumers' tastes and preferences. Once the design is finalised, the Group will commence sales and marketing activities to highlight the new product. Upon receipt of orders from customers, the Group will commence mass production. It usually takes around two months to complete this process.

### **Shenzhen Jing Chu**

The Group has also collaborated with or commissioned other design houses on product design projects since [2004]. The Group engaged Shenzhen Jing Chu to support its product design capability. Shenzhen Jing Chu was founded in 2000 by Mr. Huang and 胡景初先生 (Mr. Hu Jing Chu), an Independent Third Party and a professor at 中南林業科技大學 (Central South University of Forestry and Technology) (formerly known as 中南林學院 (Central South Forestry University)) as well as a renowned expert in furniture design. Shenzhen Jing Chu is principally engaged in the design of furniture and decorative items, corporate image consultation, interior design and decoration and software development. During the Track Record Period, the Group commissioned Shenzhen Jing Chu to design some of its classic and

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modern series of furniture and the total annual amount of fees paid by the Group to Shenzhen Jing Chu for the design services amounted to approximately HK\$[613,000], HK\$[355,000] and HK\$[915,000] respectively. Mr. Huang disposed his entire interests in Shenzhen Jing Chu in January 2009. For additional details of the transactions between the Group and Shenzhen Jing Chu, please refer to the paragraph headed "Transactions with Shenzhen Jing Chu" in this section below.

### May Day Design

In view of the increasing popularity of traditional Chinese furniture, in October 2007, the Group engaged and entered into an agreement with May Day Design (as amended and supplemented in November 2008) to design and develop a brand new product line to be marketed under the brand "CHINATAG" in the European markets. May Day Design, an Independent Third Party, is a specialised product design consulting company based in Milan, Italy. Its corporate website is [www.maydaydesign.it](http://www.maydaydesign.it). The Group chose to engage May Day Design because of its furniture design capability, knowledge of and proximity to the European markets. [It is contemplated by the Directors that the brand "CHINATAG" would be promoted as "*contemporary Italian design with traditional Chinese furniture style*".] Under the agreement with May Day Design, the Group paid €176,000 (approximately HK\$[1.9 million]) to May Day Design in four installments in exchange for May Day Design's services on a project basis including (i) market research; (ii) brand strategy; (iii) brand design; (iv) [product promotion in Shenzhen, Shanghai and Milan furniture exhibitions in 2008 and 2009;] (v) search for distribution channels; and (vi) international market development. According to the agreement with May Day Design, May Day Design has guaranteed confidentiality regarding the results of the project and has undertaken to maintain confidentiality of commercial and research secrets and policies learnt in the course of the project which are not in the public domain. No specific duration of engagement was stipulated in the agreement with May Day Design, but the project is expected to be completed by September 2009 under the said agreement. The aforesaid payment was fully settled in July 2008.

The Group has applied for the registration of the brand "CHINATAG" in the PRC in March 2008 and in Italy in June 2008. [Under the terms of the agreement with May Day Design, the Group will be the owner of intellectual property rights of all products whose product concept is developed by the Group, whereas May Day Design will be the owner of intellectual property rights of the products whose concept is developed exclusively by itself. In the latter case, the Group will pay royalties to May Day Design at such rate to be further agreed between the Group and May Day Design and [the Directors expect that the royalty would be no more than 5% of the sales price]. It is the intention of the Group to use May Day Design's exclusive design when selling the products in the European markets. The Group will develop and design a separate line of "CHINATAG" products for sale in the domestic market.]

Save for the agreement entered into with May Day Design in October 2007 (as amended and supplemented in November 2008), the Directors confirmed that May Day Design did not have any relationship, whether past or present, with the Group, its substantial Shareholders, Directors, senior management and their respective associates.

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### MARKETING AND PROMOTION

The Group’s marketing and promotional strategy aims to enhance the Group’s corporate image and to increase consumers’ awareness of the Group’s branded home furniture products.

#### Brand building

The PRC furniture industry is generally very fragmented with a large number of furniture retail chain stores, wholesalers and independent retailers with no clear dominant players. The Directors consider that strong brand building capability has laid the key foundation for the Group’s success. The Group focuses on six key areas in brand-building: brand awareness, pricing, product quality, product range, customer service and convenience. [The core concept behind these six areas is “affordable luxury” in home furniture, a concept with which the Group expects will drive consumers to readily recognise its brands.] [The Directors also formulate the brand building process to include enforcing a standard layout and stipulating design guidelines for all approved shops.]

The Group’s principal products are marketed under the brand names “Johnston”, “Orient” and “PZ-King”, each encompassing several different styles of design to cater for consumers of different price points and preferences. The Group also creates new brands such as “CHINATAG” to meet the often-changing tastes and preferences of affluent consumers. The objective of the Group’s product differentiation strategy is to expand its product range in order to accommodate different market segments.

#### Sales and marketing activities

The Group’s sales and marketing department maintains regular contacts with existing distributors with a view to maintaining good business relationships with them so that the Group can increase its understanding of the consumers’ requirements and leverage on these relationships to promote its new products. During their visits, the Group’s sales staff would (i) introduce the Group’s latest development and product information to the distributors; (ii) ensure that the approved shops are operated in accordance with the Group’s shop design and layout guidelines and operation manual in order to provide consumers with a unified shopping experience; (iii) gather market and sales information; (iv) provide latest market information; and (v) gather customers’ feedback regarding the Group’s products. In addition, the sales staff take active steps to identify prospective distributors to promote the Group’s products.

#### Multi-faceted advertising strategies

The Group employs multi-faceted advertising strategies through a variety of channels including newspapers, television (nationwide media such as China Central Television), billboards, trade publications and newsletters in the PRC. The Directors believe that such advertising campaigns are capable of reaching the Group’s target consumers. The Group has also set up a corporate website, [www.hingleegroup.com](http://www.hingleegroup.com), which serves to provide information about the Group and its various product lines. For each of the three years ended 31 December 2008, the Group spent approximately [HK\$850,000], [HK\$6,811,000] and [HK\$5,460,000] on advertising respectively.

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### Participation in trade fairs and exhibitions

In order to keep abreast with the latest trends of home furniture in terms of [colours, materials and styling], the Group participates regularly in (i) domestic trade fairs and exhibitions such as 深圳國際家具展覽會 (Shenzhen International Furniture Exhibition) held in March and August each year and 中國廣州國際傢俱博覽會 (China International Furniture Fair (Guangzhou)) held in March each year in the PRC; and (ii) international trade fairs such as Cologne International Furniture Fair, Milan International Furniture Fair and Tokyo International Furniture Fair in recent years. During these trade fairs and exhibitions, the Group promotes its new furniture products to secure sales orders. For each of the three years ended 31 December 2008, the Group incurred [HK\$83,000], [HK\$5,893,000] and [HK\$10,344,000] in participating various trade fairs and exhibitions respectively.

### Sales and marketing department

The sales and marketing department is responsible for the sales, distribution, marketing and promotional activities of the Group’s branded and unbranded products. As at 31 December 2006, 2007 and 2008, the Group’s sales and marketing department employed [47], [49] and [55] sales staff respectively. The Group provides its sales staff with an incentive payment of 0.2% on the amount of sales achieved by each of them, which amount is payable only after the sales proceeds are received by the Group. The Group’s sales and marketing department comprises three divisions, namely, classic furniture division, modern furniture division and export division which details are set out below:

<b>Divisions</b>	<b>Number of sales persons as at the Latest Practicable Date</b>	<b>Roles</b>	<b>Brands handled as at the Latest Practicable Date</b>
Classic furniture division	[25]	Formulation and execution of sales and marketing strategies of products under the classic furniture series in the PRC	“Johnston”, “New Nobleman” and “Classic Sanroy”

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**BUSINESS**

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<b>Divisions</b>	<b>Number of sales persons as at the Latest Practicable Date</b>	<b>Roles</b>	<b>Brands handled as at the Latest Practicable Date</b>
Modern furniture division	[16]	Formulation and execution of sales and marketing strategies of products produced under the modern furniture series in the PRC	“PZ-King”, “Mandarin” and “Orient”
Export division	[14]	Handling export related business of the Group’s branded and unbranded wood-based furniture and mattress products	[“Degas”], “Johnston” and “PZ-King”

*PRC market*

The classic furniture and modern furniture divisions focus on the promotion of the Group’s branded wood-based furniture products in the PRC. They are responsible for the formulation and execution of sales and marketing strategies for their respective brands in the PRC.

These two divisions collectively cover [22] provinces, [4] municipalities and [4] autonomous regions. Each sales person of the divisions is assigned to be responsible for the sales activities in a designated geographical area. As part of the Group’s customer-orientated corporate culture, sales persons assume the role of the first point of contact for customers in their respective sales regions for all matters relating to the Group’s products. The sales persons travel frequently to their designated sales regions to visit customers with a view to addressing their needs, promoting the Group’s products, keeping them informed of the Group’s latest sales and marketing strategies and soliciting restocking orders. They also conduct market researches on local consumers’ tastes and preferences with the view to building up the Group’s marketing and product development database. The Group uses the database to develop its product design and marketing strategies for the PRC market. Staff of the sales and marketing department communicate closely with the production department regarding customers’ orders and specifications and coordinate with the production department and procurement department to ensure that customers’ orders are fulfilled in a timely manner.

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### *Overseas markets*

The export division undertakes all sales related activities for the Group's branded and unbranded home furniture and mattress products in the overseas markets. The sales and marketing staff in the export division are responsible for communicating with the production and procurement departments to ensure that customers' orders are fulfilled on time. The Group's export division actively participates in trade shows and exhibitions held in the PRC and overseas to market the Group's products to potential customers and gather the latest market information regarding product trends.

### **Pricing**

The Group determines the pricing of its branded home furniture products with reference to a number of factors including direct labour costs, overheads, transportation charges, cost of raw materials, the complexity of design, prices set by competitors, the potential market demand and the expected profit margin. The Group also provides pricing guidelines which set out the recommended price range for each branded product to the approved shops but the distributors have full discretion to decide the final retail prices for their respective shops, as each of them has different cost structure in its operations. As regards the licensing arrangements, the licensees have to sell the furniture products they manufactured under licence to their customers at the prices fixed by the Group. Such price lists do not form part of the licence agreement and there is no penalty clause specified in the licence agreement for any non-compliance with the price lists. To avoid any price competition and market cannibalisation between the products sold by the distributors and the licensees, the Group differentiates products sold under the licences and the distribution framework agreements by way of different styles and target markets. The table below sets forth a summary of the styles and target markets of the Group's branded products.

	<b>Style and target market segment</b>	<b>Median price</b> <i>(RMB per set)</i>	<b>Types of materials used</b>
<b>Self-manufactured branded products</b>			
Johnston	Sophisticated middle and high price point mature consumers who demand grand and luxurious designs	[48,000]	1. MDF board and solid wood spare parts (birch wood, beach wood, oak wood, and fir wood) 2. Veneers: cherry wood style

## BUSINESS

	<b>Style and target market segment</b>	<b>Median price (RMB per set)</b>	<b>Types of materials used</b>
New Nobleman	Middle and high price point consumers who have the predilection for Spanish-styled classic furniture	[22,500]	1. MDF board 2. Veneers: beech wood style
PZ-King	Middle price point consumers who prefer contemporary furniture products of traditional style	[12,000]	1. MDF board 2. Veneers: teak wood style
Mandarin	Middle price point consumers who look for Italian-styled modern furniture	[9,500]	1. MDF board 2. Paper based fireproof surface
<b>Licensed branded products</b>			
Oriant	Young aged middle price point customers who prefer modern furniture products of simple and plain designs	[9,000]	1. MDF board 2. Lacquer surface
Classic Sanroy	High price point consumers who demand luxurious furniture products	[35,000]	1. MDF board 2. Solid wood spare parts (birch wood)

During the Track Record Period, the Group did not encounter any licensees selling products they manufactured under licence to their customers at prices different from those fixed by the Group. For overseas sales, the Group’s branded and unbranded products are generally priced with reference to a number of factors including direct labour costs, overheads, cost of raw materials, the complexity of design and the expected profit margin. The Group does not provide any guidelines on the retail price of its branded or unbranded products to the overseas customers.

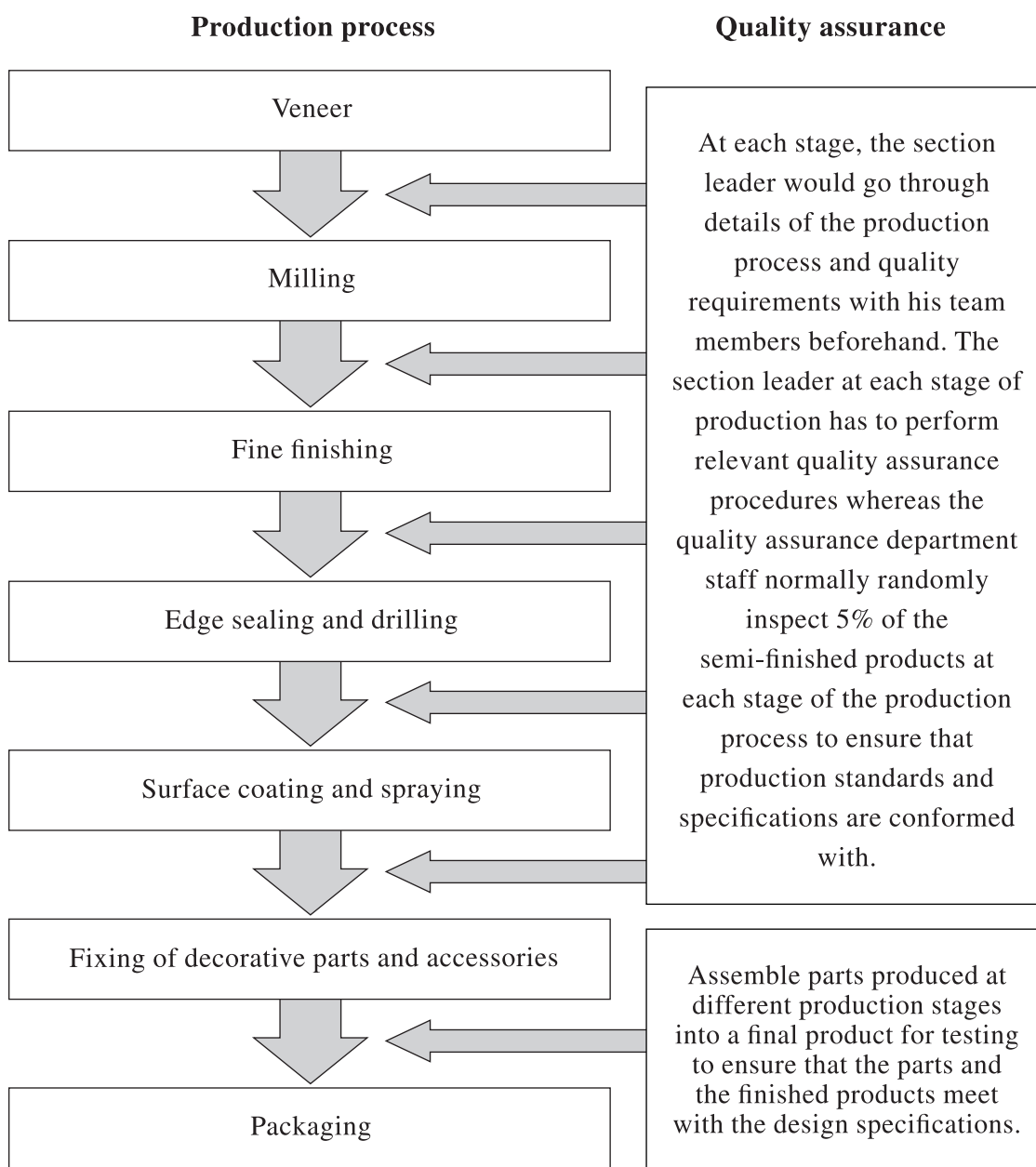
## BUSINESS

### PRODUCTION

#### Production Processes

The Group's home furniture products include wood-based furniture and mattresses. The basic production processes employed in the production of (i) wood-based furniture; and (ii) mattresses are summarised as below:

(i) *Wood-based furniture*





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### Veneer

Wood panels are sealed with veneer in accordance with design specifications. Veneer is required to be sealed smoothly and seamlessly on wood panels. It normally takes about [2] hours to complete this stage of production. (*Note*)



*Veneer*

### Milling

Wood boards sealed with veneer are milled into required specifications to produce furniture parts for further fine finishing. Allowance for errors in length and width is less than 1 millimeter. It normally takes about [6] hours to complete this stage of production. (*Note*)



*Milling*

## BUSINESS

### Fine finishing

Milled parts undergo further fine sanding, milling and scraping to produce refined finishing. For parts of curved or circular shape, a precision mould is used during the fine finishing process to ensure an accurate and consistent result. Allowance for errors in length and width is less than 1 millimeter. It normally takes about [4] hours to complete this stage of production. *(Note)*



*Fine milling*



*Curved parts finishing*



*Fine sanding*

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### Edge sealing and drilling

Edges of the wooden parts are sealed with veneer or PVC sheets to give a decorative effect. Holes are drilled on the parts for assembly. Edges should be sealed smoothly and seamlessly. Allowance for position and depth of the holes drilled is less than 0.5 millimeter. It normally takes about [6] hours to complete this stage of production. (*Note*)



