卡森國際控股有限公司

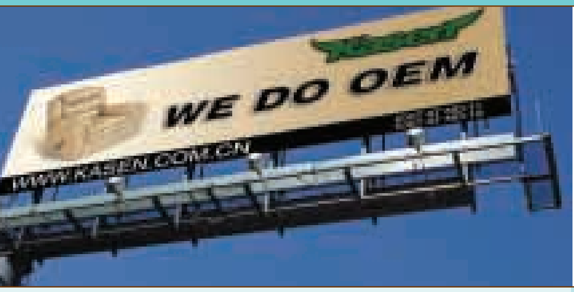
KASEN INTERNATIONAL HOLDINGS LIMITED

(an exempted company incorporated in the Cayman Islands with limited liability)

stock code : 496

Annual Report **2005**

CONTENTS



Corporate Information

BOARD OF DIRECTORS

Executive Directors

ZHU Zhangjin *(Chairman & Chief Executive Officer)*
ZHOU Xiaosong
ZHU Jianqi

Non-Executive Director

SUN Qiang Chang

Independent Non-Executive Directors

LU Yungang
CHOW Joseph
SHI Zhengfu

QUALIFIED ACCOUNTANT

LEE Lawrence

COMPANY SECRETARY

YIU Hoi Yan

STOCK CODE

0496.HK

REGISTERED OFFICE

Century Yard
Cricket Square
Hutchins Drive
P.O. Box 2681GT
George Town
Grand Cayman
British West Indies

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

259 Qianjiang Road West
Haining City
Zhejiang Province 314400
China

PLACE OF BUSINESS IN HONG KONG

Room 1605
Tai Tung Building
8 Fleming Road
Wanchai
Hong Kong

PRINCIPAL BANKERS

Bank of China, Haining Branch
Agricultural Bank of China, Haining Branch
China Construction Bank, Haining Branch
Industrial and Commercial Bank of China,
(Province Branch – Jiang Branch)
Bank of Communications, Shanghai Lujiazui Branch
Hongkong and Shanghai Banking Corporation Limited

LEGAL ADVISORS

As to Hong Kong law and United States law
O'Melveny & Myers

As to Cayman Islands law
Conyers Dill & Pearman

PRINCIPAL SHARE REGISTRAR

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
George Town
Grand Cayman
Cayman Islands
British West Indies

HONG KONG BRANCH SHARE REGISTRAR

Computershare Hong Kong Investor Services Limited
Shops 1712-16, 17th Floor
Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

AUDITORS

Deloitte Touche Tohmatsu

COMPLIANCE ADVISOR

ICEA Capital Limited

AUTHORISED REPRESENTATIVE

ZHU Jianqi
YIU Hoi Yan

Financial Highlights

RESULTS

	For the year ended December 31,			
	2005	2004	2003	2002
	RMB'000	RMB'000	RMB'000	RMB'000
Turnover	**3,475,457**	2,852,391	2,135,498	1,386,805
Profit before taxation	**278,665**	257,176	281,934	178,668
Profit attributable to equity holders of the Company	**265,699**	225,701	199,323	108,706

FINANCIAL POSITION

	At December 31,			
	2005	2004	2003	2002
	RMB'000	RMB'000	RMB'000	RMB'000
Cash and cash equivalents	**372,278**	213,458	410,293	175,111
Total borrowings	**1,291,738**	1,880,251	1,338,681	702,073
Total assets	**4,441,690**	4,036,944	2,634,285	1,344,878
Total liabilities	**2,143,824**	2,835,568	1,917,225	939,492
Equity attributable to equity holders of the Company	**2,199,560**	1,091,104	557,247	373,788

FINANCIAL AND OPERATING RATIOS

	At December 31,			
	2005	2004	2003	2002
Dividend payout ratio (%) [1]	**30%**	–	–	–
Debt to equity ratio (%) [2]	**56.2%**	156.5%	186.7%	173.2%
Net debt to equity ratio (%) [3]	**40.0%**	138.7%	129.5%	130.0%
Trade receivable turnover days [4]	**54**	35	38	27
Inventory turnover days [5]	**172**	211	134	117
Current ratio [6]	**138.3%**	93.7%	101.9%	117.2%
Earnings per share (RMB)				
Basic	**0.41**	0.47	0.46	0.25
Diluted	**0.34**	0.35	0.40	N/A

Financial Highlights

Notes:

1. The dividend per ordinary share divided by the profit attributable to equity holders of the Company per ordinary share.
2. Interest-bearing debt divided by total equity as at the end of the year.
3. Interest-bearing debt minus bank balances and cash divided by the total equity as at the end of each year.
4. Trade receivables as at the end of the year divided by turnover and multiplied by 365 days.
5. Inventories as at the end of the year divided by cost of sales and multiplied by 365 days.
6. Current assets divided by current liabilities as at the end of each year.
7. The adoption of new accounting standards in 2005 has no material impact to the Group.

Directors and Management Profiles

EXECUTIVE DIRECTORS

ZHU Zhangjin (朱張金), aged 40, joined our Company on June 12, 1995 and is our founding Chairman and Chief Executive Officer. Before founding our Company, Mr. Zhu was involved in several business ventures in the areas of textile, leather processing, garment, trading, etc. With over 18 years of experience in the leather manufacturing industry, Mr. Zhu has extensive knowledge in the upholstered furniture industry in the PRC and has been a successful entrepreneur in leather manufacturing related businesses. Mr. Zhu is also the vice chairman of the China Leather Association. In recognition of his contribution to promote the development of the leather manufacturing industry, Mr. Zhu was awarded the "Top Ten Outstanding Youths in Zhejiang Province" in 2003. In 2004, Mr. Zhu was awarded the "Top Ten Businessmen in Zhejiang."

ZHOU Xiaosong (周小松), aged 50, joined our Company on June 12, 1995 and is an executive Director, vice president, and general manager of our Leather Manufacturing Division. Mr. Zhou has spent more than 16 years in the leather manufacturing industry. He is now the director of our research and development center. Mr. Zhou obtained a diploma in Economics and Management from the Adult College of Hang Zhou University in 1999. In 2005, Mr. Zhou was appointed as an arbitrator by the China International Economic and Trade Arbitration Commission (CIETAC).

ZHU Jianqi (祝建其), aged 45, joined our Company on May 1, 1996 and is an executive Director, vice president, and general manager of our Treasury. Prior to joining our Company, he served as the deputy director and deputy manager of the Qingyun Town Industrial Office. He has more than 20 years of experience in the accounting and financial fields. Mr. Zhu also graduated from the business management Master program of the Zhejiang University of Technology in 2002. In 2003, he received a diploma in Economics from the China University of Geosciences.

NON-EXECUTIVE DIRECTOR

SUN Qiang Chang (孫強), aged 50, joined our Company as a non-executive Director on October 1, 2004. Mr. Sun is currently the managing director of Warburg Pincus Asia LLC, a leading private equity and venture capital firm. Mr. Sun has been with Warburg Pincus since 1995. Mr. Sun has spent about 20 years in the investment banking industry and private equity markets. Before joining Warburg Pincus, Mr. Sun served as an executive director of the investment banking division of Goldman Sachs (Asia) LLC. Mr. Sun is also the founding chairman of the China Venture Capital Association and a director of GOME Electrical Appliances Holding Ltd., Intime International Holdings Limited, Harbin Pharmaceutical Group Holding Co., Ltd., Enerchina Holdings Limited, Harbour Networks Holdings Limited and Datang Microelectronics Technology. Mr. Sun obtained his Bachelor of Arts degree from the Beijing Foreign Languages Institute in 1983 and his Master of Arts degree from the Joseph Lauder Institute of International Management of the University of Pennsylvania and a MBA from the Wharton School of Business of the University of Pennsylvania in 1989.

INDEPENDENT NON-EXECUTIVE DIRECTORS

LU Yungang (陸運剛), aged 43, joined our Company as an independent non-executive Director on June 17, 2005. Mr. Lu is currently founder and managing director of APAC Capital Advisors Limited ("APAC"), a Hong Kong based investment management company that specializes in Greater China equities, as well as a director of AsiaInfo Holdings, Inc. Prior to setting up APAC, Mr. Lu has worked with institutions including Credit Suisse First Boston, JP Morgan Securities Asia Inc. and Schroders Asia Limited, holding various posts including Head of China Research when he was with Credit Suisse First Boston. Mr. Lu obtained his Bachelor of Science degree from the Beijing University in July 1985 and his Master of Science degree from the Brigham Young University, Provo, Utah in 1991. He obtained a Ph.D. in Management from the University of California in September 1998.

CHOW Joseph (周凡), aged 43, joined our Company as an independent non-executive Director on July 11, 2005. Mr. Chow is currently a consultant in the fields of finance, accounting and investment, and has held senior managerial positions in various companies, including as Chief Financial Officer of Harbour Networks Limited, Chief Financial Officer with China Netcom (Holdings) Company Limited, director of strategic planning with Bombardier Capital Inc., vice president of international operations with Citigroup and corporate auditor at GE Capital. Mr. Chow had experience in internal controls and in preparing comparable financial statements in his capacity as chief financial officer as mentioned above. Mr. Chow obtained a Bachelor of Arts degree in political science from Nanjing Institute of International Relations in 1984 and a Master of Business Administration from the University of Maryland at College Park in 1993.

SHI Zhengfu (史正富), Ph.D., aged 52, joined our Company as an independent non-executive Director on June 17, 2005. Mr. Shi is the Director of the Center of New Political Economy of Fudan University, where he obtained a Master in Economics in 1985 and taught for a year before leaving to continue his studies in the US where he obtained his Doctor's degree in Economics. From 1995 to 1999, he was the Chief Executive of Sinoway Investment Ltd. Mr. Shi as an Economist is also an author of numerous books, academic journals and publications and has received numerous awards.

SENIOR MANAGEMENT AND QUALIFIED ACCOUNTANT

LEE Lawrence (李磊), aged 41, joined our Company as a member of our senior management on a full time basis, holding the positions of vice president, qualified accountant and Chief Financial Officer on August 1, 2004. Mr. Lee has over 13 years of experience in corporate finance, financial advisory and management, accounting, and auditing. He is also an associate member of the Association of Chartered Certified Accountants ("ACCA"). Before joining our Company, Mr. Lee served from July 2001 to April 2004 as Chief Financial Officer at Eagle Brand Holdings Limited, a company listed on the Singapore Stock Exchange. He also worked as a financial controller at the Korean division of Exel Plc in the UK between January 1999 to July 2001 and the senior auditor of the London international business headquarter of Waste Management Inc. in the US from January 1995 to November 1996. In 1987, Mr. Lee participated in a research program relating to the economic policies of the PRC at the Chinese Economic System Reform Research Institute and the London School of Economics. Mr. Lee received a Bachelor degree in Management and Engineering from the Beijing Institute of Technology in 1984. Mr. Lee also obtained a Master degree in Economics from the Renmin University in 1987 and a Master degree in Accounting and Finance from the London School of Economics in 1992.

JIANG Jianzhong (江建中), aged 57, joined our Company as executive vice president on March 27, 2004. Before joining our Company, in 1990 Mr. Jiang joined AB SKF, a listed company in Stockholm, and was primarily responsible for the management of the manufacturing of roller bearings and seals in China. Apart from AB SKF, Mr. Jiang also worked at Shanghai Foreign Trade General Co., Ltd., the Shanghai China Bearing Factory and the Pujiang Bearing Factory in the PRC. Mr. Jiang received a diploma in Mechanical Engineering from the Shanghai Mechanical College in 1969.

