Management Discussion and Analysis

The Directors of Tai Ping Carpets International Limited (the "Company") are pleased to present the Interim Report and condensed consolidated accounts of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2006. The consolidated results, cash flow statement and statement of changes in equity for the Group for the six months ended 30 June 2006, and the consolidated balance sheet as at 30 June 2006, all of which are unaudited and have been reviewed by the audit committee of the Company, along with selected explanatory notes, can be found on pages 12 to 36 of this report.

The Group's consolidated turnover of continuing operations for the six months ended 30 June 2006 was HK$379.9 million, a year-on-year increase of 25% or HK$77.1 million. The gross margin for the period also increased to 43%, compared with 39% in the same period in 2005. The significant increase in turnover and gross margin percentage was mainly driven by the sustained business growth and improved profitability of the carpet operations.

However, despite the increases in turnover and gross margin, the unaudited consolidated profit before tax during the period decreased to HK$12.5 million from HK$35.4 million in the corresponding period in 2005. This was mainly attributable to the HK$36.1 million gain reported in the first half of last year, which resulted from the disposal of certain non-core investments and certain reporting changes required by the adoption of the Hong Kong Financial Reporting Standards. Excluding such items, the Group made a profit before tax of HK$9.4 million in the first six months of 2006 and incurred a loss before tax of HK$0.7 million during the corresponding period in 2005.

Profit after tax of the Group in the first six months of 2006 was further reduced by HK$3.7 million due to the sale of Indigo Living Limited ("Indigo") and Banyan Tree Limited ("Banyan Tree"), which was completed in July 2006 at a consideration of HK$19.2 million in cash. As a result, the Group's profit after tax during the period decreased to HK$5.1 million, compared with HK$27.3 million in the corresponding period in 2005.

Carpet Operations

During the six-month period ended 30 June 2006, total turnover of carpet operations increased by HK$77.0 million, or 30%, to HK$337.3 million. This increase was mainly attributable to growth in the USA, in both the commercial and residential businesses. Turnover in the USA accounted for 44% of total carpet turnover in the first half year of 2006, and Asia and Europe/ Others accounted for 42% and 14% respectively. In the corresponding period in 2005, the respective shares of total carpet turnover by the USA, Asia and Europe/Others were 31%, 51% and 18%.

Gross margin during this period also grew to 44% from 39% in the same period in 2005, despite increases in fuel costs and labour rates. This improvement was mainly attributable to rising sales of higher margin carpets in the residential business and improved factory efficiencies.

As a result, the segmental loss of carpet operations during the period decreased by 49% from HK$15.2 million in the corresponding period in 2005 to HK$7.7 million.

The USA continued to be the primary growth market. Total carpet turnover in the USA during the period almost doubled year-on-year to HK$150.0 million, increasing significantly in both the commercial and residential businesses.

Despite fierce competition in certain sectors of the commercial market, the general economic environment in the USA was strong during the period, and turnover of the commercial business increased by 51% year-on-year to HK$92.2 million with improved gross margin. This strong performance was the result of the Group's investments during the past few years to support long-term growth, including recruitment of experienced sales personnel and field designers and the use of effective sales and marketing tools.

The growth of the residential business in the USA has been the result of initiatives undertaken in 2005, including the opening of the flagship Tai Ping showroom and the acquisition of Edward Fields with its national distribution network. In March 2006, Tai Ping opened a second showroom in Los Angeles, relocating and converting an old Edward Fields showroom. This was branded a Tai Ping showroom with dedicated display space and sales staff reserved for Edward Fields products. The showroom launch was well received and its average monthly sales have tripled compared with the old showroom.

The residential sector is a principal target for growth of the Group in view of its higher margin and the Group's competitive strengths in product quality, customer service, and brand positioning. The efforts made in 2005 to rationalise the Edward Fields operations after the acquisition and to develop the sales organisation started to produce results in 2006. Turnover of the residential business during the first six months of 2006 amounted to HK$54.0 million, close to the full-year turnover of 2005, and the gross margin also increased.

Another region which showed significant growth in turnover during the period was Hong Kong/China, increasing by 40% to HK$31.8 million, mainly driven by the strong hospitality sector in Hong Kong and Macau. As this growth was demand-driven and the Group's strategy has been to compete with strong customer service and product quality rather than price, the Group maintained a stable gross profit margin comparable with last year, despite intense competition from certain Chinese manufacturers.

In Thailand, both turnover and gross margin during the first half year of 2006 were flat compared with 2005, as the economy started to slow down in 2006. The launch of the environmental friendly felt-backed modular carpet tiles, branded "Eco-Soft", which was developed in-house, is expected to increase sales by expanding into new markets.

Turnover from Europe during the period was also relatively flat compared with 2005. Tai Ping used to be a niche player targeting the high-end residential market in Europe due to the fragmented markets and strong competition from small local suppliers. However, since 2005, the Group has started building a commercial business in Europe and has been making good progress in developing new markets and securing orders with new customers during the period. It is expected that most of these orders will turn into sales in the second half of 2006.

Other Operations

Market competition in the furniture and home furnishing business in Hong Kong, being operated by Indigo and Banyan Tree, continued to be intense with many new small competitors entering into the market. Overall profitability as well as returns on assets deployed were relatively low during the past few years but this business also required significant working capital to carry substantial inventories which bore a relatively high obsolescence risk.

