Management Discussion and Analysis

The Group's consolidated turnover of continuing operations for the year ended 31 December 2006 totalled HK$900.0 million, a 27% increase from HK$709.4 million in 2005. The gross margin also improved, to 43% in 2006 from 39% in 2005. These significant gains resulted directly from the Group's three-year focus on investing in and growing the carpet operations. In 2006, carpet operations accounted for 91% of the consolidated turnover of the Group's continuing operations (2005: 88%).

The Group recorded a profit attributable to equity holders of HK$32.7 million in 2006, a gain of HK$5.1 million, or 18%, as compared with HK$27.6 million in 2005. The increased profitability in 2006 was mainly attributable to the sustained business growth and margin improvement of carpet operations.

The real improvement in 2006 was in fact greater than the net profit figures reflect. Net profit in 2005 showed a substantial rise of HK$43.9 million before tax, yet the increase was principally due to the disposal of substantial non-core assets and investments, as well as revaluation surpluses of investment properties. Excluding such items, the Group's continuing operations incurred a loss of HK$15.1 million in 2005, compared with an operating profit of HK$24.2 million in 2006 on a similar basis.

Carpet Operations

Total turnover of carpet operations in 2006 increased by 30%, or HK$189.5 million, to HK$816.9 million. The improvement was mainly attributable to strong growth in the commercial and residential sectors of the USA market.

Turnover in the USA accounted for 44% of total carpet turnover in 2006, while Asia and Europe/Others accounted for 42% and 14% respectively. In 2005, the corresponding shares of total carpet turnover by the USA, Asia and Europe/Others were 35%, 48% and 17%.

Gross margin in 2006 also rose from 40% to 43%, despite increases in fuel costs and labour rates. The gain derived mainly from rising sales of higher-margin residential carpets and improved factory utilisation and efficiencies.

As a result, carpet operations made a segmental profit of HK$15.2 million in 2006, compared with a segmental loss of HK$29.9 million in 2005. The 2005 figures were adversely affected by one-time initial losses incurred that year from the costs of acquiring the business assets and incorporating the operations of Edward Fields, Inc. ("Edward Fields").

In the last quarter of 2006, the Group reorganised sales and support functions into two global business units: Commercial and Residential, Boutique Contract ("RBC"). The restructuring addresses the fact that the commercial and residential businesses have distinct customer bases, markets and distribution channels. Designed to drive the two business units to evaluate and explore new opportunities on a global basis, the initiative is meant to increase management accountability and to improve the transparency of investment and returns so as to prioritise and optimise investment and resource deployment.

Marketing & Branding

Following the previously established strategy of promoting the brand to a wider audience, Tai Ping opened new and renovated fully branded showrooms in Los Angeles, Hong Kong and New Delhi during 2006. Tai Ping continued to use its fully branded Trade Show booths in Las Vegas, Miami, Monte Carlo and Paris. Fully branded overview brochures were produced for both Commercial and RBC business units with high-quality photography and designed to complement the all-white sales tools introduced into the marketplace in 2005.

Global Marketing provided support and guidance for the commercial unit in the development of new sales tools using the revamped Carpets Inter brand identity in Thailand. Global Marketing also developed additional sales tools under the Tai Ping Contract brand.

To communicate a Tai Ping point of view to the highly sophisticated RBC audience, Global Marketing and Design teams collaborated closely on the development and introduction of distinctive hand-made collections. The teams also worked collegially to produce ancillary support materials for new product launches, including luxurious photography, collection brochures, portfolios and press kits. These efforts aided Tai Ping in obtaining a constant stream of press in a wide variety of media, from significant editorial coverage in international publications to product placement in industry and business publications. As a result, Tai Ping has gained greater brand recognition worldwide through means more cost-effective than advertising.

For Edward Fields, 2006 brought the development of a brand strategy to ensure future growth. Implementation of the Edward Fields branding effort is slated for 2007, beginning with the creation of an updated corporate identity and a newly branded showroom in New York. The launch of a company-wide newsletter and intranet helped sales and design teams access marketing tools, improve internal communications and knit together teams around the world.

USA

The USA continues to be the primary growth market. Both the commercial and residential businesses recorded strong sales growth during the year, and significantly improved operating results.

Investments made in prior years for long-term expansion in the commercial market, including the addition of experienced sales representatives and field designers and the provision of effective sales and marketing tools, have already yielded measurable results. Despite fierce competition in certain sectors of the commercial market, turnover in the commercial business increased by more than 40% to HK$208.3 million in 2006, with particular focus maintained on the booming hospitality and gaming sectors. The operating results of the commercial carpet business showed significant improvement in 2006 as the Group began to benefit from an effective leveraging of the growth, with lower incremental costs and expenses and stable gross profit margin percentages.