*Edge sealing*



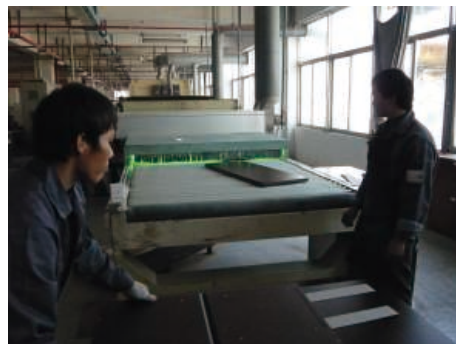
*Drilling*

### Surface coating and spraying

Edge-sealed and drilled parts are polished to produce a smooth surface. The parts may then be sprayed with a layer of transparent paint to fill any dents or gaps, if required. After polishing and spraying with a layer of transparent paint, the parts undergo multiple times of spraying with paints to produce the desired colour. A fully automatic UV spray-coating processing line is installed at the factory of Shenzhen Xingli for spraying parts. This spray-coating processing line can spray and dry the paint on a double-faced part in [10] minutes by employing UV light. Coating should be smooth and the colour evenly sprayed on the surface. It normally takes about [24] hours to complete this stage of production. (*Note*)



*Surface coating*



*UV spray-coating*

## BUSINESS

### Fixing of decorative parts and accessories

Decorative parts and accessories such as doorknobs, handles and glasses are fixed onto the processed parts. Decorative parts and accessories should be firmly affixed to the parts. It normally takes about [1.5] hours to complete this stage of production. (*Note*)



*Fixing of decorative parts and accessories*

### Packaging

Finished parts which meet the quality assurance requirements are flat-packed and ready for delivery. It normally takes about [1.5] hours to complete this stage of production. (*Note*)

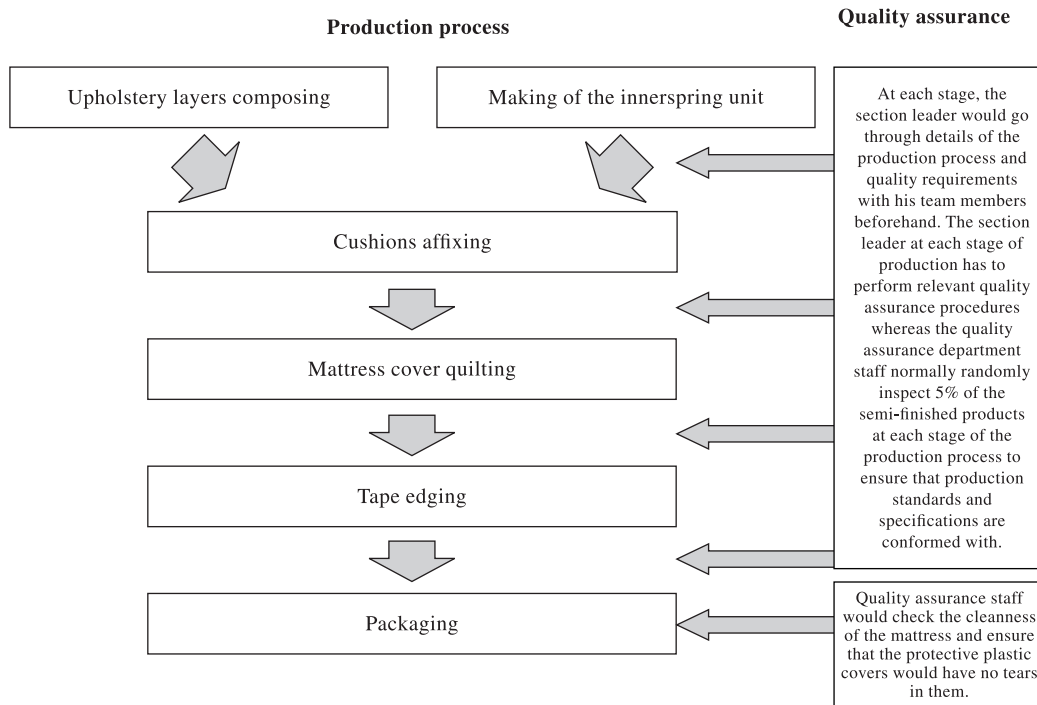


*Packaging*

*Note:* The production lead time is based on production of 50 pieces. Taking into account the availability of raw materials and the production schedule, it generally takes about 30-40 days to complete the production process for a purchase order.

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### (ii) Mattresses



#### Upholstery layers composing

The upholstery layers are composed by layer composition machine. The composed upholstery layers are sheared into required dimensions. The layers should be clean and in the right size. The final products should have a uniform thickness and flat surface. It normally takes about [10] minutes to complete this process. *(Note)*



*Layers composing*

## BUSINESS

### Making of the innerspring unit

Steel wire is coiled into wire spring units.

Wire spring units are arranged side-by-side in parallel rows and columns and are connected by steel wire coils into an innerspring unit.

Border wires then encircle around both upper and lower perimeters of the innerspring unit. Wire spring units should be of similar size and firmly connected to each other by steel wire coils. The wire spring units should be evenly distributed to form a flat innerspring unit. It normally takes about [40] minutes to complete this process. *(Note)*



*Making of the innerspring unit*

### Cushions affixing

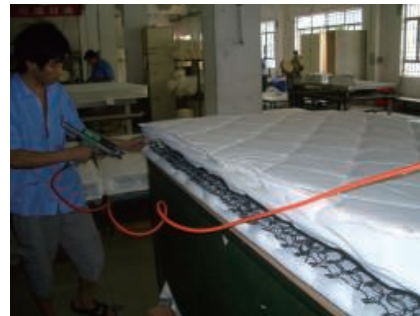
The upholstery layers are affixed onto the surfaces of the innerspring unit by nail punches. The upholstery layers should be cleaned and firmly affixed to the innerspring units. Nail punches should be separated from each other within a range of 15 to 20 centimeters depending on the product specification. It normally takes about [10] minutes to complete this process. *(Note)*



*Cushions affixing*

### Mattress cover quilting

Decorative exterior cover fabrics are affixed onto the cushion by stapler. The exterior cover used should be in accordance with the product specification and cleaned and of right size. The exterior covers should be firmly affixed to the cushions. It normally takes about [10] minutes to complete this process. *(Note)*



*Mattress cover quilting*

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### Tape edging

The edges of the semi-finished mattresses are sealed with binding tapes by sewing machines. The edges of the semi-finished mattress should be sewed seamlessly together. It normally takes about [10] minutes to complete this process. (*Note*)



*Tape edging*

### Packaging

Finished mattresses are packed with protective plastic covers and stored in the warehouses for delivery after quality assurance inspection. It normally takes about [10] minutes to complete this process. (*Note*)



*Packaging*

*Note:* The production lead time is based on production of one piece. Taking into account the availability of raw materials and the production schedule, it generally takes about 7 days to complete the production process for a purchase order.

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### Production Facilities

Currently, all of the production facilities of the Group are located at Shenzhen and Dongguan, Guangdong Province, the PRC. The production of mattresses is carried out at the production facilities of Dongguan Super Furniture while the production of wood-based furniture products classified as classic furniture series and modern furniture series is carried out at the production facilities of Shenzhen Xingli Zundian and Shenzhen Xingli respectively. The following table sets out the key information of the Group’s production facilities:

Name of the subsidiary	Location	Products manufactured	Number of full-time employees as at the Latest Practicable Date	Approximate GFA of the production facilities (excluding open space) (sq.m.)
Shenzhen Xingli Zundian	Longgang District, Shenzhen, Guangdong Province, the PRC (being the properties numbered 3-8 referred to in the valuation report set out in Appendix III to this document)	Classic furniture	[509]	[20,175]
Shenzhen Xingli	Longgang District, Shenzhen, Guangdong Province, the PRC (being the properties numbered 9 and 10 referred to in the valuation report set out in Appendix III to this document)	Modern furniture	[488]	[26,229]
Dongguan Super Furniture	Dongguan, Guangdong Province, the PRC (being the property numbered 11 referred to in the valuation report set out in Appendix III to this document)	Mattresses	[154]	[6,091]



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The following table sets out the approximate annual production capacity, the actual annual production and the utilisation rate of each of the Group’s production facilities during the Track Record Period:

	<b>For the year ended 31 December</b>		
	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Shenzhen Xingli Zundian</b>			
Approximate annual production capacity (set) <sup>1</sup>	5,200	7,700	[9,060]
Actual annual production (set)	4,600	7,050	[8,260]
Utilisation rate (%) <sup>2</sup>	88.5	91.6	[91.2]
<b>Shenzhen Xingli</b>			
Approximate annual production capacity (set) <sup>1</sup>	11,650	11,800	[11,800]
Actual annual production (set)	10,500	10,800	[9,200]
Utilisation rate (%) <sup>2</sup>	90.1	91.5	[78.0]
<b>Dongguan Super Furniture</b>			
Approximate annual production capacity (piece) <sup>1</sup>	85,000	106,000	[106,000]
Actual annual production (piece)	75,200	97,000	[70,000]
Utilisation rate (%) <sup>2</sup>	88.5	91.5	[66.0]

*Notes:*

1. The annual production capacity is determined with reference to the maximum production capacity of the machinery and labour under normal operating environment of the production facilities.
2. The utilisation rate is calculated as a ratio of the actual annual production to the approximate annual production capacity.

During the Track Record Period, the utilisation rate of production facilities of Shenzhen Xingli Zundian was stable, ranging from approximately 88.5% to 91.2%. The utilisation rate of production facilities of Shenzhen Xingli for the two years ended 31 December 2007 was approximately 90.1% and 91.5% respectively. However, for the year ended 31 December 2008, the utilisation rate dropped to 78.0%. The decrease in utilisation rate was due to the fact that the production of the “K-series” products under the brand name of “PZ-King” was outsourced to a contract manufacturer due to lack of the required production equipment at Shenzhen Xingli. The value of outsourced production with respect to the “K-series” products was approximately HK\$[19.0] million. In respect of the production facilities of Dongguan Super Furniture, the utilisation rates for the two years ended 31 December 2007 were stable at approximately 88.5% and 91.5% respectively. For the year ended 31 December 2008, due to the increase in the price of raw materials in the prior year, in particular sponges and steel wire, used in the production of mattresses, Dongguan Super Furniture raised the selling prices of the Group’s mattress products upwards to cover such increases in cost. The price adjustments resulted in a decrease in sales orders. With the reduction in mattress sales, the utilisation rate of the production facilities of Dongguan Super Furniture decreased to approximately 66.0% in 2008.

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### Expansion plan

On 29 June 2007, the Group acquired two pieces of land located at Kengzi Town, Longgang Industrial Area, Longgang District, Shenzhen, the PRC, namely Longgang Land I and Longgang Land II, for a total consideration of approximately HK\$46.8 million in order to construct the new production facilities, namely Shenzhen Xingli Production Base and Shenzhen Xingli Zundian Production Base.

As the production facilities of Shenzhen Xingli were running over 90% in 2006 and 2007 and the properties currently leased by Shenzhen Xingli to house its production facilities do not have spare space for further expansion, in order to expand the Group's business and prepare for the launch of new products, in particular the products under the brand name of "CHINATAG", the Group acquired Longgang Land I in 2007 to move its current production carried on by Shenzhen Xingli to its new production plants with larger production capacity.

The Group plans to invest approximately RMB[121.2] million (approximately HK\$[136.0] million) for the development of the Shenzhen Xingli Production Base, of which:

- approximately RMB[22.6] million (approximately HK\$[24.2] million) was paid in July 2007 for the acquisition of the land use rights of the Longgang Land I;
- approximately RMB[77.8] million (approximately HK\$[88.2] million) is for the construction costs of the Shenzhen Xingli Production Base of which approximately RMB[66.5] million (approximately HK\$[75.5] million) had already been paid up to the Latest Practicable Date, and the balance of approximately RMB[11.3] million (approximately HK\$[12.7] million) is expected to be fully settled before September 2009;
- approximately RMB[17.8] million (approximately HK\$[20.2] million) is for acquiring machinery and equipment of which approximately RMB[1.8] million (approximately HK\$[2.0] million) had already been paid up to the Latest Practicable Date, and the balance of approximately RMB[16.0] million (approximately HK\$[18.2] million) is expected to be fully settled in or before June 2009; and
- approximately RMB[3.0] million (approximately HK\$[3.4] million) will be the retention money and is expected to be paid to the construction companies one year after completion of construction of the Shenzhen Xingli Production Base.

As at the Latest Practicable Date, the total commitment for the construction of the Shenzhen Xingli Production Base amounted to approximately HK\$[19.0] million. The Group commissioned Schuler Business Solutions AG to undertake the overall design of the Shenzhen Xingli Production Base. Schuler Business Solutions AG, based in Germany, is an independent factory design consulting firm specialised in woodworking and furniture industry. As at the Latest Practicable Date, the Group had invested approximately HK\$[101.7] million in the construction of the Shenzhen Xingli Production Base, the completion of which is expected to

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take place in June 2009. The Group expects to commence the trial production in August 2009 and the full scale production in November 2009. Upon its full scale production, the Shenzhen Xingli Production Base is expected to provide an annual production capacity of approximately 31,800 furniture sets.

The Group has also planned to relocate its current production carried on by Shenzhen Xingli Zundian to Shenzhen Xingli Zundian Production Base in [around mid 2011]. The Group intends to use Shenzhen Xingli Zundian Production Base to house its classic furniture series production facilities and for the relocation of the Group's offices, staff quarters and canteen currently located at one of the Group's leased properties in Shenzhen, the PRC. The annual production capacity of the Shenzhen Xingli Zundian Production Base is expected to be approximately [30,000] sets of furniture products. The Directors plan to work out the detailed construction plan of Shenzhen Xingli Zundian Production Base in early 2010.

### Outsourcing

The Group outsources to contract manufacturers the production of certain furniture products with simple designs and minimal decorative features. The Group also outsources production of its products when its production capacity is running close to full utilisation.

During the Track Record Period, the Group engaged [16], [11] and [7] contract manufacturers in the PRC respectively, which have [1] to [13] years relationship with the Group. As at the Latest Practicable Date, the Group engaged [7] contract manufacturers in the PRC. The table below sets forth the percentages of products manufactured by these contract manufacturers and sold by the Group in terms of turnover.

	For the year ended 31 December		
	2006	2007	2008
<b>Branded</b>			
Johnston	0%	15.0%	[23.0]%
PZ-King	26.0%	35.0%	[55.2]%
Mandarin	40.0%	84.0%	[42.9]%
<b>Unbranded</b>	84.0%	72.0%	[82.4]%

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### *Selection of the contract manufacturers*

The Group selects each of its contract manufacturers based on a number of criteria, including its operating history, costs of production, quality of products, reputation, pricing, management capabilities, size of the production floor area, number of workers and ability to meet the Group's production schedule. The contract manufacturer needs to have an operating history of no less than [1] year and to have a production floor area of no less than 4,000 sq.m. as well as a work force of over 200 workers. However, the Group did not have any financial requirements (such as capital amount or operating profits) imposed on prospective contract manufacturers in the engagement process. Before the Group engages any contract manufacturer, the prospective manufacturer is required to produce sample products to demonstrate its capability of meeting the Group's standards.

### *Production outsourcing framework agreement*

Pursuant to the production outsourcing framework agreements, the Group provides the contract manufacturers with detailed product designs, specifications and raw materials requirements and each contract manufacturer is required to sign a confidentiality agreement not to disclose such confidential information to outsiders. The Directors confirmed that the Group had not experienced any breach of the confidentiality agreement by the contract manufacturers during the Track Record Period.

The outsourcing amount payable by the Group to the contract manufacturers is based on the quotation agreed between the Group and the contract manufacturers on an order by order basis with credit term of 30 days granted to the Group. The quotation also specifies the timeframe within which the outsourced products have to be delivered to the Group's warehouse. In the event that there is any delay in the delivery which causes the Group to suffer any loss in sales, the relevant contract manufacturer has to pay damages to the Group. The Directors confirmed that the Group had not experienced any major delay by the contract manufacturers in the delivery of outsourced products which caused the Group to suffer any losses or claims during the Track Record Period.

The Group entered into production outsourcing framework agreements with its contract manufacturers for a term not exceeding two years.

### *Quality assurance*

Pursuant to the production outsourcing framework agreement, the Group seconds production personnel and quality assurance personnel to provide on-site training to contract manufacturers. Besides, contract manufacturers are either provided with the principal raw materials sourced by the Group's procurement department, or they can procure themselves from the Group's designated suppliers or other suppliers so long as the raw materials can meet the requirements specified by the Group.

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Contract manufacturers are required to produce products which meet the relevant governmental and industrial standards in the PRC and overseas markets (where appropriate) or such other quality standards as agreed between the Group and the contract manufacturers.

The products manufactured by the contract manufacturers are subject to the Group's quality inspection and the contract manufacturers are responsible for rectifying any quality defects in such products as identified by the Group. In the event that any products which are sold to the Group's customers are subsequently discovered to be defective, the relevant contract manufacturers will be responsible for rectification at their own costs. It is also provided in the framework agreement that if the Group agrees to perform the rectification instead, the relevant costs are deducted from the amount payable by the Group to the contract manufacturers in settling the relevant purchases.

[Before each shipment, the Group's quality assurance personnel conduct on-site inspections and inspect approximately 5% of the finished products to ensure that the products manufactured by the contract manufacturers meet the quality standards and design specification set by the Group.]

For the three years ended 31 December 2008, the total purchases from the contract manufacturers amounted to approximately HK\$[107.7] million, HK\$[141.7] million and HK\$[180.7] million, representing approximately [36.0]%, [35.8]% and [41.7]% of the Group's total cost of sales respectively. The Directors confirmed that none of them and their respective associates and the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, had any interest in any of the contract manufacturers of the Group for each of the three years ended 31 December 2008.