XU Huaihai (徐懷海), aged 37, joined our Company as vice president and general manager of our Automotive Leather Division on May 1, 2002. Since 2001, Mr. Xu has been one of the leaders to promote the automotive leather industry in the PRC. Before joining our Company, Mr. Xu worked as a technician specializing in leather manufacturing at the People's Liberation Army. He had also served as a technical and sales supervisor of Ciba-Geigy Shanghai Co., Ltd. and a manager of the Shanghai Representative Office of TFL Gmbh. Mr. Xu graduated from Shanghai Applied Technology Institute in 1989, majoring in leather studies. In 1994, he obtained a Bachelor degree in Applied Chemistry from the East China University of Science and Technology. In 2001, he received a MBA from a joint program organized by the Shanghai University of Finance and Economics and the Webster University of the US.

ZHANG Mingfa (張明發), aged 45, joined our Company on October 1, 1997 as vice president of our Import and Export Division. With more than 25 years of experience in the leather manufacturing industry, Mr. Zhang is currently in charge of our import and export business. Mr. Zhang qualifies as an international business engineer based on a qualification certificate approved by the Ministry of Commerce of the PRC in 1995. In 1984, Mr. Zhang obtained a diploma from Chengdu University of Technology. In 1989, Mr. Zhang obtained a diploma in Business Administration from Zhejiang University of Technology.

YU Guanlin (余關林), aged 43, joined our Company in 1995 and has held positions as production manager and deputy general manager. He is currently the general manager for our Cut-and-sew Operations. Before joining our Company, Mr. Yu founded a garment company and was responsible for its design and production. Mr. Yu has extensive knowledge and experience in upholstered furniture manufacturing.

JIN Xuejiang (金雪江), aged 42, joined our Company in 2001 and has held positions as plant manager and deputy general manager. He is currently the general manager of Sofa Manufacturing. Before joining our Company, Mr. Jin founded a footwear company and was responsible for its production and sales. Mr. Jin obtained a diploma in Management from Haining Television University in 2005 and has been on a part-time Master of Business Administration course at the Management School of Zhejiang University since September 2005. Mr. Jin has extensive knowledge and experience in upholstered furniture manufacturing.

ZHANG Guming (張顧明), aged 40, joined our Company in 2003 and has held positions as general manager of our sofa manufacturing subsidiaries. He is currently the director of Human Resources. Before joining our Company, Mr. Zhang was the executive deputy general manager at Haining Dunnu Fashion Co., Ltd from May 2000 to February 2003. Prior to that, Mr. Zhang had been responsible for production management in several local companies that manufactured leather, footwear and textile. Mr. Zhang has extensive knowledge and experience in corporate management and the leather industry.

Benjamin BO (卜海剛), aged 38, joined our Company in 2001 and has held positions as sales manager, export manager, and general manager – North America Sales. He is currently the director of Sofa Sales. Before joining our Company, Mr. Bo served from 1998 to 2001 as deputy manager for Mannesmann's Demotic Material Handle Co., Ltd. (Shanghai Branch). Mr. Bo also worked from 1994 to 1998 as deputy manager of Shanghai Representative Office for Ssangyong Group, one of the largest conglomerates in Korea. Mr. Bo obtained a Bachelor degree in Industrial and Civil Construction from Tongji University in 1989.

David YU (余煥慰), aged 42, joined our Company in 2003 as general manager of Higher Point Sofa Sales. Before joining our Company, Mr. Yu served from 1994 to 2003 as deputy general manager at Cosie Leather Co., Ltd.. Mr. Yu also worked from 1981 to 1994 at the Zhejiang Branch of the Bank of China. In 1983, Mr. Yu obtained a diploma in English from Zhejiang Provincial Institute. Mr. Yu also studied Spanish and International Finance at the Mangold Institute and the University of Madrid in Spain.

COMPANY SECRETARY

YIU Hoi Yan (姚凱欣), aged 33, joined our Company as an accountant on April 29, 2004 and was later promoted to be our Company Secretary and finance and administrative manager. Before joining our Company, Ms. Yiu was a senior auditor in Horwath Hong Kong CPA Limited. She is a member of the ACCA and the Hong Kong Institute of Certified Public Accountants. Ms. Yiu obtained a Bachelor of Arts (Honors) in Accountancy from the City University of Hong Kong in 1995.

Chairman's Statement

Chairman's Statement

On behalf of the Board of Directors ("the Board"), I am pleased to report the annual results of the Company and its subsidiaries ("the Group") for the year ended December 31, 2005.

FINANCIAL RESULTS

For the year ended December 31, 2005, the Group's turnover amounted to RMB3,475,457,000, representing an increase of 21.8% as compared to RMB2,852,391,000 for the previous year. Gross profit also grew from RMB443,672,000 for the previous year to RMB548,263,000 for the current year. Profit attributable to equity holders of the Company amounted to RMB265,699,000, representing an increase of 17.7% as compared to RMB225,701,000 for the previous year.

Basic earnings per share for the year ended December 31, 2005 was RMB41 cents (2004: RMB47 cents).

The Board, therefore, recommended the payment of a final dividend of approximately RMB7.86 cents (equivalent to US0.98 cents or HK7.58 cents) per ordinary share, which is subject to shareholders' approval at the forthcoming AGM. The Company intends to make regular payment of dividends in the future, so that our shareholders can share the positive operating results of the Group.

BUSINESS REVIEW

I am pleased to announce that the Group's core business, including upholstered furniture and furniture leather, has again recorded remarkable growth in both turnover and profit, mainly attributable to active market expansion, continuous capacity uplift and rigorous cost control.

As in the previous years, the Group continues to face challenges such as increase in the cost of production and some of the raw materials. In addition, from the second half of 2005, the RMB appreciated in value against the US dollar and other foreign currencies. However, by implementing certain strategies such as continuing to develop new products with value-added features, implementing cost control and expenditure restraint and enhancing productivity, the Group was able to maintain a persistent growth of turnover and profit, while relieving the impact of increase in production cost and RMB appreciation. These strategies had been proved successful and begun to yield significant results.

BUSINESS EXPANSION AND INVESTMENT

The Higher Point Project

During the year, six of the Group's factories set up in Higher Point Sofa Industrial Park in Haining, Zhejiang Province commenced formal production. These factories recorded a turnover of RMB925,916,000 in 2005 (2004: RMB265,722,000), representing an increase of 248.5%, which marked the beginning of profit-making .The Higher Point Project, with its large scale capabilities, has aroused enormous interest of major overseas furniture manufacturers and will become the driving force for the Group's future expansion.

Total gross floor area of 741,760 square metres of the Higher Point Project had been put into use, accounting for 58% of the total gross floor area of the Group's production space. As the Group acquired the land for the Higher Point Project on rather favourable terms, with a cost of land use right of only RMB97.3 for each square metre of the gross floor area of the production space, which is far below the average cost of land use right of RMB120.3 per square metre of the gross floor area of other production facilities of the Group. The investment in the Higher Point Project enables the Group to expand its production capability at a rather low cost.

Other Investments

During the year, the Group invested US$100,000 in a joint-venture, Haining City Kasen-Melx Leather Co., Ltd. ("Kasen-Melx"), and controlled 50% of its equity in August 2005.

As Kasen-Melx has just commenced operation, it did not contribute any profit to the Group, which is within the Group's expectation. It is expected that Kasen-Melx will make contribution to the Group's profit in 2006.

In addition, in July, 2005, the Group injected RMB50,675,000 into a joint venture, Future Foam Asia, Inc. and held 25% of its equity, upon which the Group had completed its capital contribution of RMB10,240,000 to the joint venture.

Future Foam Asia, Inc. recorded a turnover of RMB6,639,000 and a loss of RMB1,114,000 attributable to the Group for the year. The loss was mainly due to the relatively high preliminary expenses arising in the start-up stage and the higher cost of production.

FUTURE PLAN AND PROSPECTS

Though facing challenges on the Group's future growth as a result of the appreciation of the RMB and rising raw material price and labour cost, I am fully confident that with the whole-hearted devotion and hard work of its employees, the Group will maintain its momentum of rapid growth.

Two of the core businesses of the Group comprise upholstered furniture and furniture leather, which have been rendering remarkable performance and up to the expectation of the Group. The Group will continue to focus on its core businesses and maintain its competitive edge, so as to seize a bigger market share in the future.

In addition to its core businesses, the Group will expand the research and development as well as sales of automotive leather and footwear leather. It is expected that the Group's joint venture, Kasen-Melx, which was established with Melx of Japan, will achieve better results in 2006. The Group will also commence research and development of outdoor casual gear, which is expected to bring significant contribution to the sales of the Group in 2006.

We believe that the global trend of manufacturing outsourcing in the upholstered furniture industry will continue, as a result, the demand for the Group's products will keep on a cheerful growth. In view of the current market conditions, the Group believes that with its competitive cost structure, vertical integrated manufacturing capabilities, large-scale operations, in-depth technology know-how, established customer base and highly devised marketing strategy, the growth momentum of the Group's sales will sustain throughout 2006.

The Group will set up and implement an ERP system in 2006 to improve its existing management IT system. The Group believes that such system will not only realise real-time management, but also improve the communication with its customers and suppliers, and strengthen financial control, particularly the management of trade receivables, trade payables and inventory.