The residential sector's first full operational year in the USA was 2006. For this area of operations, 2005 was occupied with opening the flagship Tai Ping showroom in New York and the acquisition of the business assets of Edward Fields, Inc., including its nation-wide distribution network.

Turnover of the residential business was HK$144.3 million in 2006, an increase of more than 140% over sales in 2005. The average gross profit margin was significantly higher than the commercial business. Also, the related operating costs and expenses in 2006 were relatively lower than the 2005 level, which included one-time initial expenses for business launch and additional post-acquisition costs associated with the incorporation of the Edward Fields operations.

During the year, Tai Ping opened a second showroom in Los Angeles, relocating and converting an old Edward Fields showroom. This was branded as a Tai Ping showroom with dedicated display space and sales staff reserved for Edward Fields products. A programme was developed to renovate or re-locate, as appropriate, the other Edward Fields showrooms over the next few years.

The Group expects that the residential business will be a principal target for both revenue and profit growth over the next few years because of its higher margin and the Group's competitive edge in product quality, customer service, design support, and branding.

Hong Kong, Macau and China

In the Hong Kong, Macau and China region, turnover rose to HK$80.4 million, a 26% improvement over 2005. Hong Kong and Macau's booming casino and resort markets, Tai Ping's primary segments in this region, buoyed the commercial businesses. Despite intense competition from Chinese manufacturers, the Group's sales increases did not compromise profitability. The average gross margin percentage decreased only slightly in 2006 because the Group's strategy was to compete with premium product quality and strong service commitment and design support, rather than price.

The Group also exercised tight control of incremental selling expenses, while cost management at the Foshan Nanhai factory in mainland China benefited from improved utilisation and factory efficiencies. Operating results continued to improve in 2006.

Thailand and South East Asia

Thailand's strong economy as well as the rebranding with new, improved sales tools benefited Carpets International Thailand Public Company Limited, the dominant player in the Thai domestic market selling under the "Carpets Inter" brand. Sales in 2006 increased in this region by 7% to HK$232.9 million, due to the overall growth of the commercial sector both in Thailand and throughout South East Asia.

The gross margin percentages remained relatively flat in 2006 as increases in raw material prices and energy costs offset the savings from improved factory utilisation and efficiencies.

The environmentally friendly felt-backed modular carpet tile, which was developed in-house and branded "Eco-Soft", was launched during the year. It is expected to boost sales in new markets.

Europe

Total turnover generated by the European subsidiaries amounted to HK$74.3 million, a 14% increase over 2005.

The relatively moderate increase in sales was mainly attributable to a management change in the Germany subsidiary, Tai Ping Carpets Interieur GmbH, and the postponement of several orders to 2007 at the request of customers.

The Group implemented a number of strategic initiatives in 2006 to expand its future market share of the commercial and residential businesses throughout Europe. In the past, it focused on niche markets. For the residential business, it targeted the high-end interior design community. For the commercial business, it concentrated on certain medium-scale, lower-margin projects, mainly in France and Germany. In 2007, the Group plans to explore further expanding distribution channels and establishing residential operations in key new markets.

In targeting commercial business in the UK, Middle East and other parts of Europe, the Group established a UK-based sales and design team in 2005, with a resulting sales increase to HK$18.0 million in 2006 from HK$4.4 million in 2005. The UK team remains the driving force for aggressive growth in the commercial business in Europe and Middle East.

Despite stable gross profit margin percentages, the European subsidiaries increased operating losses from 2005 to 2006. This was due both to planned personnel changes and to investments made to prepare for future business growth.

Jointly Controlled Entities and Associate

The Weihai group encompasses three jointly controlled entities : Weihai Shanhua Huabao Carpet Co. Ltd. and Weihai Shanhua Premier Carpet Co. Ltd. (both 49% owned), plus Weihai Shanhua Floorcovering Products Co. Ltd. (42% owned). Due to strong market demand and the dominant market position of its products within China, the Weihai group's combined turnover totalled HK$716.8 million, a 34% increase over the 2005 total of HK$534.1 million. Assisted by the Group in global marketing and distribution, these companies also sell Weihai "Shanhua" products outside the PRC. The complementary arrangement expands the Group's range of existing products and price points. The Group's share of profit after income tax expenses of the jointly controlled entities in 2006 amounted to HK$28.0 million, a 15% increase over the 2005 results (HK$24.3 million).