As a result, during the period the Group initiated negotiations for a sale of this business which was considered non-core. The sale was completed in July 2006 at a consideration of HK$19.2 million in cash. The financial results of Indigo and Banyan Tree (including the loss on subsequent disposal) and their assets and liabilities (adjusted to fair values) were re-grouped and presented as a "discontinued operation" in the consolidated accounts for the six months ended 30 June 2006, and the 2005 comparative figures were also restated accordingly to conform with the current presentation. As a result of this reclassification, the Group's profit after tax for the first six months of 2006 from continuing operations was reduced by HK$3.7 million.

In addition, the Group received an offer to buy a warehouse property in Thailand from the existing tenant for Thai Baht 217.7 million in cash. Rental income amounted to Thai Baht 17.8 million in 2005. The property was grouped under "investment properties" under "non-current assets" in the Group's audited accounts for the year ended 31 December 2005, and its value in the consolidated accounts amounted to Thai Baht 202.0 million as at 31 December 2005 based on the valuation conducted on an open market basis by an independent property valuer. The sale was completed in August 2006, and the property was reclassified as "current assets" from "non-current assets" and revalued to Thai Baht 217.7 million in the consolidated accounts for the six months ended 30 June 2006, resulting in a surplus of Thai Baht 15.7 million (approximately HK$3.1 million).

Outlook

The Group will continue its focus and commitment to transform itself into a global customer-focused and vertical-integrated carpet group.

On the marketing side, the Group will continue to expand market awareness of its brands and products, particularly within the architectural and design community. A branding strategy has been developed to distinguish and integrate the Tai Ping and Edward Fields brands.

Management is confident that the sales momentum can continue in the second half year of 2006 and overall operating results of the Group will continue to improve. The Group will continue to grow the business through innovative marketing and strong product quality and service, and improve its profitability through cost controls, working capital management, and continuous improvement in production efficiencies and factory utilisation.

Dividends

The Board resolves not to pay an interim dividend for the period (2005: Nil).

Capital Expenditure

During the six-month period ended 30 June 2006, the Group invested HK$13.3 million (2005: HK$42.0 million) in capital expenditure in the form of property, plant and equipment, investment properties and construction in progress. As at 30 June 2006, the aggregate net book value of the Group's property, plant and equipment, investment properties, leasehold and land use rights and construction in progress (excluding those reclassified under the category "Assets of a Disposal Group Held for Sale") amounted to HK$366.1 million (as at 31 December 2005: HK$410.6 million).

Liquidity and Financial Resources

The Group, which usually funds its business with internally generated cash flows and through banking facilities at various subsidiaries, coordinates its financing and cash management activities at the corporate level.

As at 30 June 2006, the Group had total bank borrowings of HK$77.2 million (as at 31 December 2005: HK$109.3 million). Total cash and cash equivalents amounted to HK$52.9 million (as at 31 December 2005: HK$87.1 million). The gearing ratio, calculated as net bank borrowings (total bank borrowings net of cash and cash equivalents) divided by total equity, was 3% at 30 June 2006 (as at 31 December 2005: 3%).

All bank loans to date were unsecured. Of those bank loans outstanding on 30 June 2006, 13% carried interest at floating rates; the remainder were at fixed interest rates throughout their terms.

The currency denomination of the loans and their maturity dates as at 30 June 2006 were as follows:

	As at 30 June 2006 HK$'000	As at 31 December 2005 HK$'000
Within 1 year		
Thai Baht	**27,619**	55,859
United States Dollars	**10,534**	16,977
Hong Kong Dollars	**29,000**	27,000
	67,153	99,836
Between 1 and 2 years		
Thai Baht	**10,000**	9,500
Total borrowings	**77,153**	109,336

Foreign Exchange Risks and Related Hedges

The Group has overseas operations in the PRC, Thailand, Singapore, the USA and Europe. The Group treats its investments in these foreign operations as permanent equity, so exchange differences from translating the net investments in these foreign operations do not affect cash flows and are dealt with in the reserves.

As the European and Singaporean operations are not significant in term of the Group's results and the Chinese Renminbi has been relatively stable, the exchange differences arising from overseas operations relate mostly to Thailand. The effect of these exchange differences, however, is reduced as borrowings are in local currency.

The Group's export sales are denominated primarily in US dollars, and to a much lesser extent in Euros. The Group, therefore, considered its exposure to exchange rate movements in 2006 insignificant, but continues to monitor exchange rate movements closely to ascertain if any material exposure may arise.

Employee and Remuneration Policies

As at 30 June 2006, the Group employed 3,000 employees (as at 31 December 2005: 3,100 employees). Employees are remunerated according to the nature of the job and market trends, with built-in merit components incorporated as annual incentives to reward and motivate individual performance. Since 31 December 2005, there has been no material change to the Group's employment and remuneration policies.

Contingent Liabilities

As at 30 June 2006, the Group's total contingent liabilities (see Note 13 to the accounts for full disclosure) amounted to HK$15.5 million (as at 31 December 2005: HK$8.5 million).

James H. Kaplan

Chief Executive Officer

Hong Kong, 22 September 2006