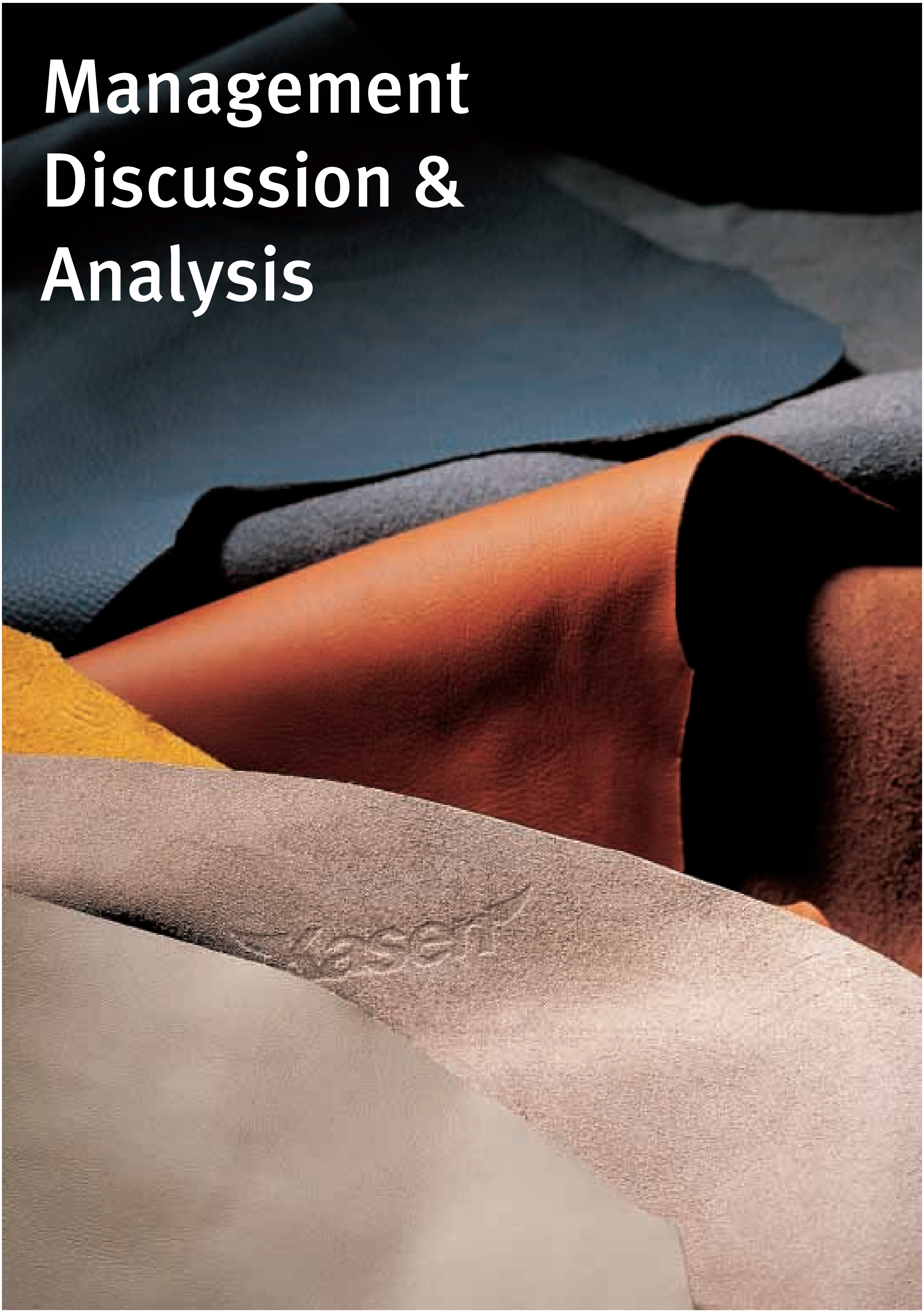
ACKNOWLEDGEMENT

I hereby take this opportunity to express my heartfelt gratitude to my fellow directors and the senior management of the Group for their support.

Also, on behalf of the Board of Directors, I wish to express my heartfelt appreciation to our employees for their outstanding service and contributions to the development of the Company, and to our suppliers, customers and shareholders for their continuous support.

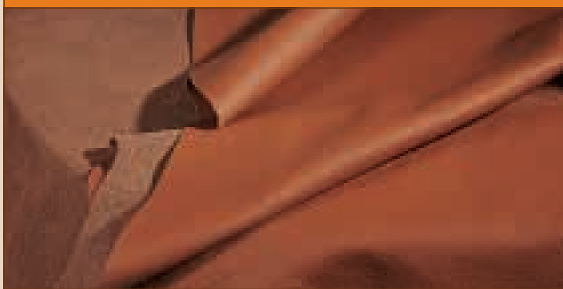
Chairman
ZHU Zhangjin
Hong Kong, April 19, 2006

Management Discussion & Analysis



Management Discussion & Analysis

Management Discussion & Analysis



GROUP PROFILE

The Group is a leading upholstered furniture and leather products manufacturer based in China. It purchases and processes raw cowhides and wet blues into finished leather and fully assembled upholstered furniture. Its principal products are leather and fabric upholstered furniture, sofa covers, furniture leather, automotive leather, footwear leather, etc. The Group primarily manufactures its upholstered furniture products in accordance with the designs of its customers, who market the Group's products under their own brand names. The Group's major customers of upholstered furniture include leading American furniture companies, such as Furniture Brands International, Inc., Berkline/Benchcraft LLC, La-Z-Boy Incorporated, Bernhardt Furniture Company, American Signature Inc., Rooms To Go, Inc. and other major international furniture companies. The Group also benefited from the trend that many companies around the world increasingly outsourced their production process to countries such as China to take advantage of their lower labour costs, the economies of scale and the stable supply of numerous products.

As at December 31, 2005, the gross floor area of our production facilities amounted to 1,300,000 square meters, with an annual production capacity of 240,000,000 square feet of sofa leather, 30,000,000 square feet of automotive leather, 6,500,000 seats of upholstered sofa and 10,000,000 seats of sofa cover.

Year 2005 was an important milestone in the Group's development history. On October 20, 2005, the Group was successfully listed on the Stock Exchange of Hong Kong. The Haining Higher Point Sofa Industrial Park, which was established by the Group as a major investor, moved forward from a construction stage into a commercial operation stage.

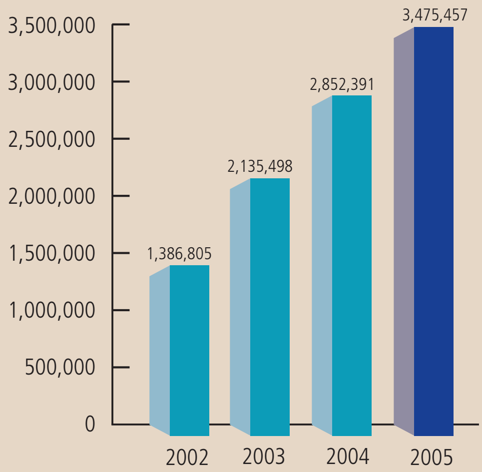
OVERVIEW

For the year ended December 31, 2005, the Group's turnover increased 21.8% to RMB3,475,457,000 (2004: RMB2,852,391,000), while its profit for the year rose 11.0% to RMB260,354,000 (2004: RMB234,530,000). The profit attributable to equity holders of the Company for 2005 was RMB265,699,000 as compared to RMB225,701,000 in 2004.

The following chart shows the consolidated turnover and profit attributable to equity holders of the Company for the four years ended December 31, 2005:

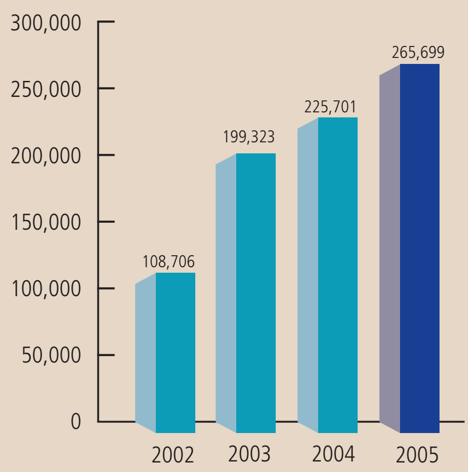
Turnover

RMB'000



Profit attributable to equity holders

RMB'000



Overall Gross Profit Margin

The Group's gross profit margin in 2005 was 15.8%, representing an improvement as compared to 15.6% in 2004.

The Group's principal raw materials are raw cowhides and wet blues, which accounted for 46.5% of the total cost of sales in 2005. The prices for raw cowhides in international market remained comparatively stable in 2005, which was the major contributor to the Group's steady gross profit margin.

However, RMB's further appreciation and costs rising in China brought challenge to the manufacturing and export industries that operate in the country. The Group was able to offset the negative impact of rising labour costs in China by improving its operation efficiency. By importing its principal raw material for production, the Group partially offset the impact of RMB's appreciation.

OPERATING EXPENSES, TAXATION AND PROFIT ATTRIBUTABLE TO EQUITY HOLDERS

Rising oil price had little influence on the Group's distribution costs, as the marine freight charges of almost all the exporting business of the Group were borne by the customers. However, the percentage of distribution costs to turnover rose slightly to 2.3% (2004: 2.0%) of the turnover, as the share of finished upholstered furniture export to the total turnover of the Group increased and land transportation cost from factory to port also climbed up.

In regard of administrative expenses, though the remuneration of the management increased in 2005, the percentage of administrative expenses to turnover remain unchanged at 3.3%, for the operating efficiency was improved after productivity of the Group increased.

In 2005, interest-bearing loans continued to be one of the major funding sources of the Group, and finance costs increased to RMB111,540,000 (2004: RMB95,419,000), of which the interest incurred by the Convertible Loans granted to the Group by Warburg Pincus amounted to RMB13,249,000 (2004: RMB14,899,000). After the initial public offering of the Group's shares, the above Convertible Loans were converted into the Group's equity, and the accumulated interests not yet paid during the past years in total of RMB32,823,000 were fully transferred into shareholders' equity.

Most of the Group's operations are carried out in the economic and technological development zones and coastal open areas of the PRC where allow income tax relieves in accordance with relevant income tax laws and regulations, so the overall effective tax rate of the Group remains approximately 6.6% (2004: 8.8%).

In September 2004, the Group redeemed the equity interests held by minority shareholders in most of its subsidiaries, except five joint ventures located in the Higher Point Sofa Industrial Park, so in 2005 minority shareholders continued to be interested in the five joint ventures located in the Higher Point Sofa Industrial Park. Profit attributable to minority shareholders represented -2.1% (2004: 3.8%) of profit after taxation .

For reasons mentioned above, profit attributable to equity holders of the Company increased by approximately 17.7% to RMB265,699,000.

SALES ANALYSIS BY PRODUCTS

Upholstered Furniture

Upholstered furniture remained the core products of the Group, and its sales accounted for 79.3% of the total turnover in 2005. As the upholstered furniture industry in the Group's principal export regions increasingly outsourced its production, the Group's upholstered furniture operation was able to increase by 35.5% in 2005, among which, the fabric upholstered furniture operation grew especially fast, up by 54.0% and took up 13.7% of the total turnover (2004: 10.9%).

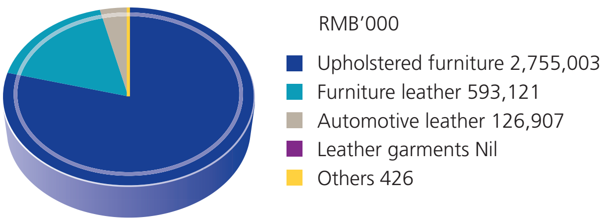
Furniture Leather

Furniture leather produced by the Group continued to be well received by overseas and domestic furniture producers, which contributed to a rapid growth in this operation in 2005. Although the Group gave priority to meet the internal requirement of its fast growing leather upholstered furniture division, the external sales of the furniture leather operation still managed to grow by 20.6% in 2005.

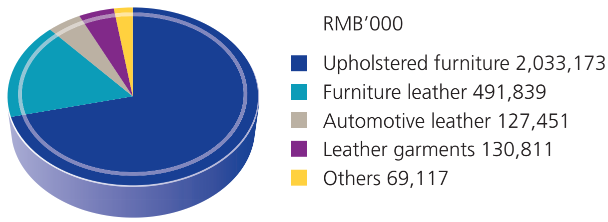
Automotive Leather

In contrast, the automotive leather operation did not achieve the expected growth in 2005, with its turnover at the same level as 2004. It was principally due to that the operation commenced in 2003 and it usually takes quite a long time to obtain product certificates from the auto makers.

The following chart shows the segmental turnover in 2005 by product type and their comparative figures in 2004.