## QUALITY ASSURANCE

The Directors consider that an established quality control system is one of the important factors contributing to the Group's success. The Group has established a stringent quality assurance system to ensure its products meet the required quality and safety standards. In recognition of the quality of the Group's production process, its subsidiaries, Shenzhen Xingli received ISO9001:2000 certification in January 2008 which is valid to January 2011 for the establishment and application of quality system for the design, production and sale of wood-based home furniture, whilst Shenzhen Xingli Zundian received ISO9001:2000 certification in [February] 2007 which is valid to February 2010 for the establishment and application of quality system for the design and manufacture of home furniture. In addition, each of Shenzhen Xingli and Shenzhen Xingli Zundian has been registered with the local entry-exit inspection and quarantine bureau in accordance with the requirements promulgated by 中華人民共和國國家質量監督檢驗檢疫總局 (The General Administration of Quality Supervision, Inspection and Quarantine of the PRC) so that they are eligible to engage in the export of wood-based furniture products. In order to be qualified for registration, Shenzhen Xingli and Shenzhen Xingli Zundian must be capable of fulfilling the quality standards and requirements on production, quality control, warehousing, and logistics imposed by the local

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bureau. Furthermore, the contract manufacturer engaged by the Group for outsourced manufacturing of wood-based furniture for export has also been registered with the local bureau in Shenzhen. The Directors confirmed that the abovementioned registration obtained by the Group and its contract manufacturer had never been suspended or revoked during the Track Record Period. For more information about the relevant laws, rules and regulations in relation to product quality to which the Group is subject, please refer to the section headed "Regulatory overview" in this document.

The Group has adopted strict quality assurance procedures at each principal stage of the production process and imposed quality assurance procedures on its contract manufacturers and licensees in order to ensure that their products manufactured under the Group's brand names meet the relevant quality standards in both the domestic and overseas markets. For details, please refer to the sub-paragraphs headed "Quality assurance procedures implemented for in-house production process" and "Quality assurance procedures imposed on contract manufacturers and licensees" below. As a result of the strict quality assurance procedures, the quantity of goods returned by its customers due to defects was immaterial during the Track Record Period. For the three years ended 31 December 2008, the Group experienced goods returned due to quality problems in domestic sales amounting to approximately HK\$[0.2] million, HK\$[0.3] million and HK\$[0.5] million respectively whilst there was no record of goods returned in export sales. Save as aforesaid, the Directors confirmed that the Group did not experience any other goods returned (including the products produced by the contract manufacturers) or product complaints during the Track Record Period.

During the Track Record Period, none of the subsidiaries of the Company in the PRC had been subject to any penalty under 中華人民共和國產品質量法 (Product Quality Law of the PRC), except for a fine of RMB3,800 occurred in relation to the non-compliance with the prescribed formaldehyde emission standard in respect of a batch of 32 bedside tables manufactured by Shenzhen Xingli in September 2006. The non-compliance incident was an isolated case. The Group sample tested the incoming MDF boards in relation to the bedside tables concerned and no [irregularity] was found. However, during a regular inspection conducted by 深圳市質量技術監督局龍崗分局 (Shenzhen Bureau of Quality and Technical Supervision, Longgang Branch), it was found that formaldehyde emission of the bedside tables concerned exceeded the prescribed standards. The Group recalled all of the relevant products from the two distributors involved, as none of those products had been sold to end consumers. The value of the products recalled was negligible. After this incident, the Group terminated the business relationship with the supplier concerned and strengthened its centralised procurement system to procure raw materials only from approved suppliers. The Group would require any new supplier of major raw materials such as MDF boards, paints, metal parts and sponge to provide the Group with independent certification of the quality of its raw materials supplied or the Group would send the raw materials supplied by such new suppliers to independent professionals for testing before accepting such new supplier as an approved supplier. In addition, the Group increased the sample testing coverage from 3% to 5%. The Directors confirmed that, save as disclosed above, the Group had not experienced any product recall or received any claim against it in respect of product quality in the past.

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Apart from ensuring that its quality assurance capabilities are up to the standards imposed by the relevant government authority for the purpose of registration as mentioned above, the Group places strong emphasis on its quality assurance procedures in meeting the quality and safety standards as set by its overseas customers as well. Overseas customers normally select its suppliers based on, among others, their standards and techniques of product quality assurance. Before engaging the Group, major prospective overseas customers usually conduct on-site interviews with the Group's production and quality assurance staff to assess the Group's capabilities in meeting the quality requirements of the relevant export markets. The overseas customers sometimes require the Group to produce sample products so as to ensure that the furniture products manufactured by the Group are able to meet their quality and safety requirements. The Group's major overseas customers from some developed countries like European Union and the United States would periodically perform on-site inspection on the Group's operations to ensure that its quality control standards continue to meet their requirements.

In addition, under the requirements from 中華人民共和國國家質量監督檢驗檢疫總局 (The General Administration of Quality Supervision, Inspection and Quarantine of the PRC), each wood-based furniture manufacturing enterprise must strictly observe the technical requirements and quality standards imposed by the respective importing countries when exporting products overseas. For each export shipment, the Group is required to apply for approval from the local entry-exit inspection and quarantine bureau which performs random inspection on the product quality before clearance can be obtained from the relevant local customs authorities. The Directors confirmed that the Group or its wood-based furniture contract manufacturer, when applying for such export approval, had not experienced any rejection during the Track Record Period. As in the importing countries, in the event that necessary filings are required to be made with the relevant local authorities in relation to the product quality and safety standard declaration, it is customary that the Group's overseas customers are responsible for fulfilling such requirements.

The Group's quality assurance department conducts quality inspections on the products manufactured by the Group and oversees the implementation of the quality assurance at every stage of in-house production process. In addition, it also performs periodic inspections on the quality of the products manufactured by the approved contract manufacturers and the licensees.

The Group's furniture products are distinguishable by their designs, craftsmanship and stylish decorative trimmings. The Directors consider that in order to ensure the quality of the Group's products, the Group needs to rely on the quality assurance staff in identifying defects in finished furniture products. As at the Latest Practicable Date, the quality assurance department comprised [23] staff members. [Although the Group's quality assurance staff do not possess any professional qualifications in relation to wood furniture or mattress quality assurance, [9] of them possess more than [10] years of experience in the furniture industry and the remaining employees have [1] to [8] years of relevant experience].

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### **Quality assurance procedures implemented for in-house production process**

The Group implements the following quality assurance procedures in respect of its production process with respect to:

*(a) Supplier selection*

Raw materials are purchased only from approved suppliers. The criteria for selecting the approved suppliers include pricing, the quality of the raw materials and after-sales services, stability of supply and delivery, ability to deliver the raw materials on time, minimum one year experience in supplying the relevant raw materials, the amount of minimum order requirement and reputation. [For every new supplier of major raw materials such as MDF board, paints, metal parts and sponge, it is required to provide the Group with independent certification of quality of its raw materials supplied or the Group will send the raw materials supplied by such new suppliers to independent professionals for testing of compliance with standards and the relevant rules and regulations before such new supplier become an approved supplier.] The Group has established a quality assurance team to select suppliers.

*(b) Incoming quality assurance*

Incoming raw materials are subject to sample inspections by the staff of the quality assurance team to ensure that they are supplied by approved suppliers and that the quality, grade and quantity of such raw materials conform to the order specifications. Raw materials which do not meet the specifications and quality standards as required by the Group are returned to the relevant suppliers.

*(c) In-process quality assurance*

In-process quality assurance measures are implemented throughout the production process to ensure that defective semi-completed products will not proceed to the next stage of the production process. The section leader at each stage of production has to perform relevant quality assurance procedures whereas the quality assurance department conducts random checks on semi-finished and finished products in order to ensure compliance with quality assurance standards of the Group. The Group's quality assurance staff normally randomly inspect 5% of the semi-finished products at each stage of the production process to ensure that production standards and specifications are conformed with. If any flaws or defects are found, the quality assurance staff will conduct another 5% random inspection. If further defects are found, the whole lot of the semi-finished parts/products will be subject to quality assurance inspection. Any items which cannot pass the quality check will be either discarded or reprocessed depending on the severity and type of error.



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*(d) Final quality assurance*

Finished products undergo final quality inspection to ensure compliance with quality assurance standards, designs and specifications of the Group. Products that passed the final quality inspection are stored in warehouses pending delivery to customers. In respect of the Group's wood based furniture products, before packaging for delivery, the quality assurance staff will test the fitting of all parts by taking a sample thereof and assemble them into finished furniture, ensuring that the parts and the finished products meet the design specifications.

*(e) Outgoing quality assurance*

Prior to delivery to customers, staff of the quality assurance department carry out random quality checks to ensure that the products to be delivered have not been damaged during storage.

### **Quality assurance procedures imposed on contract manufacturers and licensees**

The Group's quality assurance personnel provide contract manufacturers with on-site training in respect of quality assurance requirements of the Group. Before each shipment, the quality assurance personnel would conduct random checking on 5% of the finished goods to ensure that the products comply with the Group's quality standards.

The Group's quality assurance personnel are seconded to the production sites of the licensees. Under the secondment arrangement, one of the Group's experienced quality assurance personnel would be assigned to each of the four licensees and they are subject to rotation without a fixed term. The quality assurance personnel seconded at the production facilities of the licensees would provide training, guidance and supervision in respect of the production procedures and quality control to the staff of the licensees to ensure that the quality assurance procedures carried out at the production facilities of the licensees are up to the Group's standards.

### **Operational guidelines provided to approved shops and licensees**

The Group provides the approved shop operators and licensees with detailed guidelines which set out the Group's requirements on the shops' layout and decoration, marketing and advertising information of the products being sold, recommended customer service instructions and suggested pricing policy to ensure a unified brand image.

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### PROCUREMENT

The principal raw materials used in the production of the Group's home furniture products comprise MDF board, ironware and paint. For the three years ended 31 December 2008, the costs of raw materials which amounted to approximately HK\$[157.5] million, HK\$[210.7] million and HK\$[199.2] million, accounted for approximately [52.6]%, [53.1]% and [46.0]% of the Group's total cost of sales respectively.

During the Track Record Period, the costs of MDF board accounted for approximately [36.2]%, [40.1]% and [42.0]% of the Group's total cost of raw materials respectively. The Group uses MDF board of various thicknesses. The following table sets out the average purchase prices of two major types of MDF board utilised by the Group in 2006, 2007 and 2008:

<b>Thickness of MDF board</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<i>approximately</i>	<i>approximately</i>	<i>approximately</i>
	<i>RMB/unit*</i>	<i>RMB/unit*</i>	<i>RMB/unit*</i>
18 mm	[89.0]	[97.5]	[92.8]
25 mm	[127.3]	[142.0]	[136.0]

\* Each unit has a size of 1.22 metres by 2.44 metres.

The Group did not enter into any long-term supply agreements with the raw material suppliers during the Track Record Period, instead, the Group entered into framework agreements governing the major terms of the supply of raw materials with its major raw material suppliers. The price, quality and delivery time of each purchase order of raw materials are negotiated on a transaction by transaction basis with the relevant supplier. [The Group procures raw materials based on production requirements and, in general, maintains one-month inventory level. The Group's procurement department is responsible for monitoring the price fluctuations of raw materials and would rely on bulk purchases to minimise the impact of such fluctuation.]

During the Track Record Period, all the raw materials were sourced in the PRC. The purchases of raw materials are settled either on cash basis or on an open account basis in RMB with credit terms of [30] days to [90] days. The turnover days of the Group's trade payables were approximately [70] days, [68] days and [54] days for the three years ended 31 December 2008, respectively.

The Group's suppliers include raw material suppliers and contract manufacturers to which the Group outsources production of certain furniture products. For the three years ended 31 December 2008, purchases from the Group's five largest suppliers together accounted for approximately [27.7]%, [41.5]% and [49.8]% respectively of the Group's total purchases, while purchases from the Group's largest supplier accounted for approximately [9.7]%, [14.6]% and [14.4]% respectively of the Group's total purchases during the same period. The Group's five largest suppliers are mainly suppliers of raw materials for MDF board and contract

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manufacturers during the Track Record Period. As at the Latest Practicable Date, the approximate years of relationship with them ranged from [3] to [13] years. For each of the three years ended 31 December 2008, the Group did not experience any difficulties in sourcing raw materials. Given most of the Group's raw materials used in the manufacture of home furniture products are generally available commodities and the Group has established long term relationships with its suppliers, the Directors do not foresee that the Group will encounter any difficulties in sourcing raw materials from its existing suppliers or in finding alternative suppliers if necessary in the future.

The Directors confirmed that none of them and their respective associates and the Shareholders who, to the knowledge of the Directors, held 5% or more of the issued share capital of the Company as at the Latest Practicable Date, had any interest in any of the five largest suppliers of the Group for each of the three years ended 31 December 2008.

### **Inventory Control**

The Group's inventory consists of raw materials (primarily MDF board, ironware and paint), work in progress and finished goods. The inventory levels for major raw materials and finished products are determined on the basis of the level of customer orders, its production capacity and available working capital. The Group monitors its inventory levels through its ERP system which incorporates real-time inventory management, production management, materials requirement planning and purchasing management modules. Reports will be generated to show that raw materials are needed to be replenished when the inventory levels at the warehouse are lower than the optimal level. In general, the Group maintains approximately one-month inventory of key raw materials to meet production requirements and adjusts its level of finished goods based on historical sales amounts and anticipated orders from customers. The Group also conducts physical counts of the level of inventory on a quarterly basis to check against the records as shown in its ERP system and to determine whether allowance needs to be made in respect of any defective inventory items. For the three years ended 31 December 2008, the inventory turnover of the Group was approximately [50] days, [45] days and [52] days, respectively.

Inventories are valued at the lower of the cost as calculated, on the weighted average basis, and the net realisable value after making due impairment for any obsolete or slow moving items. The Group reviews the aging of inventories on a quarterly basis and will generally make impairment for any obsolete or slow moving items in accordance with the Group's policy.

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Set out below is the amount of impairment for the value of inventory during the Track Record Period:

	For the year ended 31 December		
	2006	2007	2008
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Impairment for the value of inventory	[2,000]	[501]	[2,165]

### INTELLECTUAL PROPERTY

The Directors attribute the Group's success in part to the trademarks and other intellectual property rights, including design patents, which the Group develops and owns. As at the Latest Practicable Date, the Group (i) owned [29] trademarks registered in the PRC and [7] trademarks registered in Hong Kong; and (ii) had applied for the registration of [10] trademarks in the PRC and [1] trademark in Italy. Please refer to the sub-section headed "Intellectual property" in Appendix V to this document for the validity period of the trademarks owned by the Group as at the Latest Practicable Date.

As at the Latest Practicable Date, the Group (i) owned [6] patents; and (ii) had applied for the registration of [34] patents regarding certain product designs of the Group's home furniture products in the PRC. Please refer to the sub-section headed "Intellectual property" in Appendix V to this document for the validity period of the patents owned by the Group as at the Latest Practicable Date.

As at the Latest Practicable Date, the Group was the registrant of the domain name of [www.hingleegroup.com](http://www.hingleegroup.com).

[If the pending applications for registration of the intellectual property rights of the Group are refused or rejected, the Group may consider adopting other trademarks for promotion of its products and/or using other designs in its production. In addition, the refusal of registration will not itself prevent the Group from utilising such trademarks and designs for its products unless the same constitutes an infringement of any third party's intellectual property rights. As such, the Directors believe that there may not be any material impact on the operations and financial condition of the Group should any applications for trademark or patent registration be refused or rejected.]

The Directors confirmed that so far as they were aware, there were no infringement of any intellectual property rights by the Group nor disputes regarding any intellectual property rights between the Group and any third party during the Track Record Period and the Group had not encountered any infringement of its intellectual property rights by any third party during the Track Record Period.

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During the Track Record Period, four trademark applications and one patent application in the PRC were initially refused for registration by the relevant regulatory authorities. Three out of the four trademark applications which were refused for registration during the application stage at 中華人民共和國國家工商行政管理總局商標局 (Trademark Office of State Administration for Industry and Commerce of the PRC) were finally approved by 商標評審委員會 (The Trademark Review and Adjudication Board) and obtained the registration certificates issued by 中華人民共和國國家工商行政管理總局商標局 (Trademark Office of State Administration for Industry and Commerce of the PRC). The remaining rejected trademark application related to the brand "QQ Star" (智逗星) which was rejected due to its similarity with a prior registered trademark. All the product designs under the brand "QQ Star" were subsequently merged into the brand "Orient". On the other hand, the patent application was rejected due to some technical defects inherent in the application. [Since its rejection, the Group has ceased to use the subject design thereunder in its production in October 2007.] [During the Track Record Period and] [up to the Latest Practicable Date, the Group had not received any notice from any third party alleging any infringement of intellectual property rights by the Group.]

[The Group is in the process of applying for registration of the brand "CHINATAG" in Italy]. According to a legal opinion from an Italian legal adviser obtained by the Group, under the normal circumstances, the completion of the registration procedures is expected to take three to four years from the filing date. The Group was advised by the Italian legal adviser that the chance of refusal of such registration was very low. However, the fact that the Italian Trademark and Patent Office issues a certificate of registration does not mean that the relevant trademark is valid since the novelty, which is a requirement by law, has not been examined by the said office and the novelty of such trademark may be eventually contested by legal action, though such risk is considered to be low by such Italian legal adviser.

In relation to the pending applications of the Group for registration of trademarks in the PRC, according to the PRC Legal Advisers, the time required for completion of the registration procedures cannot be ascertained as it will depend on the progress of the examination and approval procedures of 中華人民共和國國家工商行政管理總局商標局 (Trademark Office of State Administration for Industry and Commerce of the PRC). According to the PRC Legal Advisers, 中華人民共和國國家工商行政管理總局商標局 (Trademark Office of State Administration for Industry and Commerce of the PRC) will examine whether the subject trademarks are distinctive, distinguishable and whether they are in conflict with any prior right acquired by another person. Subject to the passing of the examination of 中華人民共和國國家工商行政管理總局商標局 (Trademark Office of State Administration for Industry and Commerce of the PRC), the PRC Legal Advisers advised that there would be no legal impediments for the Group to obtain the approval for the registration of such trademarks.