Philippine Carpet Manufacturing Corporation ("PCMC"), the 33% owned associate, recorded a small profit for the Group of HK$0.2 million in 2006 despite slightly lower sales, compared with a small net loss in 2005.

Other Operations

Yarn Dyeing

Premier Yarn Dyers, Inc. ("PYD"), which operates the Group's US-based yarn-dyeing facilities, posted lower turnover and segmental results for 2006, at HK$48.5 million (2005: HK$57.6 million) and HK$6.0 million (2005: HK$8.7 million), respectively.

Interior Furnishings

Indigo Living Limited ("Indigo") and Banyan Tree Limited ("Banyan Tree"), the Group's interior furnishings operations in Hong Kong, have been subjected to intense market competition during the last few years. Overall profitability and returns on assets deployed have been relatively low. In addition, the interior furnishings business requires significant working capital to carry substantial inventories with a relatively high risk of obsolescence.

In view of this, the Group sold its interests in Indigo and Banyan Tree in July 2006 at a consideration of HK$19.2 million. Their operating results for 2005 and 2006 were reclassified and presented as discontinued operation.

As a result, the segmental turnover and operating results for interior furnishings under continuing operations in both 2006 and 2005 represented that of Suzhou Shuilian Mattress Co. Ltd. only. Turnover and profit before tax in 2006 grew by HK$11.1 million and HK$1.0 million, respectively, as compared with 2005. This was mainly attributable to the booming hospitability industry in China and Hong Kong.

Property Holding

The Group disposed of an investment property in Thailand during the year for an aggregate sum of HK$43.7 million, which produced a net gain on disposal of HK$1.3 million. Rental income decreased in 2006 as a result, to HK$4.7 million (2005: HK$5.6 million).

Revaluation of investment properties held on 31 December 2006 generated for the Group a net surplus of HK$6.5 million (2005: HK$15.6 million), included in the consolidated profit and loss account.

Group Capital Expenditure

Capital expenditure in the form of property, plant, equipment and construction in progress incurred by the Group totalled HK$32.7 million in 2006 (2005: HK$63.8 million). As at 31 December 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 amounted to HK$383.5 million (2005: HK$410.6 million).

It is expected that the capital expenditure will increase in 2007 to expand factory capacities and renovate residential showrooms to support the sales growth.

Liquidity and Financial Resources

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

As at 31 December 2006, the Group had total bank borrowings of HK$11.0 million (2005: HK$109.3 million). Total cash and bank balances amounted to HK$59.0 million (2005: HK$87.1 million). The net cash balance was HK$48.0 million as at 31 December 2006. The gearing ratio, calculated as net bank borrowings (total bank borrowings net of cash and bank balances) divided by total equity, was 0% (2005: 3%).

As at 31 December 2006, the Group also held financial assets at fair value through profit or loss of HK$23.8 million.

The bank loans outstanding on 31 December 2006 were unsecured and carried interest at fixed interest rates throughout their terms. The currency denomination of the loans and their maturity dates as at 31 December 2006 were as follows:

	2006	2005
	HK$'000	HK$'000
Within 1 year		
Thai Baht	**11,000**	55,859
United States Dollar	—	16,977
Hong Kong Dollar	—	27,000
	11,000	99,836
Between 1 and 2 years		
Thai Baht	—	9,500
Total borrowings	**11,000**	109,336

Exposure to 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.

The European and Singaporean operations are not significant in terms of the Group's results. The Chinese Renminbi gradually appreciated against the Hong Kong dollar during 2006. The major exchange differences arising from overseas operations relate mostly to Thailand. The effect of these exchange differences, however, has been partly reduced because borrowings are in local currency and by hedging against some of its foreign currency exposure (including accounts receivable from export sales).

The Group's export sales are denominated primarily in US dollar, and to a much lesser extent in Euro.

The Group, therefore, considers its exposure to exchange rate movements in 2006 managed and will continue to monitor exchange rate movements closely to ascertain if any material exposure may arise.

Employee and Remuneration Policies

As at 31 December 2006, the Group employed 3,200 employees (2005: 3,100 employees). Employees are remunerated according to the nature of the job and market trends, with built-in merit components incorporated as an annual incentive to reward and motivate individual performance. Staff costs and retirement benefit costs for 2006 totalled HK$270.6 million (2005: HK$221.5 million) and HK$5.9 million (2005: HK$4.6 million) respectively.

Contingent Liabilities

As at 31 December 2006, the Group's total contingent liabilities amounted to HK$12.9 million (see Note 39 to the accounts for full disclosure) (2005: HK$8.5 million).

James H. Kaplan
Chief Executive Officer

Hong Kong, 20 April 2007