2005



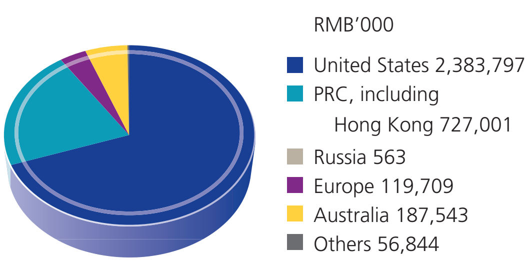
2004

SALES ANALYSIS BY REGIONS

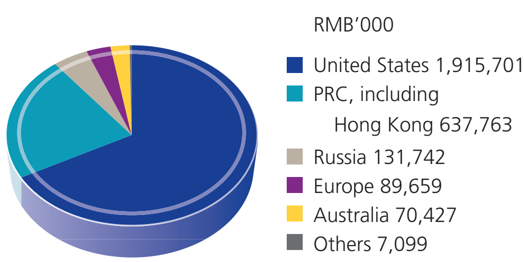
In 2005, the Group continued to expand its markets in the US, Europe and Australia. In line with the ongoing outsourcing trend of consumption products in the regions, the Group's sale increased strongly in these markets. The Group's sales in the US, Europe and Australia increased by 24.4%, 33.5% and 166.3% respectively; and, as a percentage to the total sales, the turnovers in the US, Europe and Australia accounted for 68.6%, 3.4% and 5.4% respectively.

The Group's sales to the PRC domestic market mainly involved furniture leather and automotive leather, the turnover of which represented 20.9% of its total sales. Business in this segment increased by 14.0% in 2005.

The following chart shows the segmental turnover in 2005 by geographical location and their comparative figures in 2004.



2005



2004

THE HIGHER POINT PROJECT

The Group commenced to establish Higher Point Sofa Industrial Park in Haining city, Zhejiang province, in 2004 to expand its production capacity. It was planned to include eight upholstered furniture factories after completion, with three factories to be wholly owned by the Group and other five factories to be run in the form of joint-ventures.

For the year ended December 31, 2005, one of the Group's wholly-owned subsidiaries and other five joint-ventures (collectively referred to as the "Higher Point Enterprises") in Higher Point Sofa Industrial Park formally commenced operation. The total sales amounted to RMB925,916,000 in 2005 (2004: RMB265,722,000), representing an increase of 248.5%. The Higher Point Enterprises recorded remarkable achievement in developing customers, which was reflected in the successful expansion of the Group's customer base and revenue sources, and currently became an important part of Group's operation.

As Higher Point Project was still in its preliminary stage, most workers were not well trained which resulted in a lower production efficiency. For the year ended December 31, 2005, the overall gross profit margin of the Higher Point Enterprises was 10.2%, which was lower than the average level of the Group, while the net profit was just at breakeven point. Along with the improvement of the workers' skills and the continuous rapid growth in operations, it is anticipated that the performance of the Higher Point Enterprises will be improved substantially in near future.

CAPITAL EXPENDITURE

As most investments by the Group to increase production capacity completed in previous years up to 2004, the capital expenditure in 2005 was reduced significantly to RMB231,468,000 (2004: RMB739,558,000). The capital expenditure in 2005 was mainly used in (1) construction of additional production facilities required for normal operation by Higher Point Project; (2) replacement of old furniture leather equipment with new ones; and (3) purchase of new equipment for producing automotive leather. The principal expenditure for these items were approximately RMB99,193,000, RMB66,600,000 and RMB23,339,000 respectively.

FINANCIAL RESOURCES AND LIQUIDITY

Public Offering

In late October 2005, the Shares were listed on the Stock Exchange of Hong Kong by way of public offering and placing. Out of a total of 304,220,000 Shares at initial offer price HK$2.55 per Share under the public offering and placing, we were offering 202,809,074 Shares and the selling shareholders were offering 101,410,926 Shares. The Company successfully raised HK$517,163,000, equivalent to RMB539,246,000, through its initial public offering. Of the total proceeds, approximately HK$40 million was paid for underwriting commission and expenses. At the end of 2005, the Group had used approximately RMB251 million and RMB32 million from the proceeds to repay short-term bank loans and to fund its capital expenditure respectively. The remaining amounts were deposited in short term demand bank deposits. The actual use of proceeds is in line with the guidelines as set out in the prospectus relating to the initial public offering.

Total Borrowings

As at December 31, 2005, the Group's total borrowings amounted to RMB1,291,738,000 (2004: RMB1,880,251,000). Such decrease in total borrowing was primarily because (1) the Group utilised proceeds raised through its initial public offering to repay part of its loans; (2) Warburg Pincus's Convertible loans granted to the Group were converted into equity; and (3) cash flow from operation of the Group was significantly improved.

As at December 31, 2005, the Group's total borrowings primarily comprise of (1) short-term borrowings of RMB1,191,246,000 provided by local banks, bearing an interest rate ranging from 4.0% to 8.1% per annum; and (2) long-term borrowings of RMB90,092,000 provided by local banks, bearing an interest rate ranging from 5.1% to 6.0% per annum; and (3) government debt of RMB10,400,000, bearing an interest rate of 2.55%.

Turnover Period, Liquidity and Gearing

The Group's inventory primarily represented raw cowhides and wet blues used for production, accounting for approximately 44.4% of the total inventory. In 2005, the Group endeavoured to control inventory level and managed to decrease its inventory turnover period to 172 days (2004: 211 days).

In 2005, the Group maintained export credit insurances and appropriately extended the credit terms to certain substantial customers, resulting in an increase in trade receivable turnover days to 54 days (2004: 35 days).

The Group attempted to shorten the accounts payable credit term so as to cut the purchase costs. As a result, the trade payable turnover days decreased to 77 days (2004: 102 days).

As the Group's operating cashflow continuously improved in 2005, as at December 31, 2005, its current ratio and quick ratio increased to 1.38 (2004: 0.94) and 0.71 (2004: 0.43), respectively. The Group's cash and cash equivalent balance was RMB372,278,000 (2004: RMB213,458,000).

Mainly due to the completion of its initial public offering in the year, the Group's gearing was significantly improved. Such ratios included: (1) bank borrowings to total assets, (2) bank borrowings to equity and (3) net debts (i.e. net balance between bank borrowings and cash and cash equivalent) to equity, dropped from 38.8%, 130.3% and 112.5% as at December 31, 2004 to 28.8%, 55.8% and 39.6% as at December 31, 2005, respectively. Interest rate coverage (i.e. the ratio of profit from operating activities over finance costs) was approximately 3.5 times (2004: 3.7 times). A high interest rate coverage reflected that the leverage level of the Group remained healthy.

FOREIGN EXCHANGE EXPOSURE

As the Group's businesses are principally export-related and transactions are primarily denominated in US dollars, the Directors consider the Group is exposed to foreign exchange fluctuation risks. However, as a substantial portion of procurements of the Group is denominated in US dollars, such risks can be reduced partly through natural hedges. Therefore, the Group neither used any financial instrument for hedging purposes during the year, nor had any hedging instrument outstanding as at December 31, 2005.

SYNDICATED LOAN

In late December 2005, the Group obtained a syndicated loan in aggregate of HK$125,000,000 arranged by CITIC Capital Markets Limited, with a term of three years, which will be principally used for general working capital of the Group. The three-year-term syndicated loan, drawn down in January 2006, bears interest at 2.00% over 12-month Hong Kong Interbank Offered Rate per annum.

CONTINGENT LIABILITIES

A cross-guarantee arrangement was entered into between the Group and Haining Changhai Packaging and Printing Co., Ltd. ("Haining Changhai"). The Group gave guarantee in favour of the lenders for several bank loans, in total amount of RMB67,897,000, borrowed by Haining Changhai as at December 31, 2005. Such loans will become due from March 26, 2006 to December 15, 2006, and after repayment of such loans, no guarantee will be given to other loans.

PLEDGE OF ASSETS

The Group pledged deposits to banks to secure the bills payable issued by the Group and the bank facilities granted to the Group. The deposits carry an average interest rate of 0.72%.

EMPLOYEES AND EMOLUMENTS POLICIES

As at December 31, 2005, the Group employs a total of approximately 15,000 full time employees (2004: 14,827) which included management staff, technicians, salespersons and workers. For the year ended December 31, 2005, the Group's total expenses on the remuneration of employees is RMB237,063,000 and represents 6.82% of the operating revenue of the Group. The Group's emolument policies are formulated on the performance of individual employees, which will be reviewed regularly every year. Apart from provident fund scheme (in accordance with the provisions of the Mandatory Provident Fund Schemes Ordinance for Hong Kong employees) or state-managed retirement pension scheme (for the PRC employees) and medical insurance, discretionary bonuses and employee share options are also awarded to employees according to the assessment of individual performance.

FUTURE PLANS AND PROSPECTS

The Group aims to become one of the world's leading manufacturers of leather products and upholstered furniture. To achieve this goal, the Group continues its effort in expanding its market share, strengthening product portfolios, further reducing production costs and forming strategic alliances with globally reputable leading manufacturers, so as to strengthen the Group's competitive edges in product development.

Upholstered Furniture Business

The US is currently the largest market for the Group's upholstered furniture products. Although statistics show that there is a slowdown in real estate industry in the US, the Group does not consider that it will have impact on further expansion of the Group's business in the US. This is primarily due to the fact that US brand name furniture companies will continue to save costs through manufacture outsourcing, while export from countries with low production costs (including the PRC) to the US will maintain its strong growth.

At present, the percentage of upholstered furniture imported from the PRC to the US total consumption remains at a comparatively low level, thus the US market still promises a great potential. The Group will continue to explore the US market by taking advantage of the established business relationship with leading upholstered furniture companies in the US. The Group will consider a realignment of the logistics arrangement for export to the US so as to assist its customers to reduce their logistics costs and to strengthen the Group's competitive edges.

The year 2005 witnessed a fast growth in the Group's sale of fabric upholstered furniture to the US market, representing an increase of 54%. As fabric upholstered furniture accounted for more than 70% of the total consumption of upholstered furniture in the US, and the import share in this section is comparatively low, accordingly, the Group will continue to develop more new lines of fabric upholstered furniture products.

European countries, Australia and other countries will also increase manufacture outsourcing to the PRC, which is evidenced by the fast growth in the Group's Europe and Australia businesses in 2005. The Group will put more efforts in these markets for faster growth.

In 2005, the Group's Higher Point Project achieved significant progress in turnover and gained several key customers. The Group anticipates that the sales from the Higher Point Enterprises will continue to grow rapidly in future and their profitability will improve significantly.

Furniture Leather Business

The Group purchases raw cowhides, wet blues and other raw materials and processes them into finished leather for the production of leather products and upholstered furniture. The Group is currently the largest finished leather producer in the PRC.

As a vertically integrated producer, the Group's leading position in the furniture leather industry allows it to win upholstered furniture customers' confidence through low costs, high quality and fast delivery schedule. The Group will continue to develop new lines of leather products with constantly improved textures, appearances and styles to cater its customers' needs. Meanwhile, the Group will continue to seek for alternative materials to ensure a competitive edge supported by low costs.

Automotive Leather Business

Although the development of its automotive leather operation in 2005 was disappointing, the Group remains optimistic in the outlook for the automotive leather market. At present, the Group is carrying out tests on automotive leather required for new automotive models by several automotive manufacturers at home and abroad and has obtained various product certifications. The Group anticipates that its automotive leather operation will experience a fast growth in future, but its contribution to the Group's overall turnover will be insignificant in near future.

In 2005, a joint venture was established by the Group and MELX, a leading leather producer in Japan, to develop various businesses including automotive leather products. The joint venture will increase the sales of automotive leather products to Japanese automakers.

Other Operations

To make full use of cowhides resources to enhance its profitability, the Group has carried out trial production of footwear leather since 2005, but its contribution to the Group's overall turnover will be insignificant in near future.