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Whereas in relation to the pending applications of the Group for registration of patents in the PRC, according to the PRC Legal Advisers, the time required for completion of the registration procedures cannot be ascertained as it will depend on the progress of the examination and approval procedures of 中華人民共和國國家知識產權局 (State Intellectual Property Office of the PRC). The PRC Legal Advisers have also advised that the subject designs must not be identical with or similar to any design which, before the date of filing, has been publicly disclosed in publications in the country or abroad or has been publicly used in the country, and must not be in conflict with any prior right of any other person. Subject to the examination of 中華人民共和國國家知識產權局 (State Intellectual Property Office of the PRC) in relation to the above, the compliance of the application procedures by the Group as required under 中華人民共和國專利法 (Patent Law of the PRC) and the payment of the relevant fees involved in the applications, the PRC Legal Advisers advised that there would be no legal impediments for the Group to obtain the approval for the registration of such patents.

As the Group's success depends in part on its intellectual property rights, the Group has applied and will continue to apply for registration of such intellectual property rights in the jurisdictions where they are primarily used and the Group has also made efforts for the detection and prevention of sale of counterfeit products under its brands. [Under the distribution framework agreements between the Group and its distributors, not only are the distributors forbidden to sell any counterfeit products in their approved shops, but they are also required under those agreements to give feedback to the Group on any sale of counterfeit products detected by them. Under the licence agreements between the Group and its licensees, the licensees are obliged to give notice to the Group should they become aware of any potential infringement of the Group's rights for, or any unauthorised use of, the brands which are subject to the licence agreements. In addition, if the sales persons of the Group become aware of any counterfeits of the Group's products and brands during their regular visits to the approved shops and their vicinity, they will report the same to the Group for consideration. The Group would rely on its salespersons, distributors and licensees to give feedback to the Group on any sale of counterfeit products in other stores or by other distributors not under agreements with the Group.]

Further details of the Group's intellectual property rights are set out in the sub-section headed "Intellectual property" in Appendix [V] to this document.

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### PROPERTIES

#### Owned properties

##### *Longgang Land I*

On 29 June 2007, Shenzhen Xingli entered into a contract for grant of land use rights with 深圳市國土資源和房產管理局 (Shenzhen Municipal Bureau of Land Resources and Housing Management) for the acquisition of Longgang Land I with a site area of approximately 43,817 sq.m. for a total consideration of RMB22,593,085 (approximately HK\$[24,215,525]) from 深圳市國土資源和房產管理局 (Shenzhen Municipal Bureau of Land Resources and Housing Management). As advised by the PRC Legal Advisers, the consideration payable under the relevant contract for grant of land use rights was settled on 2 July 2007. On 20 September 2007, the Group obtained the land use rights of such land for a term of 50 years with the expiry date on 28 June 2057. Under the current construction plan, the Group intends to build the Shenzhen Xingli Production Base with an aggregate GFA of approximately 38,869 sq.m. on Longgang Land I for the relocation of the Group's production facilities for modern furniture series products from one of the Group's leased properties in Shenzhen, the PRC (being the property numbered [9] referred to in the valuation report set out in Appendix III to this document) and to house the production facilities for "CHINATAG" products. The Group has commissioned Schuler Business Solutions AG to be responsible for the overall design of the production facilities. Based in Germany, Schuler Business Solutions AG, an Independent Third Party, is a factory design consulting firm specialised in woodworking and furniture industry.

The construction of the Shenzhen Xingli Production Base has commenced in [June] 2008 and is expected to complete in [June] 2009. [As at the Latest Practicable Date, superstructure of the factory buildings and the dormitory buildings of the Shenzhen Xingli Production Base has been completed, and internal renovation and installation of building services are being carried out.] The PRC Legal Advisers have advised that the Group has obtained (i) 深圳市建設工程規劃許可證 (Shenzhen Construction Work Planning Permit) on 12 and 13 March 2008; and (ii) 中華人民共和國建築工程施工許可證 (Construction Work Commencement Permit of PRC) on 21 May 2008, for the construction of production facilities on Longgang Land I and has commenced construction in compliance with relevant laws, rules and regulations and in accordance with the relevant provisions of the contract for grant of land use rights. The Group expects to commence the trial production in [August] 2009 and the full scale production in [November] 2009. It is expected that the annual production capacity of the Shenzhen Xingli Production Base will be approximately [31,800] sets of furniture products. As advised by the PRC Legal Advisers, in the event Shenzhen Xingli does not complete construction on Longgang Land I on or before 28 June 2009, Shenzhen Xingli would be subject to a penalty of a prescribed percentage of the consideration paid under the relevant contract for grant of land use rights in the following manner: (i) 5% for a delay not exceeding six months; (ii) 10% for a delay between six months but not exceeding one year; and (iii) 15% for a delay between one year but not exceeding two years. The Directors estimate that the maximum penalties that may be imposed on the Group in the event of delay in the construction on Longgang Land I will be approximately RMB[3.39] million for a delay not exceeding two

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years. The PRC Legal Advisers have also advised that in the event Shenzhen Xingli does not complete construction on Longgang Land I within two years after the prescribed time limit, the relevant land bureau is entitled to resume the land without any compensation. [The Founders and their respective investment vehicles have agreed to indemnify the Group for all penalties that the Group may incur as a result of any delay in the construction of the Shenzhen Xingli Production Base].

### *Longgang Land II*

On 29 June 2007, Shenzhen Xingli Zundian entered into a contract for grant of land use rights with 深圳市國土資源和房產管理局 (Shenzhen Municipal Bureau of Land Resources and Housing Management) for the acquisition of Longgang Land II with a site area of approximately 41,066 sq.m. for a consideration of RMB21,094,404 (approximately HK\$[22,609,212]) from 深圳市國土資源和房產管理局 (Shenzhen Municipal Bureau of Land Resources and Housing Management). As advised by the PRC Legal Advisers, the consideration payable under the relevant contract for grant of land use rights was settled on 26 October 2007. On 30 January 2008, the Group obtained the land use rights of such land for a term of 50 years with the expiry date on 28 June 2057. The Group intends to build the Shenzhen Xingli Zundian Production Base to house [its classic furniture series production facilities] and for the relocation of the Group's offices, staff quarters and canteen currently located at one of the Group's leased properties in Shenzhen, the PRC (being the property numbered [9] referred to in the valuation report set out in Appendix III to this document). It is expected that the annual production capacity of the Shenzhen Xingli Zundian Production Base will be approximately [30,000] sets of furniture products.

Pursuant to the contract for grant of land use rights in respect of Longgang Land II, the Group should commence construction on such land before 29 June 2008 and complete construction within two years after the signing of the agreement. The Group has applied to 深圳市國土資源和房產管理局 (Shenzhen Municipal Bureau of Land Resources and Housing Management) which has agreed to extend the deadline of construction commencement to 26 October 2008 and construction completion to 26 October 2009. As advised by the PRC Legal Advisers, the construction of the Shenzhen Xingli Zundian Production Base has commenced in July 2008. According to the PRC Legal Advisers, the Group has obtained (i) 深圳市建設工程規劃許可證 (Shenzhen Construction Work Planning Permit) on 13 March 2008 for the construction of production facilities with a GFA of 34,443.96 sq.m. on Longgang Land II; and (ii) 中華人民共和國建築工程施工許可證 (Construction Work Commencement Permit of PRC) on 27 June 2008 pursuant to which the Group was given permission to commence foundation works for the factory building to be built on Longgang Land II and has commenced construction in compliance with relevant laws, rules and regulations and in accordance with the relevant provisions of the contract for grant of land use rights. The Directors have confirmed that construction work of the Shenzhen Xingli Zundian Production Base has been suspended after the completion of the said foundation works since January 2009 as access to Longgang Land II was denied pending the inspection approval of the neighbouring public road works by the relevant authorities which include 深圳市龍崗區建設局 (Construction Bureau of Longgang District of Shenzhen), 深圳市龍崗區城市管理行政執法局



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(Urban Administration Enforcement Bureau of Longgang District of Shenzhen) and 深圳市龍崗區工程質量監督檢驗站 (Engineering Projects Quality Supervision and Inspection Office of Longgang District of Shenzhen). According to the PRC Legal Advisers, the pending approval of the neighbouring public road works does not affect the Group's right to use Longgang Land II but as the roads leading to such land cannot be used until the approval is granted, Shenzhen Xingli Zundian is unable to continue the construction on Longgang Land II. [The Directors believe that, having taken into account that the Group may (i) continue to use its existing classic furniture series production facilities; (ii) engage third party subcontractors within the Shenzhen area; and (iii) lease additional space as and when required since the Directors do not foresee any difficulty in identifying suitable property in Shenzhen, the pending approval of the neighbouring public road works would not affect the Group's expansion plan.] As advised by the PRC Legal Advisers, in the event Shenzhen Xingli Zundian does not complete construction on Longgang Land II on or before 26 October 2009, Shenzhen Xingli Zundian would be subject to a penalty of a prescribed percentage of the consideration paid under the relevant contract for grant of land use rights in the following manner: (i) 5% for a delay not exceeding six months; (ii) 10% for a delay between six months but not exceeding one year; and (iii) 15% for a delay between one year but not exceeding two years. The Directors estimate that the maximum penalties that may be imposed on the Group in the event of delay in the construction on Longgang Land II will be approximately RMB[3.16] million for a delay not exceeding two years. The PRC Legal Advisers have also advised that in the event Shenzhen Xingli Zundian does not complete construction on Longgang Land II within two years after the prescribed time limit, the relevant land bureau is entitled to resume the land without any compensation. [The Founders and their respective investment vehicles have agreed to indemnify the Group for all penalties that the Group may incur as a result of any delay in the construction of the Shenzhen Xingli Zundian Production Base]. [Having considered the latest degree of completion of the neighbouring public road works and the time generally required for the granting of inspection approval of public road works in the vicinity,] the Group currently expects that the construction of the Shenzhen Xingli Zundian Production Base will be resumed in around June 2010 and will be completed in [around mid 2011]. The PRC Legal Advisers visited the relevant land bureau and were given to understand that Shenzhen Xingli Zundian could apply for an extension of the construction completion date after the inspection approval of the neighbouring public road works has been granted by the relevant authorities. The PRC Legal Advisers are of the opinion that there is normally no legal obstacle for the Group to obtain such extension if the delay in construction is caused by delay of completion of the relevant public road works.

According to the PRC Legal Advisers, as the Group has obtained 深圳市建設用地規劃許可證 (Shenzhen Planning Permit on Land for Construction Use) and Real Estate Ownership Certificate in respect of each of Longgang Land I and Longgang Land II, and the considerations payable under the relevant contracts for grant of land use rights have been settled in full, the Group possesses the land use rights of Longgang Land I and Longgang Land II each for a term of 50 years up to 28 June 2057 for industrial use. The PRC Legal Advisers have further advised that it is a condition of the contracts for grant of land use rights of the Land that the land use rights of these two pieces of land are not allowed to be transferred or leased. As a result, the valuer has assigned no commercial value to such land. Please also

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refer to the paragraph headed "The Group's owned properties cannot be transferred to third parties" in the section headed "Risk factors" in this document. Nevertheless, as advised by the PRC Legal Advisers, the Group is the legal owner of the land use rights of Longgang Land I and Longgang Land II and the non-transferability of such land does not affect the Group's rights to such land.

### **Leased properties**

As at the Latest Practicable Date, the Group leased [9] properties in the PRC which were mainly used as production facilities, offices, warehouses and staff quarters and one property in Hong Kong which was used as office premises. All of these properties are leased from Independent Third Parties.

With respect to one of the Group's leased properties in the PRC, being the property numbered [10] referred to in the valuation report set out in Appendix III to this document, no title documents had been provided by the relevant lessor evidencing its legal title to such property. This property is located in Shenzhen, the PRC and has been used by the Group for storage purposes. According to the PRC Legal Advisers, as the relevant lessor has not provided the Group with the relevant title documents, its legal right to lease such property to the Group is in doubt. Accordingly, the PRC Legal Advisers are not able to opine on the validity and legality of the lease agreement of this property. As advised by the PRC Legal Advisers, the lessor has not provided the relevant title documents for registration, which resulted in the delay in registering the lease agreement with the relevant property leasing administration authority. The PRC Legal Advisers have also advised that the relevant lessor is liable for the failure to register the lease agreement and as such, Shenzhen Xingli would not be subject to any administrative penalty. However, there is no assurance that the rights of the Group to use and occupy this property will not be challenged in the future. Nevertheless, the Directors do not consider such property to be crucial to the Group's business and operations as it is used for non-production purposes. The Directors believe that comparable properties in the vicinity could be easily identified in the event that the Group is required to relocate from this property. The Directors currently estimate that the relocation costs would amount to approximately [RMB400,000] and the time required to complete such relocation would be about one week, and they do not anticipate any significant disruption to the Group's operations or loss of profit during the relocation of the said property. The Group currently intends to relocate this warehouse to the Shenzhen Xingli Production Base following completion of the construction which is expected to take place in [June 2009]. For more information about the Shenzhen Xingli Production Base, please refer to the sub-paragraph headed "Owned properties" above. The PRC Legal Advisers have advised that pursuant to the supplemental agreement entered into between the Group and the lessor on 9 October 2008, the Group may, among other things, terminate the lease agreement in respect of this property one year from the date of the lease agreement (being 1 June 2008) by giving the lessor one month's prior notice or a payment of one month's rental in lieu of notice. The Founders and their respective investment vehicles have agreed to indemnify the Group for all claims, damages, costs, expenses and penalties that the Group may incur as a result of the non-registration of the relevant lease agreement.

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In addition, the lease agreement of one of the Group's leased properties located in Shenzhen, the PRC, being the property numbered [9] referred to in the valuation report set out in Appendix III to this document, had not been registered with the relevant property leasing administration authority as at the Latest Practicable Date. As advised by the PRC Legal Advisers, the lessor has not provided the relevant title documents for registration, which resulted in the delay in registering with the relevant property leasing administration authority. This property has been leased to Shenzhen Xingli to house its production facilities for modern home furniture products and for other purposes including offices, staff quarters and canteen. For the year ended 31 December 2008, the annual production capacity of these production facilities was approximately [11,800] sets of furniture products. During the Track Record Period, the percentage of the Group's turnover and profit contributed by the production facilities located on this leased property was approximately [34.9]%, [32.9]% and [29.9]% respectively, and nil, nil and approximately [18.0]% respectively.

According to the PRC Legal Advisers, the lease agreement in respect of the said leased property is legally enforceable and the failure to register the same does not affect its validity. As advised by the PRC Legal Advisers, Shenzhen Xingli has written to the lessor on 1 March 2008 and 1 September 2008 requesting the lessor to register the relevant lease agreement with the relevant property leasing administration authority. The PRC Legal Advisers have further advised that the relevant lessor is liable for the failure to register the lease agreement and as such, Shenzhen Xingli would not be subject to any administrative penalty. However, in the event the present owner disposes of the property, the subsequent owner of the property has the right to require Shenzhen Xingli to move out from the property and thus there is no assurance that the right of the Group to use and occupy this leased property will not be interfered with in the future due to the failure to register the relevant lease agreement. The Group plans to relocate the existing production facilities of Shenzhen Xingli to the Shenzhen Xingli Production Base following completion of the construction which is expected to take place in [June 2009], and the non-production facilities to the Shenzhen Xingli Zundian Production Base following completion of the construction which is expected to take place in [around mid 2011]. For more information about the Shenzhen Xingli Production Base and the Shenzhen Xingli Zundian Production Base, please refer to the sub-paragraph headed "Owned properties" above. Although the percentage of the Group's profit contributed by the production facilities located on this leased property has increased from nil for the two years ended 31 December 2007 to approximately [18.0]% for the year ended 31 December 2008, given that (i) the Group will relocate the said production facilities to the Shenzhen Xingli Production Base following completion of the construction which is expected to take place in [June 2009]; (ii) in the event that the Group is required to relocate from this leased property, the Directors (a) do not foresee any difficulty in identifying comparable property in Shenzhen at about the same rental; (b) currently expect that the relocation costs would amount to approximately [RMB1.4 million] and the time required to complete such relocation would be about [two] weeks; (c) estimate that the loss of profit due to relocation would amount to approximately RMB[200,000]; and (d) believe that the production processes which are currently undertaken at this property could be subcontracted to third party subcontractors within Shenzhen, including the contract manufacturers currently engaged by the Group; and (iii) the Group is entitled to seek compensation from the lessor if it is required to relocate from such property due to non-registration of the lease agreement, the Directors consider that this property is not crucial to the Group's operations. The PRC Legal Advisers have further advised that the lessor has

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agreed to indemnify Shenzhen Xingli for all damages incurred in connection with any penalties that may be imposed on the Group as a result of the non-registration of the relevant lease agreement.

Completion of the relocation of the production facilities of Shenzhen Xingli to the Shenzhen Xingli Production Base is expected to take place in [September 2009]. [The Directors do not expect any material interruption to the Group's production as a result of the relocation to the Shenzhen Xingli Production Base as it plans to move the production facilities to the new production site in several stages gradually and will prepare for concurrent operation of the existing and the new production plant at the Shenzhen Xingli Production Base during the relocation period. The Directors believe that such measures will effectively secure the proper operation of the production during the relocation period.] The Group will terminate the existing lease in respect of this property after completion of the relocation as described above. The PRC Legal Advisers have advised that pursuant to the supplemental agreement entered into between the Group and the lessor on 9 October 2008, the Group may, among other things, terminate the lease agreement in respect of this property by giving the lessor one month's prior notice or a payment of one month's rental in lieu of notice. Nevertheless, the Founders and their respective investment vehicles have agreed to indemnify the Group for all claims, damages, costs, expenses and penalties that the Group may incur as a result of the non-registration of the relevant lease agreement to the extent that damages, if any, recovered from the relevant lessor are insufficient to cover the related costs incurred by the Group.