In order to make full use of its advantages in cutting and sewing and to improve the utilization of production facilities, from the beginning of 2006, the Group has expanded its business into the field of outdoor leisure products, mainly including tents, sleeping bags, outdoor furniture, etc. In February 2006, a supply agreement was entered into between the Group and North Pole Limited, an associate of the Group, with a term of three years. The transaction was approved at the Extraordinary General Meeting held on March 31, 2006.

Directors' Report

The directors present their annual report and the audited consolidated financial statements of the Company for the year ended December 31, 2005.

The shares of the Company were listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") with effect from October 20, 2005.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company. Its subsidiaries are principally engaged in the processing of raw cowhides and wet blues into finished leather or fully assembled leather products.

RESULTS

The results of the Group for the year ended December 31, 2005 are set out in the consolidated income statement on page 35.

DIVIDENDS

The directors recommend the payment of a final dividend of approximately RMB7.86 cents (equivalent to US0.98 cents or HK7.58 cents) per ordinary share for the year ended December 31, 2005, subject to approval by the shareholders of the Company at the annual general meeting to be held on May 30, 2006. The translation of RMB into Hong Kong dollars is made at the exchange rate of HK$1.00=RMB1.0363 as at April 19, 2006. The actual translation rate for the purpose of dividend payment in Hong Kong dollars will be based on the official exchange rate of RMB against Hong Kong dollars as quoted by the People's Bank of China on May 30, 2006, being the date of the annual general meeting on which the final dividend will be proposed to the shareholders of the Company for the approval. Subject to the approval by the shareholders, the proposed final dividend is expected to be paid on or about June 29, 2006 to the shareholders whose names are on the registers of members of the Company on May 30, 2006.

TRADING RESULT AND PUBLISHED FORECAST

The consolidated profit attributable to the equity holders of the Company for the year amounted to approximately RMB266 million, represents an excess of 2.3% of the profit forecast of approximately RMB260 million included in the Company's prospectus dated October 10, 2005. The difference is principally attributable to favourable sales variances in the fourth quarter of 2005.

DISTRIBUTABLE RESERVES OF THE COMPANY

The amount of the Company's reserves available for distribution to shareholders as at December 31, 2005, calculated in accordance with International Financial Reporting Standards, was approximately RMB1,004 million.

FINANCIAL SUMMARY

A summary of the results, assets and liabilities of the Group for the past financial periods is set out on page 3.

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group acquired property, plant and equipment of approximately RMB231 million for the purpose of expanding its production capacity.

Details of these and other movements in the property, plant and equipment of the Group during the year are set out in note 15 to the financial statements.

VALUATION OF PROPERTIES

In the prospectus dated October 10, 2005, the Company disclosed based on a valuation report, the valuation of its properties as of August 31, 2005 of approximately RMB1,044 million. The revalued amount of the properties has not been incorporated in the financial statements for the year ended December 31, 2005. These properties have been included in the consolidated balance sheet at December 31, 2005 at RMB758 million, being their historical cost less accumulated depreciation and accumulated impairment losses. Had the properties been stated at their revalued amount in the financial statements, additional depreciation of approximately RMB3 million would have been charged against the consolidated income statement.

SHARE CAPITAL

Details of the Company's share capital are set out in note 29 to the financial statements.

MAJOR CUSTOMERS AND SUPPLIERS

During the year, the aggregate sales attributable to the Group's five largest customers comprised approximately 38.22% of the Group's total sales and the sales attributable to the Group's largest customer were approximately 10.72% of the Group's total sales.

The aggregate purchase during the year attributable to the Group's five largest suppliers was less than 30% of the Group's total purchases.

Two of the top five largest suppliers, Yili Horgos Leather Co., Ltd. and Baiyin Kasen Leather Co., Ltd are companies in which Mr. Zhu, Zhangjin, Chairman of the Group has beneficial interests. Yili Horgos Leather Co., Ltd. and Baiyin Kasen Leather Co., Ltd. are 45% and 90% owned by Zhejiang Sunbridge Industrial (Group) Co., Ltd., a company which Mr. Zhu indirectly controls over 30% of the voting power at general meeting.

Other than as disclosed above, none of the directors, their associates or any shareholders which, to the knowledge of the directors, owned more than 5% of the Company's issued share capital had any interest in the share capital of any of the five largest customers and suppliers of the Group.

DIRECTORS

The directors of the Company during the year and up to the date of this report are:

Executive directors

ZHU Zhangjin *(Chairman)*
ZHOU Xiaosong
ZHU Jianqi
JIANG Jianzhong (resigned on June 17, 2005)

Non-executive director

SUN Qiang Chang

Independent non-executive directors

HAN Ying	(appointed on June 17, 2005 and resigned on July 11, 2005)
LU Yungang	(appointed on June 17, 2005)
SHI Zhengfu	(appointed on June 17, 2005)
CHOW Joseph	(appointed on July 11, 2005)

In accordance with provision 87 of the Articles, Messrs. Zhou Xiaosong and Zhu Jianqi will retire from office of executive directors by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting. Mr. Sun Qiang Chang will retire from office of non-executive director and will not offer himself for re-election at the forthcoming annual general meeting.

None of the directors being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation (other than statutory compensation).

BRIEF DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief details of directors and senior management are set out on pages 5 to 8.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at December 31, 2005, the interests of the directors and chief executives of the Company in the shares of the Company (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") are as follows:

Name of director	Capacity	Number of issued ordinary shares held	Percentage of the Company's issued share capital
Zhu Zhangjin	Beneficial owner	328,867,019	32.43%
Zhou Xiaosong	Beneficial owner	8,173,912	0.81%
Zhu Jianqi	Beneficial owner	7,478,260	0.74%

All the interests disclosed above represent long positions in the shares of the Company.

Save as disclosed herein, none of the directors nor the chief executives of the Company has any interests or short positions in any shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code as at December 31, 2005.

SHARE OPTIONS

Particulars of the Company's share option scheme are set out in note 30 to the financial statements.

Subsequent to the balance sheet date, the board of directors of the Company granted 30,200,000 share options to certain directors and employees of the Company and the exercisable price of the share options was HK$2.38 per share. The closing price of the Company's shares immediately before the date of grant was HK$2.30 per share.

SUBSTANTIAL SHAREHOLDERS

As at December 31, 2005, the following persons (other than directors or chief executives of the Company stated in "Directors' and Chief Executives' Interests and Short Positions in Shares, Underlying Shares and Debentures") had interests or short positions in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO:

Name of Shareholder	Capacity	Short position	Long position	Number of issued shares held	Percentage of the Company's issued share capital
Warburg Pincus & Co.[1]	Interest of controlled corporation	–	186,989,966	186,989,966	18.44%
UBS AG	Beneficial owner	10,141,412	78,529,412	88,670,824	8.74%
Warburg Pincus Private Equity VIII L. P.[1]	Beneficial owner	–	90,605,988	90,605,988	8.94%
Griffin John Anthony	Beneficial owner	–	71,022,000	71,022,000	7.00%
Warburg Pincus Partners LLC[1]	Beneficial owner	–	186,989,966	186,989,966	18.44%
Warburg Pincus International Partners L.P.[1]	Beneficial owner	–	89,616,811	89,616,811	8.84%

Note 1: Warburg Pincus International Partners, L.P., and Warburg Pincus Private Equity VIII L.P. are part of the Warburg Pincus Funds. The general partner of the Warburg Pincus Funds is Warburg Pincus Partners LLC, which is a subsidiary of Warburg Pincus & Co. Each of Warburg Pincus Partners LLC and Warburg Pincus & Co. is therefore deemed to be interested in the shares held by the Warburg Pincus Funds, which includes Warburg Pincus International Partners, L.P. and Warburg Pincus Private Equity VIII L.P. as well as four other funds consisted in the Warburg Pincus Funds.

Save as disclosed herein, the Company has not been notified of any other person (other than a director or a chief executive of the Company) who had an interest or a short position in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO as at December 31, 2005.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBT SECURITIES

Other than the share option scheme disclosed in note 30 to the financial statements, at no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debt securities (including debentures) of, the Company or any other body corporate.

CONNECTED TRANSACTIONS

During the year ended December 31, 2005, the Group entered into the following transactions with its connected persons. The transactions are defined by the Listing Rules as "continuing connected transactions". Waivers from strict compliance with the announcement requirements, or the announcement and independent shareholders' approval requirements, had been received from the Stock Exchange. The transactions are subject to the reporting requirements set out in Chapter 14A of the Listing Rules.

(1) Agreement for purchase of sofa fabrics from Wansheng Silk

On January 1, 2005, Haining Wansheng Silk Waving Co., Ltd. ("Wansheng Silk") entered into an agreement with Haining Wansheng Furniture Co., Ltd. ("Wansheng Furniture") and Haining Kasen Leather Co., Ltd. ("Haining Kasen") which will expire on December 31, 2007 and, subject to compliance with Listing Rules requirements regarding connected transactions, automatically renewable for 3 year terms thereafter. Wansheng Silk is an associate of Mr. Sun Jianxin, the non-executive director of the Company, and therefore Wansheng Silk is a connected person of the Company. The pricing under this agreement is determined by reference to the prevailing market price. Details of this agreement have been set out in the prospectus of the Company dated October 10, 2005 ("the Prospectus").

Pursuant to this agreement, Wansheng Furniture and Haining Kasen purchase sofa fabrics for use in making upholstered furniture from Wansheng Silk. Wansheng Silk is a manufacturer of silk and other fabrics, suitable for use in sofas. During the year, the aggregate value of the transaction under this agreement was RMB9,895,000, within the estimate of RMB10,000,000 as disclosed in the Prospectus.

(2) Agreement for sale of production wastes to Yujie

On January 1,2005, Haining Yujie Material Recycling Co., Ltd. ("Yujie") entered into an agreement with Zhejiang Kasen Industrial Co., Ltd. ("Zhejiang Kasen") which will expire on December 31, 2007 and, subject to compliance with Listing Rules requirements regarding connected transactions, automatically renewable for 3 year terms thereafter. Yujie is an 80% owned subsidiary of Zhejiang Sunbridge Industrial (Group) Co., Ltd. ("Sunbridge") and Sunbridge is a company in which Mr. Zhu Zhangjin indirectly controls more than 30% of the voting power at general meetings. The pricing under this agreement is determined by reference to the prevailing market price. Details of this agreement have been set out in the Prospectus.

Pursuant to this agreement, Yujie will purchase wastes (including reside leather, used tubs, hair and fat) from the Company's subsidiaries (including Zhejiang Kasen, Haining Kasen, Haining Home Impression Furniture Co., Ltd., Haining Schinder Tanning Co., Ltd., Haining Gaosheng Leather Co., Ltd. and Haining Kareno Furniture Co., Ltd.). Yujie is one of the largest recycling companies in Haining and is located near many of the Group's production facilities (all within approximately 10 km). The Company believes that by selling wastes to Yujie, the Group will achieve an efficient management of disposal logistics and an effective supervision of its employees in the sale of wastes. During the year, the aggregate value of the transaction under this agreement was RMB11,369,000, within the estimate of RMB16,000,000 as disclosed in the Prospectus.

(3) Agreement for sale of upholstered furniture to Starcorp

On January 1, 2005, Starcorp Corporation Pty. Ltd. ("Starcorp") entered into an agreement with Zhejiang Kasen which will expire on December 31, 2007 and, subject to compliance with Listing Rules requirements regarding connected transactions, automatically renewable for 3 year terms thereafter. Starcorp is a 70% owned subsidiary of Sunbridge and Sunbridge is a company in which Mr. Zhu Zhangjin indirectly controls more than 30% of the voting power at general meetings. The pricing under this agreement is determined by reference to the prevailing market price. Details of this agreement have been set out in the Prospectus.

Pursuant to this agreement, Zhejiang Kasen will through its subsidiaries (including Haining Kareno Furniture Co., Ltd., Haining Home Impression Furniture Co., Ltd. and Haining Home Point Furniture Co., Ltd.) sell upholstered furniture to Starcorp. Starcorp's core business is retail sales of wooden and other upholstered furniture in Australia and the Company considers that this provides a good opportunity for the Group to increase its sales of the upholstered furniture in the Australian market. During the year, the aggregate value of the transaction under this agreement was RMB57,443,000, within the revised estimate of RMB58,000,000 as disclosed in the announcement dated December 22, 2005.

(4) Agreement for purchase of wet blues from Kezilesu Xinrong, Yili Horgos and Baiyin Kasen

On January 1, 2005, Kezilesu Xinrong Leather Co., Ltd. ("Kezilesu Xinrong"), Yili Horgos Leather Co., Ltd. ("Yili Horgos") and Baiyin Kasen Leather Co., Ltd. ("Baiyin Kasen") entered into an agreement with Zhejiang Kasen which will expire on December 31, 2007 and, subject to compliance with Listing Rules requirements regarding connected transactions, automatically renewable for 3 year terms thereafter. Kezilesu Xinrong, Yili Horgos and Baiyin Kasen are each a subsidiary of Sunbridge and Sunbridge is a company in which Mr. Zhu Zhangjin indirectly controls more than 30% of the voting power at general meetings. The pricing under this agreement is determined by reference to the prevailing market price. Details of this agreement have been set out in the Prospectus.

Pursuant to this agreement, the Company will purchase wet blues from Kezilesu Xinrong, Yili Horgos and Baiyin Kasen. Kezilesu Xinrong, Yili Horgos and Baiyin Kasen are the largest importer of raw cowhides in Southern Xinjiang, Northern Xinjiang and Gansu Provinces respectively, and process such raw cowhides into wet blues. The Group needs to source wet blues externally from time to time and it would also be an advantage in saving transportation and handling costs for the Group if the processing and enhancement of raw cowhides into wet blues were performed near the place of origin of the raw cowhides. During the year, the aggregate value under this agreement for the purchases of wet blues from Kezilesu Xinrong, Yili Horgos and Baiyin Kasen were RMB35,981,000, RMB108,522,000 and RMB148,680,000 respectively. The aggregate of these purchases are within the estimate of RMB460,000,000 as disclosed in the Prospectus.

Pursuant to Rule 14A.38 of the Rules Governing the Listing Securities on the Stock Exchange of Hong Kong, the board of directors engaged the auditors of the Company to perform certain agreed upon procedures in respect of the continuing connected transactions of the Group. The auditors have reported their factual findings on these procedures to the board of directors.

In the opinion of the independent non-executive directors, the continuing connected transactions entered into by the Group were:

(i) in the ordinary and usual course of business of the Group;

(ii) either (a) on normal commercial terms; or (b) where there is no available comparison, on terms that are no less favorable to the Group than terms to or from independent third parties; and

(iii) in accordance with the agreements governing the transactions on terms that are fair and reasonable so far as the shareholders of the Company.

Save as disclosed above, there were no other transactions which need to be disclosed as connected transactions in accordance with the requirements of the Listing Rules from October 20, 2005 to December 31, 2005.

On December 22, 2005, the Group revised its annual cap in respect of continuing sales transactions with Starcorp Corporation Pty. Ltd, a company in which Mr. Zhu Zhangjin has beneficial interests through Zhejiang Sunbridge Industrial (Group) Co., Ltd, for the year ended December 31, 2005. On February 22, 2006, the Group entered into agreements with North Pole Ltd. and North Pole (China) Ltd., which are subsidiaries of a shareholder of the Company for the continuing sales transactions. The annual cap in respect of the continuing transactions for the three years ending December 31, 2008 are RMB250 million, RMB500 million, and RMB800 million respectively.

DIRECTORS' INTEREST IN CONTRACTS

Save as disclosed under the heading "Connected Transactions", there were no contracts of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly and indirectly, subsisted at the end of the year or at any time during the year.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

At no time during the year, did the Company nor any of its subsidiaries purchase, sell or redeem any of the Company's listed securities.

SUFFICIENCY OF PUBLIC FLOAT

Based on information that is available to the Company and within the knowledge of its directors, the Company has maintained sufficient public float as required under the Listing Rules from October 20, 2005 to December 31, 2005.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

None of the Directors hold any interests in any competing business against the Company or any of its jointly-controlled entities and subsidiaries for the year ended December 31, 2005.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Article of Association, or the laws of the Caymans Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

INDEPENDENT NON-EXECUTIVE DIRECTORS' CONFIRMATION OF INDEPENDENCE

The Company has received, from each of the independent non-executive directors, Messrs. LU Yungang, CHOW Joseph, SHI Zhengfu, a confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the independent non-executive directors are independent.

AUDIT COMMITTEE

An Audit Committee was established by the Company in September 2005 to review and supervise the Company's financial reporting process and internal controls. The Audit Committee comprises the three independent non-executive directors of the Company. Mr. CHOW Joseph is the chairman of the Audit Committee.

The annual results of the Company have been reviewed by the Audit Committee.

REMUNERATION COMMITTEE

A Remuneration Committee was established by the Company in September 2005 to establish policies, review and determine the remuneration of the directors and the senior management. The Remuneration Committee comprises two independent non-executive directors and a non-executive director of the Company. Mr. SUN Qiang Chang is the chairman of the Remuneration Committee.

AUDITORS

A resolution will be submitted to the annual general meeting of the Company to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board

ZHU Zhangjin
Director

Hong Kong, April 19, 2006

Corporate Governance Report

The Board is committed to maintain a high standard of corporate governance by continuously improving its management accountability and transparency to shareholders and the public.

CORPORATE GOVERNANCE PRACTICES

In the opinion of the Directors, the Company has complied with the code provisions set out in the Code on Corporate Governance Practices ("Code") contained in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules") since our IPO date being October 20, 2005 to December 31, 2005 (the "Period"), except for Mr. Zhu Zhangjin who had served as both the Chairman of the Board and the Chief Executive Officer of the Company (see the details set out in the section "Chairman and Chief Executive Officer" below).

DIRECTORS' SECURITIES TRANSACTIONS

During the Period, the Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 of the Listing Rules. The Company has made specific inquiry with all directors of the Company and they have all confirmed their compliance during the Period with the required standards set out in the Model Code.

BOARD OF DIRECTORS

Board Composition

The Board currently comprises seven members, including three executive Directors, one non-executive Director and three independent non-executive Directors. The names, biographical details of the Directors and the relationships among them are set out in the "Directors and Management Profiles" section on pages 5 to 8 of this annual report.

The Company has received an annual confirmation of independence from each of the three independent non-executive directors pursuant to rule 3.13 of the Listing Rules. Based on the contents of such confirmation, the Company considers that the three independent non-executive directors are independent and that they all met the specific independence guidelines as set out in rule 3.13 of the Listing Rules.

Board Functions

The Board oversees the overall management and operations of the Company. Major responsibilities include:

1. devising the company's overall business and financial strategies;

2. setting key performance targets;

3. approving budgets and major expenditures;

4. monitoring the performance of the management.

The Directors acknowledge that they are responsible for preparing accounts for each financial period on a going concern basis, with supporting assumptions or qualification as necessary.

Board Meetings

The Board held six meetings in 2005. The attendance records of individual Directors are set out below:

	Attendance
Executive Directors	
Zhu Zhangjin	6/6
Zhou Xiaosong	6/6
Zhu Jianqi	6/6
Non-Executive Director	
Sun Qiang Chang	6/6
Independent Non-Executive Directors	
Lu Yungang (appointed on June 17, 2005)	2/3
Chow Joseph (appointed on July 11, 2005)	2/3
Shi Zhengfu (appointed on June 17, 2005)	2/3

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The Company does not at present separate the roles of Chairman and Chief Executive Officer. Mr. Zhu Zhangjin is the Chairman and Chief Executive Officer of the Company responsible for overseeing the operations of the Group. The Company is currently considering to appoint a new Chief Executive Officer to replace Mr. Zhu if candidate with suitable leadership, knowledge, skills and experience can be identified within or outside the Group. However, due to the nature and extent of the Group's operations, in particular in Mainland China and the in-depth knowledge and experience in the leather and upholstery furniture market required for the position of Chief Executive Officer, it is not possible to determine as to when the appointment of a new Chief Executive Officer of the Company can be effected. However, the Board believes that the appointment of Mr. Zhu as the Chairman and Chief Executive Officer of the Company will not impair the balance of power and authority between the Board and the management of the Company, and is most beneficial to the Company's interest at present.

NON-EXECUTIVE DIRECTORS AND RE-ELECTION

There is no service contract between the Company and the non-executive Director and independent non-executive Directors. They are subject to rotational retirement and re-election at annual general meetings pursuant to Article 87 of the Articles of Association of the Company every three years. At every annual general meeting, one-third of the directors for the time being or, if their number is not a multiple of three, the number nearest to but not less than one-third, shall retire from office by rotation.

REMUNERATION OF DIRECTORS

The Group's policy on remuneration for its executive Directors is that remuneration level is linked with specified performance targets. Bonus payments are determined based on an annual performance evaluation and share option scheme is also introduced to ensure interests of executive Directors are in alignment with that of the shareholders.

Remuneration of independent non-executive Directors is determined with reference to the market level and will be reviewed to reflect changes in the market.

REMUNERATION COMMITTEE

The Remuneration Committee was set up in September 2005 and it comprises three members, two of which are independent non-executive directors, as follows:

SUN Qiang Chang *(Chairman of the Remuneration Committee)*
LU Yungang
SHI Zhengfu

The Remuneration Committee meets at least once a year and at such other times as its chairman requires. No meeting was held by the Remuneration Committee after the listing of the Company's shares on the Stock Exchange of Hong Kong on October 20, 2005.

The Remuneration Committee has adopted written terms of reference in compliance with code provisions B.1.3(a) to (f) of the Code. The responsibilities of the Remuneration Committee are to review and develop the Group's policy on remuneration for its Directors (including executive Directors) so as to ensure that it attracts, retains and motivates the Directors to manage the Company and the Group successfully. The Remuneration Committee has been delegated with the powers and authorities to implement the share option scheme of the Company and to deal with all compensation matters regarding the Directors of the Company. Directors do not participate in decisions regarding their own remuneration.

The Remuneration Committee proposed to convene a committee meeting in May or June 2006 for the purpose of reviewing and approving the policy for the remuneration of directors.