[The Directors confirmed that up to the Latest Practicable Date, nothing had come to their attention that there was any dispute regarding the use of any of the two leased properties as described above by the Group. The Group has adopted an internal policy that in case of leasing property from external landlord in the future, all necessary title documents in respect of the leased property shall be requested from the prospective landlord at the stage of negotiation and before signing the lease agreement for any new premises leased by the Group and the registration of the lease agreement shall be pursued by the landlord shortly after signing of the lease agreement. All registered lease agreements have to be filed with the compliance department of the Group.]

Details of the property interests of the Group are set out in Appendix [III] to this document.

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### AWARDS AND RECOGNITIONS

The Group differentiates itself from its competitors through its comprehensive range of products, high quality products, strong product development capability and branding. Over the years, the Group has been granted or accredited a number of awards and certifications by various regional, national, international and industry associations in recognition of the Group's industry standing and product quality. The table below sets forth some of the major awards and certifications granted to the Group:

<b>Year of grant</b>	<b>Title of award or certification</b>	<b>Awarding association</b>
March 2004	第十四屆深圳國際家具展覽會 客廳家具系列亞軍 (The 14th Shenzhen International Furniture Exhibition First Runner Up of Living Room Furniture Series)	SFTA
August 2004	第十五屆深圳國際家具展覽會 歐洲古典家具系列優秀產品 (The 15th Shenzhen International Furniture Exhibition Outstanding Prize of European Classic Furniture Series)	SFTA
December 2004	突出貢獻獎 (Exceptional Contributions Award)	SFTA
January 2005	2000-2004 年度廣東省優秀家具 出口企業 (Certificate of Excellent Export- Oriented Furniture Enterprise in Guangdong Province (2000-2004))	廣東省家具商會 (Guangdong Furniture Chamber of Commerce)
March 2005	第十六屆深圳國際家具展覽會 現代版式臥室家具系列金獎 (The 16th Shenzhen International Furniture Exhibition Winner of Contemporary Bedroom Furniture Series)	SFTA
August 2006	第十九屆深圳國際家具展覽會 民用書房家具系列金獎 (The 19th Shenzhen International Furniture Exhibition Gold Award of Study Room Home Furniture Series)	SFTA

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Year of grant	Title of award or certification	Awarding association
December 2006	中國十大家具品牌 (2005-2006) — 尊典，歐瑞系列產品 (Top 10 Famous Furniture Brands in China (2005-2006) – Johnston and Oriant Brand Furniture Series)	中華全國工商業 聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce)
February 2007	ISO 9001:2000 (Shenzhen Xingli Zundian)	SGS United Kingdom Limited
August 2007	第二十一屆深圳國際家具展覽會 古典臥室家具系列銅獎 (The 21st Shenzhen International Furniture Exhibition Bronze Award of Classic Bedroom Furniture Series)	SFTA
January 2008	ISO 9001: 2000 (Shenzhen Xingli)	Moody International Certification Limited
August 2008	中國十大家具品牌—尊典，歐瑞 (2007-2008) (Top 10 Famous Furniture Brands in China – Johnston and Oriant (2007-2008))	中華全國工商業 聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce)
August 2008	質量環保產品認證證書 (Environmental Label Certificate)	中國質量認證中心 (China Quality Certification Centre)

### Background of awarding associations

1. SFTA was established in 1986 as a non-profit organisation duly registered with the Shenzhen Municipality (Shenzhen Civil Affairs Bureau). SFTA has a mission to serve the marketing and technological needs of the furniture industry participants, as well as to assist the furniture industry participants to communicate with the relevant government authorities. SFTA has over [500] members consisting of furniture manufacturers and raw material and furniture accessories suppliers. Two subsidiaries of the Company, namely Shenzhen Xingli and Shenzhen Xingli Zundian, are currently members of SFTA. Mr. Huang, one of the Founders, has been the chairman of SFTA since 2004. The chairman is elected by the members of SFTA and is not a full-time position. The SFTA employs full time staff to manage its daily operation, which is overseen by the secretary of the association. During the Track Record Period, the Group obtained a number of awards commended by the SFTA. The Directors confirmed that the granting of these awards to the Group was decided by a panel of judges independent of Mr. Huang, the substantial Shareholders, Directors, senior management and their respective associates. In addition, SFTA was instrumental in assisting the Group in acquiring Longgang Land I and

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Longgang Land II from the local land bureau. In settling the land use rights premium for Longgang Land II, SFTA arranged a member of the association, an Independent Third Party, who intended to jointly develop the said land with the Group, to provide a non-interest bearing short term advance of RMB22 million (or equivalent to approximately HK\$[23.6] million) to the Group in 2007. The Group agreed to add such member as a co-owner in the title documents of the said land, which the Group attempted but failed. The Group understood from the relevant government authority that it would be deemed as a change of ownership, as the land use rights of the said land were restricted from transfer. Therefore, the plan to jointly develop Longgang Land II between the Group and such member was cancelled and the Group fully repaid the short term advance in July 2008 accordingly. The Directors confirmed that there was no benefit granted to the said Independent Third Party for the provision of the advance to the Group. Save as disclosed above, there was no other business relationship, whether present or past, between SFTA and the Group, its substantial shareholders, Directors, senior management and their respective associates.

2. 廣東省家具商會 (Guangdong Furniture Chamber of Commerce) is a non-profit organisation duly registered with 廣東省民政廳 (Department of Civil Affairs of Guangdong Province) and is under the supervision and guidance of 廣東省民政廳 (Department of Civil Affairs of Guangdong Province) and 廣東省工商業聯合會 (Guangdong Federation of Industry and Commerce). It has over [200] members including industry participants involved in furniture design and decoration, furniture manufacturers and raw material suppliers.
3. 中華全國工商業聯合會家具裝飾業商會 (China Furniture & Decoration Chamber of Commerce) is a non-profit making organisation duly approved by 中華全國工商業聯合會 (All-China Federation of Industry & Commerce) in August 2002, and is under the supervision and guidance of 中華全國工商業聯合會 (All-China Federation of Industry & Commerce). It has approximately [ten thousand] members including furniture manufacturers, furniture design and decoration companies, kitchen cabinet companies, bathroom accessories companies, flooring companies and furniture accessories suppliers. Its mission is to provide its members with technical, management, legal and financial consultancy, to organise its members to join trading forums and furniture exhibitions and to communicate with furniture associations in Hong Kong and other parts of the world.
4. SGS United Kingdom Limited, founded in 1878 and an independent organisation based in the United Kingdom, specialises in providing inspection, verification, testing and certification services. It has gained accreditation to issue the certification by the United Kingdom Accreditation Service, the sole and non-profit national accreditation body recognised by the government of the United Kingdom. The ISO 9001:2000 certificate that Shenzhen Xingli Zundian has obtained is valid for the period of three years from 9 February 2007 to 8 February 2010. SGS United Kingdom Limited implements annual surveillance visits. According to the codes of practice of SGS United Kingdom Limited, the certificate will remain valid until its expiry date, unless the surveillance reveals that

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the management system and/or products have not met the certificate requirements. The certificate shall be revoked if the certification requirements are not fulfilled. Shenzhen Xingli Zundian has met the standards of the annual surveillance visits for the years of 2007 and 2008. During the Track Record Period and up to the Latest Practicable Date, the ISO 9001:2000 certificate obtained by Shenzhen Xingli Zundian remained valid.

5. Moody International Certification Limited, founded in 1987 and an independent organisation with its head office based in the United Kingdom, specialises in providing professional, certification and registration services and offers two types of surveillance options for ISO 9000 and ISO 14001. It has gained accreditation to issue the certification by the United Kingdom Accreditation Service, the sole and non-profit national accreditation body recognised by the government of the United Kingdom.

The ISO 9001:2000 standard is based on the eight principles which include customer focus, leadership, involvement of people, process approach, system approach to management, continual improvement, factual approach to decision making and mutually beneficial supplier relationships. The ISO 9001:2000 certificate that Shenzhen Xingli has obtained is valid for the period of three years from 22 January 2008 to 21 January 2011. Moody International Certification Limited implements annual surveillance visits and approves an annual re-audit stamp on the ISO 9001:2000 certificate at the end of each of the three years where the surveillance reveals that the management system and/or products have met the certificate requirements. Shenzhen Xingli has met the standards of the annual surveillance visit and has obtained an annual re-audit stamp on the certification for the year of 2008. During the Track Record Period and up to the Latest Practicable Date, the ISO 9001:2000 certificate obtained by Shenzhen Xingli remained valid.

6. 中國質量認證中心 (China Quality Certification Center), duly approved by 中華人民共和國國家質量監督檢驗檢疫總局 (The General Administration of Quality Supervision, Inspection and Quarantine of PRC) and 中國國家認證認可監督管理委員會 (The Certification and Accreditation Administration of PRC), is affiliated with 中國檢驗認證集團 (China Certification & Inspection Group) and is responsible for statutory inspection of shipments to the PRC. Its services include authority to undertake tasks of various compulsory quality certifications, provision of training service for certifications and issuing the certificates of ISO9001 and ISO14001. The Environmental Label Certificates that Shenzhen Xingli and Shenzhen Xingli Zundian have obtained are valid for the period of three years from 15 August 2008 to 15 August 2011. According to the code of practice of furniture quality environmental certification issued by 中國質量認證中心 (China Quality Certification Center), surveillance visits are implemented annually. The certificate shall be revoked if the certificate requirements are not fulfilled. During the Track Record Period and up to the Latest Practicable Date, the Environmental Label Certificates obtained by both Shenzhen Xingli and Shenzhen Xingli Zundian remained valid.



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According to the information available on the website of China Quality Certification Centre, the assessment criteria of Environmental Label Certificate is based on a number of laws, rules and regulations issued by government authorities, such as, GB 18580-2001 室內裝飾裝修材料人造板及其製品中甲醛釋放限量 (GB 18580-2001 Indoor Decoration and Refurbishing Materials – Limit of Formaldehyde Emission of Wooden Based Panels and related Finished Products), GB 18581-2001 室內裝飾裝修材料溶劑型木器塗料中有害物質限量 (GB 18581-2001 Indoor Decoration and Refurbishing Materials – Limit of Harmful Substances of Solvent Coatings for Woodenware), GB 18583-2001 室內裝飾裝修材料膠黏劑中有害物質限量 (GB 18583-2001 Indoor Decoration and Refurbishing Materials – Limit of Harmful Substances of Adhesives), GB 18584-2001 室內裝飾裝修材料木家具中有害物質限量 (GB 18584-2001 Indoor Decoration and Refurbishing Materials – Limit of Harmful Substances of Wood Based Furniture), GB 5296.6-2004 《消費品使用說明第6部份：家具》 (GB 5296.6-2004 Instruction for Use of Consumer Products – Part 6: Furniture).

None of the certifications obtained by the Group has been suspended or terminated during the validity period.

## COMPETITION

The home furniture industry in the PRC is highly competitive and comprises mostly small to medium size market participants. There is no significant entry barrier to the home furniture industry and therefore no brand has apparently dominated the market. The Group faces competition from other medium to large scale home furniture manufacturers and suppliers, in particular, those with their own established brand names and strong design capabilities. The Directors believe that the competitive landscape is characterised by the increasing number of market participants and ever higher consumers' demands and expectations as to price, design, style and product quality of furniture.

The Directors attribute the Group's success to its well marketed brand names, wide range of product designs, comprehensive product portfolio and high product quality standards. By leveraging these strengths, the Directors are confident that the Group will be able to maintain its competitive edges over its competitors, which in turn will enable the Group to achieve its goal of becoming a leading home furniture provider in both the PRC and the overseas markets.

## INSURANCE

The Group maintains insurance policies in respect of the Group's properties including office premises, production facilities, inventory and other principal assets covering physical loss or damage arising from natural hazards or accidents in relation to the operations of the Group, and work-related injury insurance policies covering the medical treatment and financial compensation arising from the work-related injuries suffered by its employees.

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Apart from these, the Group does not maintain any other insurance policies such as insurance relating to third party liability or product liability for the Group’s products and the products manufactured under the Group’s licensed brands. [It is the current intention of the Group not to maintain insurance policy covering product liability risk after [●] as] it is the common industry practice that product liability insurance is not subscribed by furniture companies and product liability insurance is not compulsory under the PRC law. The Group has adopted stringent quality assurance policies in raw material procurement and production, and carries out quality control inspections at every stage of its production. Furthermore, the Group provides detailed product design specifications to its licensees and contract manufacturers and conducts on-site production training and inspection. Products manufactured by the Group’s licensees and contract manufacturers are subject to the Group’s quality assurance inspections as mentioned in the paragraph headed “Quality assurance” in this section above. [During the Track Record Period, the Group did not receive any claims from customers against it in respect of product liability.]

[Having taking into account that the Group has subscribed the required insurance under the PRC rules and regulations as confirmed by the PRC Legal Advisers and the Group’s insurance coverage is in line with the industry practice,] the Directors believe that the Group’s existing insurance policies and insured limits are sufficient to cover the risks that the Group may be exposed to arising from the loss or damage to its assets, human resources and business operations. The Group reviews its insurance policies and coverage from time to time and makes adjustments if necessary. During the Track Record Period, the Group had not been the subject of any material insurance claims.

## COMPLIANCE AND LITIGATION

Save as disclosed in this document, as at the Latest Practicable Date and for the Track Record Period, the Group was not engaged in any litigation, arbitration or claim of material importance, and there was no litigation, arbitration or claim pending or threatened by or against the Group or any of the Directors, which could have a material adverse effect on the results of operations or financial condition of the Group.

### **Compliance with environmental protection laws, rules and regulations**

The operation and business of the subsidiaries of the Company in the PRC, namely Shenzhen Xingli, Shenzhen Xingli Zundian and Dongguan Super Furniture, are subject to the PRC environmental laws, rules and regulations which include 中華人民共和國環境保護法 (Environmental Protection Law of the PRC), 中華人民共和國環境影響評價法 (Environmental Impact Assessment Law of the PRC), 中華人民共和國環境噪聲污染防治法 (Law of the PRC on the Prevention and Control of Environmental Noise Pollution), 建設項目竣工環境保護驗收管理辦法 (Administrative Measures for Environmental Protection Examination and Approval Upon Completion of Construction Projects) and 建設項目環境保護管理條例 (Regulations Governing Environmental Protection in Construction Projects). In relation to the properties occupied by the Company’s subsidiaries in the PRC to house the production facilities during the Track Record Period, each of Shenzhen Xingli, Shenzhen Xingli Zundian

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and Dongguan Super Furniture has obtained approvals from the relevant authorities for an environmental impact assessment before commencement of the construction work on the relevant properties but has not obtained the environmental protection facilities approval prior to the commencement of its operations. According to the PRC Legal Advisers, in order to obtain the environmental protection facilities approval, the applicant has to produce a valid title document or a registered lease agreement with respect to the relevant property. Since the lease agreements in respect of the relevant properties of Shenzhen Xingli and Dongguan Super Furniture had not been registered with the relevant property leasing administration authorities, Shenzhen Xingli and Dongguan Super Furniture were unable to apply for the environmental protection facilities approval. As regards Shenzhen Xingli Zundian, the PRC Legal Advisers visited the local environmental protection authority and were given to understand that since it was stated that no environmental protection facilities inspection was required in the environmental impact assessment obtained by Shenzhen Xingli Zundian, Shenzhen Xingli Zundian was not required to apply for the environmental protection facilities approval. According to the PRC Legal Advisers, pursuant to 建設項目竣工環境保護驗收管理辦法 (Administrative Measures for Environmental Protection Examination and Approval Upon Completion of Construction Projects), an enterprise may be subject to a maximum fine of RMB100,000 and/or may be ordered to suspend operations if it has not obtained the environmental protection facilities approval prior to commencement of operations. Up to the Latest Practicable Date, neither Shenzhen Xingli Zundian nor Dongguan Super Furniture had received any notice from the relevant authorities for not obtaining the relevant environmental protection facilities approval. Nevertheless, Shenzhen Xingli was fined for RMB10,000 and ordered to suspend its operation in March 2004 for failing to complete the construction of its waste water treatment facilities prior to the commencement of its operation. Shenzhen Xingli took corrective measures by constructing sewage treatment facilities for filtering pollutants contained in the waste water. Save for the cost of approximately RMB[34,000] incurred in acquiring certain building materials in constructing the sewage treatment facilities by Shenzhen Xingli, there was no material financial loss suffered by the Group arising from the rectification works and the suspension of operation of Shenzhen Xingli. Furthermore, as advised by the PRC Legal Advisers, Shenzhen Xingli has paid the fine of RMB10,000 as mentioned above and is presently in normal operation.

The PRC Legal Advisers visited the relevant local environmental protection authority in Shenzhen and were given to understand that since Shenzhen Xingli was unable to apply for the environmental protection facilities approval as no valid title document in respect of the relevant property was available and the level of pollution that might be caused by the operations of Shenzhen Xingli was not material, the relevant authority did not strictly require Shenzhen Xingli to apply for the environmental protection facilities inspection prior to the commencement of operations. The PRC Legal Advisers also understood from the relevant environmental protection authority that as Shenzhen Xingli is presently in normal operation and has been subject to on-going monitoring by the relevant authority, Shenzhen Xingli would not be required to obtain the environmental protection facilities approval for its production facilities. Having considered that (i) Shenzhen Xingli took corrective measures after being fined for RMB10,000 and ordered to suspend its operation in March 2004 as described above, and was allowed to resume operation by the relevant environmental protection authority and

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is presently in normal operation; and (ii) the relevant environmental protection authority has indicated that it would not require Shenzhen Xingli to apply for the environmental protection facilities approval for its production facilities, the PRC Legal Advisers are of the opinion that Shenzhen Xingli would not be penalised for not obtaining the environmental protection facilities approval.

The PRC Legal Advisers also visited the local environmental protection authority in Dongguan and were given to understand that since Dongguan Super Furniture was not qualified to apply for the environmental protection facilities approval as no registered lease agreement in respect of the relevant property was available at the relevant time, and the relevant environmental protection authority considered the level of pollution that might be caused by the operations of Dongguan Super Furniture to be relatively low, Dongguan Super Furniture was allowed to commence operation. As advised by the PRC Legal Advisers, Dongguan Super Furniture has never been subject to any penalty with respect to environmental protection issues. The PRC Legal Advisers have also advised that the local environmental protection authority in Dongguan has issued a notice in October 2007 allowing enterprises which have not obtained the environmental protection facilities approval prior to the commencement of operations to apply for such approval provided the level of pollution that might be caused by the operations of these enterprises is considered to be relatively low. The PRC Legal Advisers have confirmed that Dongguan Super Furniture has applied for the environmental protection facilities approval and was issued an application acceptance notice by the local environmental protection authority in March 2009. As advised by the PRC Legal Advisers, they are not aware of any legal obstacle for Dongguan Super Furniture to obtain such environmental protection facilities approval on the following basis: (i) Dongguan Super Furniture confirmed that it has installed the necessary environmental protection facilities to comply with the relevant environmental laws, rules and regulations in the PRC; (ii) Dongguan Super Furniture has been subject to the on-going supervision by the relevant environmental protection authority which has never imposed any penalty with respect to environmental protection issues on Dongguan Super Furniture since the commencement of its operations and has issued 環保守法證明 (Certificate of Compliance with Environmental Laws) to Dongguan Super Furniture; and (iii) according to a written confirmation from the local environmental protection authority dated 20 May 2009, the local environmental protection authority has conducted an on-site investigation of the environmental protection facilities of Dongguan Super Furniture on 8 April 2009 and is currently processing the environmental protection facilities approval. The PRC Legal Advisers have further advised that, in the event that Dongguan Super Furniture is unable to satisfy the requirements of the relevant environmental protection authority with respect to obtaining the environmental protection facilities approval and fails to rectify any shortcoming identified within the prescribed time frame, Dongguan Super Furniture may be subject to a maximum fine of RMB100,000 and/or ordered to suspend operations. Furthermore, as advised by the PRC Legal Advisers, Dongguan Super Furniture has obtained 環保守法證明 (Certificate of Compliance with Environmental Laws) issued by the local environmental protection authority which, as advised by the PRC Legal Advisers, is an appropriate competent authority for granting such certificate. The certificate states that Dongguan Super Furniture has complied with environmental protection requirements since its establishment up to the issue of the certificate in March 2009. The PRC Legal Advisers are of the opinion that since Dongguan

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Super Furniture has obtained the Certificate of Compliance with the Environmental Laws and the relevant environmental protection authority has accepted Dongguan Super Furniture's application for the environmental protection facilities approval, Dongguan Super Furniture would not be penalised for not obtaining the environmental protection facilities approval prior to the commencement of operations.

As regards Shenzhen Xingli Zundian, the PRC Legal Advisers are of the opinion that as Shenzhen Xingli Zundian was not required to apply for the environmental protection facilities approval, and the relevant environmental protection authority has issued 環保守法證明 (Certificate of Compliance with Environmental Laws) to Shenzhen Xingli Zundian (more details of which are set out below), Shenzhen Xingli Zundian is in compliance with environmental protection requirements in the PRC. Moreover, the PRC Legal Advisers were not aware of any penalty that might be imposed on Shenzhen Xingli Zundian by the relevant environmental protection authority.

Furthermore, as advised by the PRC Legal Advisers, each of Shenzhen Xingli and Shenzhen Xingli Zundian has obtained 環保守法證明 (Certificates of Compliance with Environmental Laws) issued by the relevant environmental protection authority which, as advised by the PRC Legal Advisers, is an appropriate competent authority for granting such certificates. The certificates state that each of them has complied with environmental protection requirements for each of the three-year periods prior to the issue of such certificates in May 2008 and in March 2009 respectively. In August 2008, each of Shenzhen Xingli and Shenzhen Xingli Zundian was also granted 質量環保產品認證證書 (Environmental Label Certificate) issued by 中國質量認證中心 (China Quality Certification Centre).

The major environmental impacts arising from the Group's production of furniture products and mattresses include the discharge of waste water, the emission of dusts into the air and the generation of noise pollution. In order to comply with relevant environmental protection laws, rules and regulations in the PRC, the Group (i) has constructed sewage treatment facilities that help to recycle the waste water discharged; (ii) has installed a centralised dust vacuum system that collects dust and wooden particles generated during the production process; (iii) has installed an anti-noise pollution device to reduce the noise level generated during the production process; (iv) has equipped itself with a fully automatic UV spray-coating processing line which helps to reduce the level of air pollution and waste water discharge in spraying process; and (v) has engaged a waste water treatment company to collect the residual waste water monthly and has engaged a solid waste treatment company to daily remove the solid wastes collected from the Group's production facilities for further treatment.

In addition to the aforesaid measures taken by the Group, the Group will continue to monitor and improve its operation in order to ensure due compliance with the relevant environmental laws, rules and regulations in the PRC at present and in the future by (i) providing regular training on an annual basis to the staff of the Group with respect to the environmental protection; and (ii) making required regulatory filings within the prescribed time frame. The Group has set up a safety supervision division which is responsible for formulation and implementation of both environmental protection and production safety

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compliance measures and provision of regular training to the staff of the Group. [The division comprises [5] members. The head of the division has over [seven] years of experience in environmental protection and production safety matters and has completed an [environmental management system internal audit] course which covered, among others, environmental protection and safety production and quality management.] The Group has appointed Mr. Cheung, one of the executive Directors, to take full charge of the construction progress of the new production plants and to ensure that the new production plants are in compliance with the relevant environmental laws, rules and regulations in the PRC. Mr. Cheung is also required to submit written progress reports to the Board and the compliance department of the Group once every two months on the construction progress as well as the environmental compliance of these production plants. The Shenzhen Xingli Production Base and Shenzhen Xingli Zundian Production Base will adopt similar measures and the same types of devices and equipment currently used at the Group's existing production facilities to reduce the impact of the production on the environment and to comply with the relevant environmental protection requirements.

For the three years ended 31 December 2008, the costs (covering training, certification and purchases of related hardwares) incurred in the compliance with relevant laws, rules and regulations in the PRC in respect of the environmental protection amounted to approximately RMB[216,000], RMB[236,000] and RMB[291,000] respectively. The Directors believe that the costs to be incurred will not increase substantially for the year ending 31 December 2009.

Save for the failure in obtaining the relevant environmental protection facilities approvals by Shenzhen Xingli and Dongguan Super Furniture, the Directors confirmed that, during the Track Record Period, each of the Company's subsidiaries in the PRC had not committed any other non-compliance acts in breach of environmental protection laws, rules or regulations in the PRC and had not been required to pay any fines and penalties in respect thereof. Taking into account that (i) with the implementation of the above mentioned measures, no material environmental pollution incident caused by the Group was discovered; (ii) each of Shenzhen Xingli and Shenzhen Xingli Zundian has obtained the 環保守法證明 (Certificates of Compliance with Environmental Laws) issued by the relevant competent environmental protection authority which state that each of them has complied with environmental protection requirements for each of the three-year periods prior to the issue of such certificates in May 2008 and in March 2009 respectively and Dongguan Super Furniture has obtained 環保守法證明 (Certificate of Compliance with Environmental Laws) issued by the local competent environmental protection authority which states that Dongguan Super Furniture has complied with environmental protection requirements since its establishment up to the issue of the certificate in March 2009; and (iii) in August 2008, each of Shenzhen Xingli and Shenzhen Xingli Zundian was also granted 品質環保產品認證證書 (Environmental Label Certificate) issued by 中國品質認證中心 (China Quality Certification Centre), the Directors are of the view that the current environmental protection measures are sufficient for the Group to comply with the relevant laws, rules and regulations.

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The PRC Legal Advisers have also confirmed that, save for the failure in obtaining the relevant environmental protection facilities approvals by Shenzhen Xingli and Dongguan Super Furniture and the penalties of RMB10,000 imposed on Shenzhen Xingli by the relevant authority in March 2004 as described above, (i) the Group has fully complied with the relevant environmental protection laws, rules and regulations in the PRC in all material respects; (ii) no material environmental pollution incident caused by the Group was discovered; and (iii) no penalties, fines or sanctions of any kind regarding environmental protection was imposed on the Group by any relevant environmental protection authorities in the PRC.

### **Compliance with safety laws, rules and regulations**

The Group is subject to relevant laws, rules and regulations in the PRC in respect of production safety including 中華人民共和國安全生產法 (PRC Production Safety Law) which is the principal law governing the supervision and administration of production safety in the PRC. The Group provides training with respect to production safety to the employees on a regular basis to enhance their safety awareness and provides each employee with a handbook on production safety in relation to operation of equipment and machinery. The Group has set up a safety supervision division which is responsible for formulation and implementation of both environmental protection and production safety compliance measures and providing regular training to the staff of the Group. The staff in charge of production safety and production safety training have completed professional training in respect of production safety organised by local safety production inspection authorities. The Directors consider that as during the Track Record Period, there was no [material] accident occurred during the production process in the PRC, nor was there any violation or breach of the relevant laws, rules and regulations in the PRC in relation to production safety, the production safety measures mentioned above are sufficient for the Group to comply with the relevant laws, rules and regulations. In the future, the Group will continue its current practice in providing training to its employees to strengthen their awareness of production safety in order to minimise the risks of occurrence of production accidents.

For the three years ended 31 December 2008, the costs incurred in the compliance with relevant laws, rules and regulations in the PRC with respect to production safety amounted to approximately RMB[45,000], RMB[48,000] and RMB[70,000] respectively. The Directors consider that the costs to be incurred will not change materially for the year ending 31 December 2009.

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**Non-compliance incidents**

During the Track Record Period, the Group had inadvertently failed to comply with certain laws, rules and regulations of the PRC and Hong Kong which non-compliance is summarised below:

Items of non-compliance	Name(s) of the group company(ies)	Particulars of non-compliance (relevant period)	Reason for the non-compliance	Remedial actions	Potential maximum penalty/fine (or penalty/fine actually imposed)	Basis of the potential penalty/fine (or penalty/fine actually imposed)
(1) Non-compliance with the environmental laws, rules and regulations in the PRC	Shenzhen Xingli and Dongguan Super Furniture	Failed to obtain the environmental protection facilities approval prior to the commencement of its operations (since December 2002 and October 2005 by Shenzhen Xingli and Dongguan Super Furniture respectively).	As the relevant lessor of the factory premises of Shenzhen Xingli had not provided any valid title document in respect of the relevant property upon the application by Shenzhen Xingli for the environmental protection facilities approval prior to the commencement of its operations, Shenzhen Xingli was unable to apply for the environmental protection facilities approval. Dongguan Super Furniture was unable to apply for the environmental protection facilities approval prior to the commencement of its operations as no registered lease agreement in respect of the relevant property was available at the relevant time.	Shenzhen Xingli has obtained the 環保守法證明 (Certificates of Compliance with the Environmental Laws) issued by the local environmental protection authority which, as advised by the PRC Legal Advisers, is an appropriate competent authority for granting such certificates. The certificates state that Shenzhen Xingli has not incurred any environmental pollution incident or violated any environment laws, rules and regulations for each of the 3-year periods prior to the issue of such certificates in May 2008 and March 2009 respectively, and the existing production process has not caused any environmental pollution, and has satisfied the relevant environmental requirements respectively. According to the PRC Legal Advisers, the non-compliance in relation to Shenzhen Xingli's failure in obtaining the environmental protection facilities approval occurred prior to the said 3-year periods.	Each of Shenzhen Xingli and Dongguan Super Furniture may be subject to a maximum fine of RMB100,000 and/or may be ordered to suspend operations. The PRC Legal Advisers are of the opinion that as (i) Shenzhen Xingli took corrective measures after being fined for RMB10,000 and ordered to suspend its operation in March 2004 as described in the sub-paragraph headed "Compliance with environmental protection laws, rules and regulations" above and has resumed operation with approval from the relevant environmental protection authority; and (ii) the relevant environmental protection authority has indicated that it would not require Shenzhen Xingli to apply for the environmental protection facilities approval for its production facilities, Shenzhen Xingli would not be penalised for not obtaining the environmental protection facilities approval. Furthermore, the PRC Legal Advisers are of the opinion that since the relevant authority understood that Dongguan Super Furniture was previously unable to apply for the environmental protection facilities approval, and the relevant environmental protection authority has already accepted Dongguan Super Furniture's application for the environmental protection facilities approval, Dongguan Super Furniture would not be penalised for not obtaining the environmental protection facilities approval prior to the commencement of operations. Up to the Latest Practicable Date, the Group had not received any notice, reminder or directive from the relevant authorities requiring it to make such payment with respect to the aforesaid fine or to suspend operations.]	建設項目竣工環境保護驗收管理辦法 (Administrative Measures for Environmental Protection Examination and Approval Upon Completion of Construction Projects)



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Items of non-compliance	Name(s) of the group company(ies)	Particulars of non-compliance (relevant period)	Reason for the non-compliance	Remedial actions	Potential maximum penalty/fine (or penalty/fine actually imposed)	Basis of the potential penalty/fine (or penalty/fine actually imposed)
(2) Non-compliance with the PRC employee social welfare contribution regulations	Shenzhen Xingli and Shenzhen Xingli Zundian	No contribution for housing provident funds was made until 1 March 2009.	As advised by the PRC Legal Advisers after making enquiries with the relevant local authorities, the relevant local authorities have not strictly required the payment of housing provident fund contribution.	As advised by the PRC Legal Advisers, Shenzhen Xingli and Shenzhen Xingli Zundian have voluntarily offered to provide for the outstanding contribution, but the relevant local authorities in Shenzhen have declined to accept. The PRC Legal Advisers visited the relevant local social insurance authority and were given to understand that since no housing provident fund authorities have been set up in Shenzhen, the relevant local social insurance authority is accepting the housing provident fund contribution payments on their behalf and would not strictly enforce the payment of housing provident fund contributions or accept the payment of outstanding housing provident fund contributions. The PRC Legal Advisers further advised that the relevant local authority would only accept the payment of housing provident funds contribution for employees who hold Shenzhen household registration.	Each of Shenzhen Xingli and Shenzhen Xingli Zundian may be subject to a maximum penalty of RMB50,000 if it fails to pay the outstanding amount within the prescribed time limit upon receiving a demand note issued by the relevant authorities. Up to the Latest Practicable Date, the Group had [not received any notice, reminder or directive from the relevant authorities requiring it to make such payment with respect to the outstanding amount.]	住房公積金管理條例 (Regulations on Management of Housing Provident Fund)
	Dongguan Super Furniture	Dongguan Super Furniture has only made the employee social insurances contributions for a number of staff members, which was less than the actual number of employees hired until 1 January 2009.	Due to high turnover rate of newly recruited staff at Dongguan Super Furniture, the Company has failed to keep track of its contribution to the employee social insurances.	The Group has quantified the amounts of outstanding contributions for the housing provident fund up to [31 December] 2008 to be approximately RMB[808,000] and has made [full] provisions in its accounts.  As advised by the PRC Legal Advisers, in order to support local enterprises in Dongguan due to the current economic downturn, the relevant local authority would not require Dongguan Super Furniture to pay the outstanding contributions, nor impose any penalties on Dongguan Super Furniture for the failure to make the employee social insurances contribution.  Dongguan Super Furniture has made the required contribution for the employee social insurances from 1 January 2009.	Dongguan Super Furniture is, in addition to settling its unpaid contribution, subject to a maximum overdue penalty of 0.2% of the outstanding social insurance payments per day if it fails to pay off the outstanding amount within the prescribed time limit upon receiving a demand note issued by the relevant administrations. Up to the Latest Practicable Date, the Group had [not received any notice, reminder or directive from the relevant authorities requiring it to make such payment with respect to the outstanding amount.]	社會保險費申報繳納管理暫行辦法 (Provisional Measures on the Administration of Declaration and Payment of Social Insurance Premium)
			The Group has quantified the amounts of outstanding contributions for the employee social insurances up to [31 December] 2008 to be approximately RMB[1,436,000] and has made [full] provisions in its accounts.			