NOMINATION OF DIRECTORS

For the purpose of nomination of Directors, as the Company finds it not necessary to establish a separate Nomination Committee, therefore the task of nominating Directors is vested with the Board of the Company. The Board (i) reviews the structure, size and composition (including the skills, knowledge and experience) of Board members on a regular basis and make recommendation regarding and proposed changes; (ii) identifies individuals suitably qualified to become Board members; (iii) assesses the independence of independent non-executive Directors; and (iv) makes recommendations on relevant matters relating to the appointment and re-appointment of Directors and succession planning for Directors. In 2005, the Board had nominated and appointed Mr. Lu Yungang, Mr. Chow Joseph and Mr. Shi Zhengfu as independent non-executive Directors. Before they were nominated for election, the Board had assessed their independence.

AUDITOR'S REMUNERATION

The Company's external auditors are Deloitte Touche Tohmatsu. For the year ended December 31, 2005, the auditors of the Company received approximately RMB3.0 million for audit services.

The Company also incurred approximately RMB6.2 million for the services provided by Deloitte Touche Tohmatsu as reporting accountants in respect of the listing of the Company's shares on the Stock Exchange of Hong Kong.

A statement by the auditors about their reporting responsibilities is included in the page 34 of the Annual Report 2005 under the section "Auditors' Report".

AUDIT COMMITTEE

The audit committee was set up in September 2005 and it comprises three independent non-executive Directors:

CHOW Joseph *(Chairman of the Audit Committee)*
LU Yungang
SHI Zhengfu

The Board has the responsibility to present a clean and balanced assessment of the performance, result and prospects of the Group. It is also responsible for preparing financial statements with a true and fair view.

The audit committee, delegated by the Board to assess matters related to the financial statements of the accounts and to provide recommendations and advices, was set up with written terms of reference prepared based on the Listing Rules and code provisions B.1.3(a) to (f) of the Code. The primary duties of the audit committee are (i) to review the Company's annual reports and accounts and interim reports and results announcements and to provide advice and comments thereon to the directors; (ii) to review the Company's internal control procedures; and (iii) to recommend to the Board on the appointment, re-appointment, and removal of the external auditors.

In order to review and to supervise the Company's financial reporting and internal control procedures, the Audit Committee meets at least twice a year and the Chief Financial Officer, internal auditor and a representative of the external auditors normally are invited to attend the meetings.

After the listing of the Company's shares on the Stock Exchange of Hong Kong on October 20, 2005, the Audit Committee held one meeting on December 22, 2005 with an attendance rate of 100%. The meeting was attended by external auditors and the Company's senior management to discuss audit plans.

The Audit Committee also held a meeting on April 19, 2006 to review the Group's results for the year ended December 31, 2005 with an attendance rate of 100%. The Chief Financial Officer, internal auditor and representatives of the external auditors attended the meeting.

The Audit Committee reported that there is no material uncertainty that cast doubt on the Company's ability to continue as a going concern. There is no disagreement between the Board and the Audit Committee on the selection and appointment of the external auditors.

The Board has accepted the recommendation from the Audit Committee on re-appointing Deloitte Touche Tohmatsu as the external auditors of the Group.

INTERNAL CONTROL

The Company conducted a review of its internal controls with an overall objective of providing management with information to identify significant weaknesses in relevant procedures, systems and controls. The Company intends to perform an annual review of the effectiveness of the systems of internal controls to ensure adequate control mechanism is in place.

Auditors' Report

Deloitte.
德勤

TO THE SHAREHOLDERS OF KASEN INTERNATIONAL HOLDINGS LIMITED

(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Kasen International Holdings Limited (the "Company") and its subsidiaries (the "Group") from pages 35 to 88 which have been prepared in accordance with International Financial Reporting Standards.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of consolidated financial statements which give a true and fair view. In preparing consolidated financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those consolidated financial statements and to report our opinion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the circumstances of the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the consolidated financial statements are free from material misstatement. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Group, as at December 31, 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong
April 19, 2006

Consolidated Income Statement

For the year ended December 31, 2005

	Notes	2005 RMB'000	2004 RMB'000
Turnover	6	**3,475,457**	2,852,391
Cost of sales		**(2,927,194)**	(2,408,719)
Gross profit		**548,263**	443,672
Other income	7	**62,285**	189,895
Distribution costs		**(81,524)**	(56,487)
Administrative expenses		**(113,180)**	(93,902)
Other expenses		**(23,145)**	(133,596)
Share of loss of an associate	18	**(1,114)**	–
(Loss) gain on disposals of subsidiaries		**(1,380)**	3,013
Finance costs	8	**(111,540)**	(95,419)
Profit before taxation	9	**278,665**	257,176
Taxation	11	**(18,311)**	(22,646)
Profit for the year		**260,354**	234,530
Attributable to:			
Equity holders of the Company		**265,699**	225,701
Minority interests		**(5,345)**	8,829
		260,354	234,530
Earnings per share	12		
Basic		**41 cents**	47 cents
Diluted		**34 cents**	35 cents

The directors have recommended the payment of a final dividend of approximately RMB7.86 cents (equivalent to US0.98 cents or HK7.58 cents) per ordinary share (2004: Nil) for the year ended December 31, 2005 amounting to approximately RMB79,704,000, subject to approval by the shareholders of the Company at the annual general meeting to be held on May 30, 2006.

Consolidated Balance Sheet

As at December 31, 2005

	Notes	2005 RMB'000	2004 RMB'000
NON-CURRENT ASSETS			
Goodwill	13	**181,006**	181,006
Negative goodwill	14	**–**	(4,395)
Property, plant and equipment	15	**1,281,230**	1,146,912
Prepaid lease payment – non-current portion	16	**142,812**	140,801
Intangible assets	17	**1,077**	905
Interest in an associate	18	**9,127**	5,173
Interest in a jointly controlled entity	19	**811**	–
Available-for-sale investments	20	**310**	2,410
		1,616,373	1,472,812
CURRENT ASSETS			
Inventories	21	**1,378,842**	1,392,738
Trade and other receivables	22	**795,665**	529,466
Prepaid lease payment – current portion	16	**3,543**	3,436
Held for trading investments	23	**–**	3,505
Amounts due from related companies	24	**21,253**	173,795
Taxes recoverable		**13,624**	8,549
Pledged bank deposits	25	**240,112**	239,185
Bank balances and cash	25	**372,278**	213,458
		2,825,317	2,564,132
TOTAL ASSETS		**4,441,690**	4,036,944
CURRENT LIABILITIES			
Trade, bills and other payables	26	**783,992**	873,382
Amounts due to related companies	24	**60,287**	74,289
Bank and other borrowings – due within one year	27	**1,191,246**	1,472,825
Convertible loan notes	28	**–**	304,934
Taxes payable		**7,807**	7,646
		2,043,332	2,733,076
NET CURRENT ASSETS (LIABILITIES)		**781,985**	(168,944)
TOTAL ASSETS LESS CURRENT LIABILITIES		**2,398,358**	1,303,868
NON-CURRENT LIABILITIES			
Bank and other borrowings – due after one year	27	**100,492**	102,492
		100,492	102,492
NET ASSETS		**2,297,866**	1,201,376

Consolidated Balance Sheet (cont'd)

As at December 31, 2005

	Note	2005 RMB'000	2004 RMB'000
CAPITAL AND RESERVES			
Share capital	29	**1,256**	689
Reserves		**2,198,304**	1,090,415
Equity attributable to equity holders of the Company		**2,199,560**	1,091,104
Minority interests		**98,306**	110,272
Total equity		**2,297,866**	1,201,376

The financial statements on pages 35 to 88 were approved and authorized for issue by the Board of Directors on April 19, 2006 and are signed on its behalf by:

ZHU Zhangjin
Director

ZHU Jianqi
Director

Consolidated Statement of Changes in Equity

For the year ended December 31, 2005

	Attributable to equity holders of the Company									
	Share capital RMB'000	Share premium RMB'000	Equity reserve RMB'000	Exchange reserve RMB'000	Statutory reserve RMB'000 (Note 31)	Special reserve RMB'000 (Note 31)	Retained earnings RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At January 1, 2004	541	–	1,291	(479)	99,055	168,659	288,180	557,247	159,813	717,060
Exchange differences arising on translation of overseas operations recognized directly in equity	–	–	–	(183)	–	–	–	(183)	(29)	(212)
Profit for the year	–	–	–	–	–	–	225,701	225,701	8,829	234,530
Total recognized income and expense for the year	–	–	–	(183)	–	–	225,701	225,518	8,800	234,318
Issue of shares	15	21,036	–	–	–	–	–	21,051	–	21,051
Acquisition of additional interests in subsidiaries	133	287,155	–	–	–	–	–	287,288	(85,613)	201,675
Disposal of subsidiaries	–	–	–	–	–	–	–	–	(7,690)	(7,690)
Appropriation of statutory reserve	–	–	–	–	42,776	–	(42,776)	–	–	–
Capital contribution from minority shareholders	–	–	–	–	–	–	–	–	34,962	34,962
At December 31, 2004	689	308,191	1,291	(662)	141,831	168,659	471,105	1,091,104	110,272	1,201,376
Effects of change in accounting policies (Note 2)	–	–	–	–	–	–	4,395	4,395	–	4,395
At January 1, 2005 as restated	689	308,191	1,291	(662)	141,831	168,659	475,500	1,095,499	110,272	1,205,771
Exchange differences arising on translation of overseas operations recognized directly in equity	–	–	–	(131)	–	–	–	(131)	–	(131)
Profit for the year	–	–	–	–	–	–	265,699	265,699	(5,345)	260,354
Total recognized income and expense for the year	–	–	–	(131)	–	–	265,699	265,568	(5,345)	260,223
Issue of new shares	246	539,000	–	–	–	–	–	539,246	–	539,246
Transaction costs attribute to issue of new shares	–	(38,511)	–	–	–	–	–	(38,511)	–	(38,511)
Conversion of convertible loan notes	321	337,437	–	–	–	–	–	337,758	–	337,758
Transfer to share premium on conversion of convertible loan notes	–	1,291	(1,291)	–	–	–	–	–	–	–
Acquisition of additional interests in subsidiaries	–	–	–	–	–	–	–	–	(6,621)	(6,621)
Appropriation of statutory reserve	–	–	–	–	27,431	–	(27,431)	–	–	–
At December 31, 2005	**1,256**	**1,147,408**	**–**	**(793)**	**169,262**	**168,659**	**713,768**	**2,199,560**	**98,306**	**2,297,866**

Consolidated Cash Flow Statement

For the year ended December 31, 2005

	2005 RMB'000	2004 RMB'000
OPERATING ACTIVITIES		
Profit before taxation	**278,665**	257,176
Adjustments for:		
Impairment loss recognized in respect of trade and other receivables	**5,630**	9,968
Allowances for inventories	**3,532**	32,273
Amortization of intangible assets	**225**	113
Release of prepaid lease payment	**3,436**	3,201
Depreciation of property, plant and equipment	**87,474**	61,155
(Gain) loss on disposal of property, plant and equipment	**(26)**	833
Interest expenses	**111,540**	95,419
Interest income	**(7,487)**	(4,106)
Issue of shares to a then employee charge to employee benefit expense	**–**	301
Loss (gain) on disposals of subsidiaries	**1,380**	(3,013)
Gain on disposals of available-for-sale investments	**(305)**	–
Share of loss of an associate	**1,114**	–
Release of negative goodwill to income statement	**–**	(518)
Discounts on acquisition of an additional interest in a subsidiary	**(5,300)**	–
Operating cash flows before movements in working capital	**479,878**	452,802
Decrease (increase) in inventories	**10,364**	(877,074)
Increase in trade and other receivables	**(273,209)**	(129,587)
Decrease in amounts due from related companies	**152,542**	63,227
(Decrease) increase in trade, bills and other payables	**(108,310)**	507,681
Increase in amounts due to related companies	**22,908**	36,684
Cash generated from operations	**284,173**	53,733
Income taxes paid	**(31,774)**	(50,395)
Income taxes refunded	**8,549**	13,941
NET CASH FROM OPERATING ACTIVITIES	**260,948**	17,279