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Items of non-compliance	Name(s) of the group company(ies)	Particulars of non-compliance (relevant period)	Reason for the non-compliance	Remedial actions	Potential maximum penalty/fine (or penalty/fine actually imposed)	Basis of the potential penalty/fine (or penalty/fine actually imposed)
(3) Non-compliance with the Companies Ordinance and Business Registration Ordinance	Hing Lee Furniture Group Limited	Late filings in relation to the resignation of company secretary (during the period from January 2006 to March 2008) and the appointment of new company secretary (during the period from January 2006 to March 2006) in contravention of the relevant provisions of the Companies Ordinance.	Prior to 1 December 2007, no strict requirements of payment of housing provident fund for any companies located in Dongguan were imposed by the relevant local authority. As 東莞市住房公積金繳存管理辦法 (Measures on the Administration of Declaration and Payment of Housing Provident Fund in Dongguan) came into effective on 1 December 2007, Dongguan Super Furniture is required to pay housing provident fund from 1 December 2007 onward.	The required filings with the Companies Registry had already been made in March 2006 and March 2008 respectively.	Based on the legal advice obtained by the Company, an Ordinance may be tried if it is brought within 3 years after commission of the offence. In respect of the late filing which was made in March 2006, as more than 3 years have elapsed after the last day of continued default, no action may now be brought against Hing Lee Furniture Group Limited or its officer in default for such non-compliance. In respect of the late filing which was made in March 2008, as less than 3 years have elapsed after the last day of this continued default and based on the continued default of 714 days, the aggregate estimated maximum amount of potential fines arising from such non-compliance will not be more than HK\$24,200, which represents the maximum punishment of a level 3 fine (being HK\$10,000 at present) for the offence and a daily default fine of HK\$300 for continued default. Up to the Latest Practicable Date, the Group had [not been prosecuted nor received any notice of prosecution with respect to such non-compliance.]	東莞市住房公積金繳存管理辦法 (Measures on the Administration of Declaration and Payment of Housing Provident Fund in Dongguan)
		No contribution for housing provident funds was made until 1 January 2009.	Dongguan Super Furniture has made enquiries with the relevant authorities regarding the payment of the outstanding of the housing provident funds contribution. The relevant authorities in Dongguan represented to the PRC Legal Advisers that in order to support local enterprises in Dongguan in the current economic downturn, the relevant local authority would not require Dongguan Super Furniture to pay the outstanding contributions, nor impose any penalties on Dongguan Super Furniture for the failure to make the housing provident fund contribution.] Dongguan Super Furniture has made the required contribution for housing provident funds from 1 January 2009. The Group has quantified the amounts of outstanding contributions for housing provident funds up to [31 December] 2008 to be approximately RMB[148,000] and has made [full] provisions in its accounts.	Dongguan Super Furniture may be subject to a maximum penalty of RMB50,000 if it fails to pay the outstanding amount within the prescribed time limit upon receiving a demand note issued by the relevant authorities. Up to the Latest Practicable Date, the Group had [not received any notice, reminder or directive from the relevant authorities requiring it to make such payment with respect to the outstanding amount.]		

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Items of non-compliance	Name(s) of the group company(ies)	Particulars of non-compliance (relevant period)	Reason for the non-compliance	Remedial actions	Potential maximum penalty/fine (or penalty/fine actually imposed)	Basis of the potential penalty/fine (or penalty/fine actually imposed)
	Hing Lee Furniture	Failure to apply for registration under Part XI of the Companies Ordinance within one month after its establishment of place of business (during the period commencing from May 2005 to October 2008).	During the period from 2005 to late 2006, the Group experienced high staff turnover in the finance and accounting department and the department head had changed three times as mentioned above. Due to the lack of continuity in the staff of the finance and accounting department, such filing was not made within the prescribed time frame.	Application for registration was submitted on 3 October 2008.	Hing Lee Furniture was ordered to pay a fine of HK\$2,064.00 and amend/ restitution of HK\$5,436.00 in a court hearing on 17 February 2009. The total sum of HK\$7,500 was duly paid on 23 February 2009.	Companies Ordinance
		Failure to apply for business registration under the Business Registration Ordinance within one month of its commencement of business (during the period commencing from May 2005 to October 2008).	During the period from 2005 to late 2006, the Group experienced high staff turnover in the finance and accounting department and the department head had changed three times as mentioned above. Due to the lack of continuity in the staff of the finance and accounting department, such filing was not made within the prescribed time frame.	Application for business registration was made on 13 October 2008 and business registration certificates have already been issued to Hing Lee Furniture.	Based on the legal advice obtained by the Company, any person who fails to make timely application for business registration shall be guilty of an offence and shall be liable to a maximum punishment of a fine of HK\$5,000 and imprisonment for 1 year. The secretary, manager or any director of Hing Lee Furniture (which include the Founders) shall also be answerable for such non-compliance.	Business Registration Ordinance
					Based on the verbal enquiry by the legal advisers of the Company with an officer of the Business Registration Office on 17 September 2008, if a company volunteered to make a late application for business registration, there would not be any penalty but the company would be required to pay the business registration fees for the past years. According to such officer, no one had been sentenced to imprisonment as a result of failure to obtain business registration so far. Hing Lee Furniture has paid the business registration fees on 13 October 2008 for the past years since its commencement of business. Up to the Latest Practicable Date, the Group had not been prosecuted nor received any notice of prosecution with respect to such non-compliance.]	
					[Based on the information obtained in the verbal enquiry, the Company's legal advisers also consider that the practical risk of the secretary, manager or directors being prosecuted and sentenced to imprisonment upon conviction as a result of such non-compliance appears to be relatively low.]	
					Under the Business Registration Ordinance, no prosecution thereunder shall be commenced save within 6 years from the date of the commission of the offence.	

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Items of non-compliance	Name(s) of the group company(ies)	Particulars of non-compliance (relevant period)	Reason for the non-compliance	Remedial actions	Potential maximum penalty/fine (or penalty/fine actually imposed)	Basis of the potential penalty/fine (or penalty/fine actually imposed)
(4) Non-compliance with the Inland Revenue Ordinance	Hing Lee Furniture	Failure to notify the IRD of its chargeability to tax within the prescribed time (the years of assessment 2005/2006 to 2007/2008).	<p>In April 2005, as the Group acquired Hing Lee Furniture to handle the export trading business, it started to recruit accounting professionals in Hong Kong to take charge of the finance and accounting department. However, during the period from 2005 to late 2006, the Group experienced rather high staff turnover in the finance and accounting department and the department head had changed three times as mentioned in item (3) above. Having mistakenly considered the export trading business of Hing Lee Furniture (a BVI incorporated company) as being carried out offshore and not being subject to Hong Kong tax, and due to the lack of continuity in the staff of the finance and accounting department, Hing Lee Furniture failed to notify the IRD of its chargeability to tax within the prescribed time. At the time of finalising its 2006 accounts in around November 2007, Hing Lee Furniture became aware of the possibility that it might be subject to Hong Kong tax. However, it was not certain of the extent of its exposure. The Group's chief financial officer initially discussed the issue with Hing Lee Furniture's auditors. In March 2008, Hing Lee Furniture approached the tax accountants which is a firm headed by two professionally qualified accountants and engaged in provision of, among others, services in relation to compliance with tax regulatory requirements of Hong Kong and tax disputes with IRD. In June 2008, Hing Lee Furniture formally engaged the said tax accountants.</p>	<p>Hing Lee Furniture has appointed tax accountants to assist it in making filings with the IRD. Hing Lee Furniture has voluntarily informed the IRD of its chargeability to tax for these three assessment years and submitted its accounts for the relevant years to the IRD in October 2008 and submitted its profit tax returns for the said years of assessment in December 2008. In January 2009, the IRD issued assessments demanding final tax for 2005/2006, 2006/2007 and 2007/2008 with a total tax payable of HK\$408,867, HK\$1,499,863 and HK\$720,582 respectively. The amounts were fully paid on 3 March 2009 in accordance with the payment schedule of the IRD.</p> <p>The Group has also made provision in its accounts in respect of the undercharged tax and surcharge and penalties. As the directors of Hing Lee Furniture became aware of the possibility of chargeability to tax of Hing Lee Furniture around November 2007 when finalising the 2006 accounts, Hing Lee Furniture made a provision for taxation of approximately HK\$1.9 million in its 2006 financial statements. However, the related amounts of surcharge and penalty were uncertain based on the information available at that time and therefore no provision in relation thereto was made in Hing Lee Furniture's 2006 accounts. Having sought advice from the tax accountants in 2008, the directors of Hing Lee Furniture provided approximately HK\$2.7 million for the accumulated surcharge and penalty (representing 100% of the estimated undercharged tax) and approximately HK\$0.7 million for undercharged tax for the year of assessment 2007/2008 in Hing Lee Furniture's 2007 accounts. The Group has also engaged the tax accountants to assist it in making filings to the IRD for the years of assessment 2008/2009 and 2009/2010.</p>	<p>Pursuant to the Inland Revenue Ordinance, any person who, without reasonable excuse, fails to inform the IRD of its chargeability to tax shall be guilty of an offence and liable for a level 3 fine (i.e. fine of HK\$10,000) and a further fine of treble the amount of tax which has been undercharged in consequence of such failure, and no person shall be liable unless the complaint concerning such offence was made before the expiration of 6 years from the end of the relevant year of assessment. Alternatively, the IRD may, instead of prosecution, impose an additional tax for a maximum amount of treble the amount of tax which has been so undercharged and there is no express stipulation as to the period within which the IRD could take action against Hing Lee Furniture for the imposition of additional tax under the Inland Revenue Ordinance.</p>	<p>Inland Revenue Ordinance</p>

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In view of the occurrence of the above mentioned non-compliance instances, in December 2008, the Group has set up a compliance department, headed by the chief financial officer and staffed by a qualified accountant and an internal audit manager who graduated with an accountancy degree from 廣東省外貿學院 (Guangdong Province Institute of International Trade) with over [25] years of experience in financial management as well as over [5] years of experience in internal audit, to ensure that the Group's operations are in compliance with applicable laws, rules and regulations, to strengthen its existing internal control framework, recommend best practices for corporate governance issues and report internal control deficiencies as well as remedial plans from time to time. The compliance department reports directly to the Board. The independent non-executive Directors will designate one of its members, namely Mr. Kong Hing Ki, to review the operations of the compliance department on a quarterly basis and report to the Board on any deficiency identified as well as the recommendation for appropriate rectifying action.

During the course of its operation in the past years, the Group has compiled and implemented various internal control policies and procedures concerning [cash management, financial reporting, sales and marketing, product pricing, accounts receivable management, raw material procurement, inventory control, fixed asset acquisition, operating budget control, approval of major contract and staff recruitment.] The compliance department has properly consolidated and documented these policies and procedures together with other corporate governance practices into a compliance manual. Such manual has been distributed to each department head by the end of 2008 and the compliance department also went through this manual with the department heads in [early January 2009]. Furthermore, the Group has taken the following steps to prevent recurrence of the above mentioned non-compliance incidents:

In the PRC

**a. Non-compliance with the environmental laws, rules and regulations**

Mr. Cheung, one of the executive Directors, is responsible for taking full charge of monitoring the construction progress of the Shenzhen Xingli Production Base and the Shenzhen Xingli Zundian Production Base and ensuring that the new production plants are in compliance with the relevant environmental laws, rules and regulations in the PRC. Mr. Cheung is also required to submit written progress report to the Board and the compliance department once every two months on the construction as well as the environmental compliance of these production plants. For details of the relevant properties, please refer to the sub-paragraph headed "Owned properties" in the paragraph headed "Properties" in this section above.

In addition, written policy has been laid down that, in case of leasing property from third party landlord, all necessary title documents in respect of the leased property shall be requested from the prospective landlord at the stage of negotiation and before signing the lease agreement and the registration of the lease agreement shall be pursued by the landlord shortly after signing in order to apply for the environmental protection facilities approval. All registered lease agreements have to be filed with the compliance department of the Group.

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**b. Non-compliance with the PRC employee social welfare contribution regulations**

The Group has designated a member of the finance and accounting department in the PRC to handle the calculation, reporting and payment of the relevant social welfare and housing provident fund contributions of the Company's subsidiaries in the PRC. The compliance department has laid down written guidelines on how to calculate the contribution amounts in accordance with the relevant laws, rules and regulations. The designated finance and accounting personnel will have the calculation checked and cleared by the compliance department before processing payment.

In Hong Kong

**c. Non-compliance with the Companies Ordinance and the Business Registration Ordinance**

The qualified accountant will be responsible to ensure that all the Company's subsidiaries in Hong Kong are in full compliance with their annual reporting requirements in accordance with the Companies Ordinance and the Business Registration Ordinance. The chief financial officer has prepared a checklist of filings which the Company's subsidiaries in Hong Kong need to perform annually in accordance with the applicable laws, rules and regulations. The qualified accountant needs to report to the chief financial officer with the checklist completed on a quarterly basis. [The Directors consider the required filings are routine and simple tasks and therefore reporting on a quarterly basis would be sufficient.]

**d. Non-compliance with the Inland Revenue Ordinance**

The chief financial officer will be responsible to ensure that all the Company's subsidiaries conducting business in Hong Kong are in full compliance with the Inland Revenue Ordinance. The chief financial officer is also given the authority to seek external professional advice and assistance if needed. Furthermore, the Board will also engage an external tax accountant to opine on whether such subsidiaries are in full compliance with the Inland Revenue Ordinance. The Group has engaged the tax accountants as mentioned above to assist it in making filings to the IRD for the years of assessment 2008/2009 and 2009/2010.

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To prevent the occurrence of any non-compliance of laws, rules and regulations in future, the Directors have taken or will undertake the following steps and measures to further enhance the Group's corporate governance practices and the effectiveness of its internal control procedures:

1. prior to [●], the Directors have attended training sessions conducted by the Company's legal advisers on the on-going obligations and duties of a director of a company whose shares are listed on the Stock Exchange under the Listing Rules;
2. prior to [●], the executive Directors have attended training sessions conducted by [●] on various on-going obligations and duties of a listed issuer and its directors under the Listing Rules and the Takeovers Codes;
3. prior to [●], the Directors have received and reviewed a detailed memorandum prepared by the Company's legal advisers setting out the Listing Rules and general Hong Kong companies law requirements and obligations of the Directors after [●];
4. prior to [●], the Group has hired an additional qualified accountant to handle listed company compliance matters in Hong Kong and to work together with the chief financial officer in setting up the compliance department to monitor all compliance and corporate governance matters of the Group. The compliance department will be given access to external professional parties, such as the compliance advisers, external legal counsel in Hong Kong and the PRC, tax accountants and auditors, retained by the Group from time to time. The compliance department will report any non-compliance matters so detected and recommend best practices for any corporate governance issues to the Board;
5. written policy has been laid down that (i) recurring business related contract with value over HK\$1 million; and (ii) non-recurring business related contract with value over HK\$0.5 million, shall, in addition to the approval of the relevant department head, have to be reviewed and approved by the compliance department before they are signed by an executive Director;
6. the setting up of an audit committee which comprises [all] the independent non-executive Directors who have the duties to, among other things, review the internal control systems and procedures for compliance with the relevant accounting, financial and Listing Rules requirements. The audit committee has adopted written terms of reference in compliance with the Code on Corporate Governance Practices as set out in Appendix 14 to the Listing Rules. The audit committee will, upon due and careful inquiries, disclose its major view regarding the Company's compliance and internal control related matters in its annual report for each of the two financial years immediately after [●];

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7. subsequent to [●], the Company will engage an internal control review consultancy professional or other professional adviser as determined by the audit committee to carry out an assessment on internal control systems and procedures in relation to financial reporting, disclosure under the Listing Rules and the Companies Ordinance, and risk management. Material findings of such assessment together with any suggested rectifying measures will be published in the Company’s annual report for each of the two financial years after [●]; and
8. the executive Directors have undertaken to [●] to attend external continuous training sessions relating to corporate governance for five hours each year for two years after [●].

Save for the aforesaid instances of non-compliance of the Inland Revenue Ordinance, the Companies Ordinance and the Business Registration Ordinance as at the Latest Practicable Date, no member of the Group was engaged in any litigation, arbitration or claim that would have a material adverse effect on the Group’s financial condition and results of operations, taken as a whole, and so far as the Directors were aware, no litigation, arbitration or claim was pending or threatened by or against any member of the Group.

Save for the various instances of non-compliance as mentioned above and in the section headed “Risk factors” in this document, as advised by the legal advisers to the Company, the Group has obtained all necessary permits, licences and approvals for their operations in accordance with the applicable laws, rules and regulations in the jurisdictions where it operated throughout the Track Record Period.

According to the legal advice obtained by the Company, the Company’s operating subsidiaries in Hong Kong, namely Hing Lee (China) and Hing Lee Furniture, were not required to obtain permits, certificates and licences from regulatory bodies under the laws of Hong Kong for their business operations in Hong Kong during the Track Record Period other than those required under the Business Registration Ordinance and their business operations in Hong Kong are not prohibited by Hong Kong law. Hing Lee (China) and Hing Lee Furniture have been duly registered under the Business Registration Ordinance.

[The Directors confirmed that save as disclosed above and in the section headed “Risk factors” in this document, the Group had complied with all relevant laws, rules and regulations in all material respects in all jurisdictions where it operated during the Track Record Period.] [The PRC Legal Advisers have also confirmed that save as disclosed in this document, they are not aware of any non-compliance of relevant laws, rules and regulations in any material aspects in the PRC by Shenzhen Xingli, Shenzhen Xingli Zundian and Dongguan Super Furniture during the Track Record Period.]



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### INDEMNITIES

Pursuant to the Deed of Indemnity (the document referred to in paragraph (ix) in the sub-section headed “Summary of material contracts” in Appendix V to this document), the Founders and their respective investment vehicles (namely King Right Holdings Limited, United Sino Limited, Golden Sunday Limited and Top Right Trading Limited) (collectively the “Indemnifiers”) have given joint and several indemnities in favour of the Company (for itself and as trustee for other members of the Group), in connection with, inter alia:

- (i) estate duty which might be payable by any member of the Group by reason of transfer of property on or before the date on which [●] becomes unconditional (the “Effective Date”);
- (ii) any tax liabilities falling on any member of the Group resulting from or by reference to any income, profits or gains, transactions, events, matters or things earned, accrued or received, entered into or occurring on or before the Effective Date;
- (iii) any expenses, payments, sums, outgoings, fees, demands, claims, damages, losses, costs, charges, liabilities, fines, penalties and tax (collectively, the “Costs”) which any member of the Group may incur, suffer or accrue, directly or indirectly, from or on the basis of or in connection with any failure, delay or defects of corporate or regulatory compliance under, or any breach of any provision of, the Companies Ordinance, the Business Registration Ordinance or the Inland Revenue Ordinance by any member of the Group on or before the Effective Date;
- (iv) any Costs which any member of the Group may incur, suffer or accrue, directly or indirectly, from or on the basis of or in connection with any litigation, arbitration or other proceedings or investigations against any member of the Group arising or accruing in relation to the operation of any member of the Group on or before the Effective Date;
- (v) any Costs which any member of the Group may incur, suffer or accrue, directly or indirectly, from or on the basis of or in connection with:
  - (a) any default, failure or delay in complying with, or any breach of, any law in the PRC by any of Shenzhen Xingli, Shenzhen Xingli Zundian and Dongguan Super Furniture (collectively, the “PRC Subsidiaries” and each a “PRC Subsidiary”) on or before the Effective Date;
  - (b) any default, failure or delay of any PRC Subsidiary in setting up, or making contributions towards all kinds of insurances, funds, contributions or otherwise required to be insured or made by such PRC Subsidiary under the laws in the PRC for the benefits of their respective employees, or any part thereof on or before the Effective Date;

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- (c) any default, failure or delay in registering, or any non-registration of, any tenancy agreement or arrangement entered into, or purported to be entered into, by any PRC Subsidiary as lessee on or before the Effective Date in respect of any leased property located in the PRC;
- (d) any termination or invalidity of any tenancy agreement or arrangement entered into, or purported to be entered into, by any PRC Subsidiary as lessee on or before the Effective Date in respect of any leased property in the PRC by reason of the lack of power, authority or capacity of the lessor or purported lessor in letting the relevant property to the relevant PRC Subsidiary or in entering into the relevant tenancy agreement or arrangement, including but not limited to any and all Costs in respect of relocation and removal of the relevant PRC Subsidiary to a new premises;
- (e) any default, failure or delay in the construction of the Shenzhen Xingli Zundian Production Base or any non-compliance or breach of any term or condition of 深圳市土地使用權出讓合同 (the contract for grant of land use rights in Shenzhen) (Shen Di He Zi 2007 No.5057) dated 29 June 2007 including but not limited to the resumption of the relevant land by the PRC government authorities;
- (f) any default, failure or delay in the construction of the Shenzhen Xingli Production Base or any non-compliance or breach of any term or condition of 深圳市土地使用權出讓合同 (the contract for grant of land use rights in Shenzhen) (Shen Di He Zi 2007 No. 5058) dated 29 June 2007, including but not limited to the resumption of the relevant land by the PRC government authorities;
- (g) any use of any intellectual property by any PRC Subsidiary under any licence agreements or arrangements entered into or purported to be entered into, between such PRC Subsidiary and Sharp Motion on or before the Effective Date; and
- (h) any claim against any member of the Group in respect of any of the foregoing.

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The Indemnifiers will, however, not be liable under the Deed of Indemnity under the following circumstances:

- (i) In respect of any taxation and taxation claims to the extent that:
  - (a) provision or reserve has been made for such taxation in the audited consolidated accounts of the Group as set out in Appendix I to this document;
  - (b) such taxation or liability falling on any member of the Group in respect of its accounting period commencing after 31 December 2008 and ending on the Effective Date, unless such taxation or liability would not have arisen but for some act or omission of, or transaction voluntarily effected by, any member of the Group with the prior written consent or agreement or acquiescence of the Indemnifiers other than any of the following (in which case the limitation of liability shall still apply):
    - (1) any such act, omission or transaction carried out or effected in the ordinary course of business or in the ordinary course of acquiring and disposing of capital assets after 31 December 2008; or
    - (2) any such act, omission or transaction carried out, effected or entered into pursuant to a legally binding commitment created on or before 31 December 2008;
  - (c) such tax claim arises or is incurred as a result of the imposition of taxation as a consequence of any retrospective change in the law or interpretation or practice coming into force after the Effective Date or to the extent that such claim arises or is increased by an increase in tax rates after such date with retrospective effect; or
  - (d) any provision or reserve made for taxation in the audited consolidated accounts of the Group as set out in Appendix I to this document which is finally established to be an excessive reserve or over provision, then the Indemnifiers' liability (if any) in respect of taxation shall be reduced by an amount not exceeding such over-provision or excessive reserve, provided that the amount of any such over-provision or excessive reserve applied pursuant to this paragraph to reduce the Indemnifiers' liability in respect of such taxation shall not be available in respect of any liability arising thereafter in which event the Indemnifiers shall be obliged to indemnify each member of the Group against any liability, loss or damage arising from such liability.]

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- (ii) In respect of the indemnity contained in paragraphs (iii) to (v) above to the extent that:
- (a) provision or reserve has been made for such liabilities in the audited consolidated accounts of the Group as set out in Appendix I to this document; or
  - (b) any Costs falling within paragraphs (iii) to (v) above arises or is incurred as a consequence of any retrospective change in the applicable law or the interpretation or practice thereof by the relevant authority coming into force after the Effective Date or to the extent that the same arises or is increased by reason of such retrospective changes.

### RELATIONSHIP WITH THE CONTROLLING SHAREHOLDER

Immediately after completion of [●], Mr. Fang Shin, the controlling shareholder of the Company, will effectively hold, through Triple Express, approximately [●]% of the issued share capital of the Company. Mr. Fang Shin does not hold any interest in any business which competes or is likely to compete with that of the Group pursuant to Rule 8.10 of the Listing Rules. Save for Mr. Fang Yan Zau, Alexander who is a non-executive Director and the son of Mr. Fang Shin, none of the Directors is considered to be connected with Triple Express, Mr. Fang Shin and their respective associates. The Directors have confirmed that none of them and their respective associates is engaged in any business that, directly or indirectly, competes or may compete with the business of the Group.

### Independence of management, financing and operation

The Directors consider that the Group will be able to conduct its business operationally and financially independent of the Controlling Shareholder.

#### *Management independence*

The Board comprises two executive Directors, one non-executive Director and three independent non-executive Directors. As confirmed by the Directors, the Group has all along been managed by the Founders and the senior management team of the Group. The appointment of Mr. Fang Yan Zau, Alexander is for the Controlling Shareholder to have representation on the Board and Mr. Fang Yan Zau, Alexander has not played any executive role nor has he participated in the daily operations of the Group. Accordingly, the Board functions independently from Triple Express, Mr. Fang Shin and their respective associates.

#### *Financial independence*

During the Track Record Period and up to the Latest Practicable Date, no guarantee or security was provided by Mr. Fang Shin, Triple Express or any of their respective associates with respect to any bank or other borrowings or indebtedness of any members of the Group. Therefore, there is no financial dependence of the Group on the Controlling Shareholder.

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### *Operational independence*

The Group has independent work forces to carry out sourcing, manufacturing, sales and marketing functions and has not shared its operation team with Triple Express, Mr. Fang Shin or any of their respective associates. The Group has independent access to its suppliers and customers and has established a set of internal controls to facilitate the effective operations of its business. During the Track Record Period and up to the Latest Practicable Date, the Group and the Controlling Shareholder did not have any common/shared facilities/resources, and there was no business transaction between the Group on one hand and Triple Express, Mr. Fang Shin or any of their respective associates on the other hand. The Directors consider that the Group’s operations do not rely on Triple Express, Mr. Fang Shin or any of their respective associates.

Given the above reasons, the Directors are of the view that the Group is capable of carrying on its business independently of the Controlling Shareholder and its associates after [●].

### **NON-COMPETITION UNDERTAKINGS**

Pursuant to the Non-competition Deed, each of [Triple Express], [Mr. Fang Shin], [Mr. Sung], [Mr. Cheung], [Mr. Chan] and [Mr. Huang] (each a “Covenantor” and collectively “Covenantors”) has irrevocably undertaken and covenanted with the Company (for itself and as trustee for its subsidiaries) that he/it shall not, directly or indirectly, either alone or in conjunction with or on behalf of or for any other person, either on his/its own account or for any other person, and shall procure that entities or companies controlled by him/it (other than the Group) not to:

- (a) solicit, interfere with or endeavour to entice away from the Group any person, firm, company or organisation who to his/its knowledge is from time to time or has at any time within the immediate past two years before the date of such solicitation, interference or enticement been a customer, supplier or employee of the Group for the purpose of conducting any Restricted Business (as defined below);
- (b) be engaged, interested or otherwise involved, directly or indirectly, in the business of design, manufacture, sales, marketing of wood-based home furniture and mattresses, and/or any franchising or licensing of such business, in the PRC, Europe, Asia [and in any other countries where any member of the Group carries on businesses from time to time] (the “Restricted Business”);

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- (c) solicit for employment by him/it or entities or companies controlled by him/it (other than the Group) or at any time employ or procure the employment of any person who has, at any time within immediate past two years before the date of such solicitation or employment, been or is a director, manager, employee of or consultant to the Group who is or may be likely to be in possession of any confidential information or trade secrets relating to the Restricted Business being carried on by the Group;
- (d) make use of any information pertaining to the business of the Group which may have come to his/its knowledge in his/its capacity as a Shareholder or a director of any member of the Group for the purpose of competing with the business of the Group; and
- (e) directly or indirectly solicit or persuade any person who has dealt with the Group or is in the process of negotiating with the Group in relation to the Restricted Business to cease to deal with the Group or reduce the amount of business which such person would normally do with the Group.

Pursuant to the Non-competition Deed, each of the Covenantors has also undertaken that he/it shall not, and shall procure entities or companies controlled by him/it not to take up any business opportunities relating to the Restricted Business which are offered to him/it or which he/it becomes aware of ("Business Opportunity"), whether or not such Business Opportunity has been referred to and/or rejected by the Group.]

Notwithstanding the above undertakings, the Covenantors are not restricted to:

- (a) hold or be interested in any securities in any company which engages or involves, directly or indirectly, in the Restricted Business provided that (i) such securities are listed on a recognised stock exchange; (ii) the amount of such holding does not exceed 10% of the entire issued share capital of such company; (iii) the relevant Covenantor is not the single largest shareholder of such company; and (iv) the relevant Covenantor does not control the board of directors of such company;
- (b) hold any securities in any member of the Group; and
- (c) engage in or discharge any duty, service or act for the benefit of any member of the Group.

The obligations of the Covenantors under the Non-competition Deed shall cease to be of any force and effect on the earlier of:

- (a) (i) in respect of each of Mr. Fang Shin and Triple Express, the date on which he/it ceases to be the Controlling Shareholder; and (ii) in respect of the Founders, the later of the date on which such Covenantor holds less than [1]% of the entire issued share capital of the Company or ceases to hold any directorship in the Group;
- (b) the date on which the cancellation or withdrawal of the [●] becomes effective (for the avoidance of doubt, excluding [●] due to any reason); or

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- (c) the date on which the Group ceases to engage in the Restricted Business.

If any of the independent non-executive Directors becomes aware that any Covenantor is in breach of the Non-competition Deed, then the independent non-executive Directors on behalf of the Company shall, without prejudice to any other rights or remedies available to the Company, have the right to demand the adoption by such Covenantor of appropriate measures to remedy the breach. Each Covenantor has agreed and undertaken to act, and to procure companies or entities controlled by him/it to act, promptly and effectively in accordance with the instructions of the majority of the independent non-executive Directors and whenever possible to reverse and remedy any such wrongdoings as soon as possible.

The Company will disclose decisions on matters reviewed by the independent non-executive Directors (if any) relating to the compliance and/or enforcement of the Non-competition Deed in its annual report or, when the Board considers it appropriate, by way of an announcement.

Each of the Covenantors has also undertaken to the Company to provide such information in relation to the compliance of the Non-competition Deed by him/it from time to time upon request by the Company and/or the independent non-executive Directors and to make an annual confirmation to the Company as to his/its compliance with the Non-competition Deed and that he/it will also make such declaration as may be required under the Listing Rules (if any) in relation to any competition with the Group or any member of the Group or his/its compliance with the terms of the Non-competition Deed.

## TRANSACTIONS WITH SHENZHEN JING CHU

Mr. Huang is a director of certain subsidiaries of the Company and the sole beneficial owner of Top Right Trading Limited, which will be interested in approximately [8.60]% of the issued share capital of the Company upon [●].

Shenzhen Jing Chu was founded in May 2000 by Mr. Huang and 胡景初先生 (Mr. Hu Jing Chu), an Independent Third Party, and was owned as to 60% by Mr. Huang and 40% by 胡景初先生 (Mr. Hu Jing Chu). 胡景初先生 (Mr. Hu Jing Chu) is a professor at 中南林業科技大學 (Central South University of Forestry and Technology) (formerly known as 中南林學院 (Central South Forestry University)) as well as a renowned expert in furniture design. In January 2008, Shenzhen Jing Chu's shareholding was changed to as to 80% owned by Mr. Huang, 15% by 劉永飛先生 (Mr. Liu Yong Fei), an Independent Third Party, and 5% by 胡景初先生 (Mr. Hu Jing Chu). In January 2009, Mr. Huang disposed of his entire interests in Shenzhen Jing Chu and as at the Latest Practicable Date, Shenzhen Jing Chu was owned by Mr. Hu Jing Chu and two other Independent Third Parties. Save and except the transactions between the Group and Shenzhen Jing Chu, Mr. Hu Jing Chu has no other business relationship with the Group and its connected persons. Despite his investment in Shenzhen Jing Chu, Mr. Huang did not participate in the daily operation of Shenzhen Jing Chu.

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### Reasons for engaging Shenzhen Jing Chu

The Group is principally engaged in the design, manufacture and sale of a wide range of home furniture products including wood-based furniture and mattresses. Shenzhen Jing Chu is principally engaged in (i) the design of furniture and decorative items; (ii) corporate image consultation; (iii) interior design and decoration; and (iv) software development. Shenzhen Jing Chu is engaged on an ad hoc basis when the Group's in-house product design and development teams have been fully occupied by their respective projects. The Directors considered that engaging Shenzhen Jing Chu would save the Group from incurring cost in establishing and maintaining a large number of in-house product design and development personnel and would bring in new ideas and techniques. As such, the Group's product design and development department can concentrate on existing product development projects. [Shenzhen Jing Chu has been engaged by the Group in view of the expertise of its founder, namely Mr. Hu Jing Chu in furniture design. Mr. Hu is a professor with specialisation in furniture design and manufacturing at 中南林業科技大學 (Central South University of Forestry and Technology). Based on Mr. Hu Jing Chu's expertise and knowledge in the area of furniture design, the Directors decided to engage Shenzhen Jing Chu to provide design services to Shenzhen Xingli since 2004 and to Shenzhen Xingli Zundian since 2006.

### 2009 Design Agreements dated 2 January 2009

[Pursuant to the 2009 Design Agreements, the service fees payable to Shenzhen Jing Chu take the forms of (i) a fixed design fee (in respect of Shenzhen Xingli: RMB2,000 per drawing for each product; in respect of Shenzhen Xingli Zundian: RMB1,000 per drawing for each product); plus (ii) commission based on certain percentages of the invoiced amount of Shenzhen Xingli and Shenzhen Xingli Zundian derived from the sale of the products designed by Shenzhen Jing Chu for a period of 3 years commencing from the date of the agreement. The rate of commission payable by Shenzhen Xingli is 2% in respect of products for domestic sale or 1.5% in respect of products for export and the rate payable by Shenzhen Xingli Zundian is 1.5% in respect of products for domestic sales or export.]

Given the disposal by Mr. Huang of his entire interests in Shenzhen Jing Chu in January 2009, the transactions between the Group and Shenzhen Jing Chu will no longer constitute continuing connected transactions of the Company under the Listing Rules upon [●].

### Commission payable under the previous design agreements

[Each of Shenzhen Xingli and Shenzhen Xingli Zundian has engaged Shenzhen Jing Chu to provide design services since 2004 and 2006 respectively. Although the agreements prior to the 2009 Design Agreements have all expired, Shenzhen Jing Chu was still entitled to commission derived from the sales of products designed by it during the respective terms of the following agreements as at the Latest Practicable Date:

1. two agreements dated 1 January 2007 and 1 January 2008 respectively (as supplemented by a supplemental agreement dated 24 September 2008) entered into with Shenzhen Xingli for a term of one year each; and



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2. an agreement dated 1 January 2008 (as supplemented by a supplemental agreement dated 24 September 2008) entered into with Shenzhen Xingli Zundian for a term of one year.

The fees payable to Shenzhen Jing Chu under the above agreements took the form of a fixed design fee and commission based on certain percentages of the invoiced amount of Shenzhen Xingli or Shenzhen Xingli Zundian (as the case may be) derived from the sale of the products designed by Shenzhen Jing Chu for a period of 3 years commencing from the respective dates of the previous agreements as mentioned above. In respect of the aforementioned agreements between Shenzhen Xingli and Shenzhen Jing Chu, the fixed design fee was RMB2,000 per drawing for each product and the rate of commission payable by Shenzhen Xingli was no more than 2% (depending on the pricing of the relevant products). In respect of the aforementioned agreement between Shenzhen Xingli Zundian and Shenzhen Jing Chu, the fixed design fee was RMB1,000 per drawing for each product and the rate of commission payable by Shenzhen Xingli Zundian is charged at 1.5%. Save for the 2009 Design Agreements and the previous agreements as mentioned above, there is no other agreement between Shenzhen Jing Chu and the Group under which fee or commission is still payable by the Group.

For each of the three financial years ended 31 December 2008, the total annual amount of fees paid by the Group to Shenzhen Jing Chu for the latter's design services amounted to approximately HK\$613,000, HK\$355,000 and HK\$[916,000] respectively.

### **Intellectual property rights**

Pursuant to the terms of the 2009 Design Agreements and the previous agreements as mentioned above, the intellectual property rights of the designs produced by Shenzhen Jing Chu, once adopted by Shenzhen Xingli or Shenzhen Xingli Zundian, belong to Shenzhen Xingli or Shenzhen Xingli Zundian (as the case may be). Shenzhen Jing Chu is also forbidden from carrying out any further transaction in respect of such design for whatever reason under the terms of the 2009 Design Agreements and the aforementioned previous agreements. In case the Group's rights are infringed, the Group can resort to legal proceedings to resolve the matter.

[The Directors (including the independent non-executive Directors) are of the view that the transactions contemplated under the 2009 Design Agreements and occurred under the previous agreements were entered into in the ordinary and usual course of business of the Group and on normal commercial terms and are fair and reasonable and in the interests of the Group and the Shareholders as a whole.]