Consolidated Cash Flow Statement (cont'd)

For the year ended December 31, 2005

	Notes	2005 RMB'000	2004 RMB'000
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(194,462)**	(738,797)
Increase in prepaid lease payment		**(5,554)**	(24,698)
Investment in an associate		**(5,068)**	(5,173)
Payment for acquisition of additional interest in subsidiaries		**(1,321)**	–
Increase in pledged bank deposits		**(927)**	(161,087)
Investment in a jointly controlled entity		**(811)**	–
Purchase of intangible assets		**(397)**	(761)
Proceeds from disposals of property, plant and equipment		**9,305**	20,768
Interest received		**7,487**	4,106
Proceeds from sales of available-for-sales investments		**2,405**	1,051
Proceeds from sales of held for trading investments		**3,505**	–
Purchase of investments in securities		**–**	(3,815)
Purchase of subsidiaries	32	**–**	–
Disposal of subsidiaries	33	**–**	(71,587)
NET CASH USED IN INVESTING ACTIVITIES		**(185,838)**	(979,993)
FINANCING ACTIVITIES			
Bank and other borrowings raised		**3,068,370**	2,366,019
Issue of shares		**539,246**	20,750
Advances from related companies		**41,311**	64,880
Repayment of bank and other borrowings		**(3,351,949)**	(1,716,018)
Interest paid		**(96,536)**	(80,413)
Repayment to related companies		**(78,221)**	(48,800)
Transaction costs attributable to issue of new shares		**(38,511)**	–
Proceeds on issue of convertible loan notes		**–**	124,499
Capital contribution from minority shareholders		**–**	34,962
NET CASH FROM FINANCING ACTIVITIES		**83,710**	765,879
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**158,820**	(196,835)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR		**213,458**	410,293
CASH AND CASH EQUIVALENTS AT END OF THE YEAR, represented by bank balances and cash		**372,278**	213,458

Notes to the Financial Statements

For the year ended December 31, 2005

1. GENERAL

The Company is a public limited company incorporated in the Cayman Islands and its shares are listed on the Stock Exchange of Hong Kong Limited ("Stock Exchange") since October 20, 2005. The addresses of the registered office and principal place of business of the Company are disclosed in the corporate information to the annual report.

The Company acts as an investment holding company. Its subsidiaries are principally engaged in the processing of raw cowhides and wet blues into finished leather or fully assembled leather products.

In preparation for listing of the Company's shares on the Stock Exchange, the Company underwent a group reorganization (the "Reorganization"). The Reorganization principally involved (1) the shareholders (the "Founding Shareholder Group") of Zhejiang Kasen Industrial Co., Ltd. ("Zhejiang Kasen"), the then principal operating company and a holding company of certain subsidiaries of the Company, subscribed for a total of 231,095,052 ordinary shares of US$0.0001 each of the Company on January 14, 2003 and February 14, 2003 respectively, so as to set up a holding company; and (2) a transfer of the entire ownership interest in Zhejiang Kasen to the Company, Zhejiang Kasen and the Company were controlled by the Founding Shareholder Group throughout the Reorganization. The Founding Shareholder Group, as a result of contractual agreements, was regarded as a single entity controlling the Group and governed the financial and operating policies of the Group. In respect of step (2) of the Reorganization above, such contractual agreements include (i) a declaration of trust signed by Mr. Zhu Zhangjin ("Mr. Zhu"), a director and a shareholder of the Company, on February 26, 2003 which declared that 11.00% of the equity interest Mr. Zhu held in the Company was held on trust for two of the shareholders of Zhejiang Kasen ("Township Shareholders") and gave Mr. Zhu the full power to vote in his discretion on behalf of the Township Shareholders; and (ii) a voting agreement dated February 26, 2003 whereby the 21 individual shareholders of Zhejiang Kasen granted Mr. Zhu full power to vote on their behalf all shares owned by them. The declaration of trust and the voting agreement were terminated on September 16, 2004 and October 9, 2005, respectively; and (3) in return for the ownership interest in Zhejiang Kasen transferred by the Founding Shareholder Group, the Founding Shareholder Group subscribed for 421,078,856 further ordinary shares of US$0.0001 each in the Company on September 16, 2004 and the Reorganization was completed on the same date.

Accordingly, for the purpose of the preparation of the financial statements of the Group, the Group accounted for Zhejiang Kasen as a wholly-owned subsidiary on the basis that the Company has been considered as the holding company of Zhejiang Kasen and its subsidiaries throughout the period, using the principles of common control except for those subsidiaries which were established or acquired during the period.

The functional currency of the Company is United States Dollars. The majority of the operation of the Group is in the People's Republic of China and the financial statements are therefore presented in Renminbi ("RMB").

Notes to the Financial Statements (cont'd)
For the year ended December 31, 2005

2. CHANGE IN ACCOUNTING POLICIES AND SUMMARY OF THE EFFECTS

In the current year, the Group has applied the new and revised International Financial Reporting Standards ("IFRS"), International Accounting Standards ("IASs") and Interpretations ("IFRIC") (hereinafter collectively referred to as "new IFRSs") issued by International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretation Committee of the IASB that are effective for accounting periods beginning on or after January 1, 2005. The adoption of the new IFRSs has resulted in changes of the Group's accounting policies in the following areas that have an effect on the results for the current or prior accounting periods are prepared and presented.

Business Combinations

IFRS 3 Business Combinations is effective for business combinations for which the agreement date is on or after March 31, 2004 and from the beginning of its first annual period beginning on or after March 31, 2004 (i.e. the financial year beginning on January 1, 2005). The principal effects upon application of the transitional provision of IFRS 3 on January 1, 2005 to negative goodwill arising from business combinations are summarized below:

Excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost (previously known as "negative goodwill")

In accordance with IFRS 3, any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of acquisition ("discount on acquisition") is recognized immediately in profit or loss in the period in which the acquisition takes place. In previous periods, negative goodwill arising on acquisitions was presented as a deduction from assets and released to income based on an analysis of the circumstances from which the balance resulted. In accordance with the relevant transitional provisions in IFRS 3, the Group derecognized all negative goodwill on January 1, 2005. A corresponding adjustment to the Group's retained earnings of approximately RMB4,395,000 has been made.

The impact of the change in accounting policy for the year is an increase in other operating income of approximately RMB4,252,000 and an increase in net assets at January 1, 2005 of approximately RMB4,395,000.

Share-based Payments

In the current year, the Group has applied IFRS 2 *Share-based Payment* which requires an expense to be recognized where the Group buys goods or obtains services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares or rights over shares ("cash-settled transactions"). The principal impact of IFRS 2 on the Group is in relation to the expensing of the fair value of share options granted to directors and employees of the Company, determined at the date of grant of the share options, over the vesting period. Prior to the application of IFRS 2, the Group did not recognize the financial effect of these share options until they were exercised. The Group has applied IFRS 2 to share options granted on or after January 1, 2005. Because there were no unvested share options at January 1, 2005, comparative figures for last year need not to be restated. During the year, no share options have been granted by the Company.

2. CHANGE IN ACCOUNTING POLICIES AND SUMMARY OF THE EFFECTS *(Continued)*

Summary of the effects of the changes in accounting policies

The effects of the changes in the accounting policies described above are an increase in discounts on acquisition of an additional interest in a subsidiary of approximately RMB4,252,000 for the current year (2004: Nil).

The Group has not early applied the following new standards, amendments and interpretations that have been issued but are not yet effective. The directors of the Company have commenced considering the potential impact of these new standards, amendments and interpretations. Except for IAS 39 & IFRS 4 (Amendments) on financial guarantee contracts (which requires financial guarantees to be initially measured at fair value), which may have potential impact to the financial statements, the directors anticipate that the adoption of these new standards, amendments and interpretations, should not result in any significant changes in the future as to how the results and financial position are prepared and presented. The Group is still not in the position to reasonably estimate the impact that may arise from IAS 39 & IFRS 4 (Amendments).

IAS 1 (Amendment)	Capital Disclosures[1]
IAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures[2]
IAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions[2]
IAS 39 (Amendment)	The Fair Value Option[2]
IAS 39 & IFRS 4 (Amendments)	Financial Guarantee Contracts[2]
IFRS 6	Exploration for and Evaluation of Mineral Resources[2]
IFRS 7	Financial Instruments: Disclosures[1]
IFRIC 4	Determining whether an Arrangement Contains a Lease[2]
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds[2]
IFRIC 6	Liabilities arising from Participating in a Specific Market, – Waste Electrical and Electronic Equipment[3]
IFRIC 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[4]
IFRIC 8	Scope of IFRS 2[5]
IFRIC 9	Reassessment of Embedded Derivatives[6]

[1] Effective for annual periods beginning on or after January 1, 2007.
[2] Effective for annual periods beginning on or after January 1, 2006.
[3] Effective for annual periods beginning on or after December 1, 2005.
[4] Effective for annual periods beginning on or after March 1, 2006.
[5] Effective for annual periods beginning on or after May 1, 2006.
[6] Effective for annual periods beginning on or after June 1, 2006.

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with IFRS. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and by the Hong Kong Companies Ordinance.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company and its subsidiaries. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of the subsidiaries to bring the accounting policies used in line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the consolidation. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Business combinations

Other than business combinations involving entities under common control (i.e. the Reorganisation as set out in note 1), the acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognized at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* ("IFRS 5"), which are recognized and measured at fair value less costs to sell.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair values of the assets, liabilities and contingent liabilities recognized.

When the Group increases its interest in an entity that is already a subsidiary, the difference between the consideration paid for the additional interest and the fair value of the net assets of the subsidiary attributable to the additional interest acquired is recognized as goodwill or discount on acquisition.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Business combinations *(Continued)*

Goodwill

Goodwill arising on the acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the net fair values of the identifiable assets, liabilities and contingent liabilities of the subsidiary recognized at the date of acquisition.

Goodwill is recognized as an asset at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognized for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

The Group's policy for goodwill arising on the acquisition of an associate is described under 'Investments in associates' below.

Excess of an acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost ("discount on acquisition")

A discount on acquisition arising on an acquisition of a subsidiary or an associate for which an agreement date is on or after March 31, 2004 represents the excess of the acquirer's interest in the net fair values of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the business combination and should be recognized immediately in income statement.

In accordance with the transitional rules of IFRS 3, all negative goodwill as at January 1, 2005 has been derecognized.

Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in this financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the associate, less any identified impairment loss. When the Group's share of losses of an associates equal or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognizing its share of further losses. An additional share of losses is provided for and a liability is recognized only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Investments in associates *(Continued)*

Any excess of the cost of acquisition over the Group's share of the net fair values of the identifiable assets, liabilities and contingent liabilities of the associate recognized at the date of acquisition is recognized as goodwill. Goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment. Any excess of the Group's share of the net fair values of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognized immediately in profit or loss.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Jointly controlled entities

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

Jointly controlled entities are accounted for using the equity method.

The results and assets and liabilities of jointly controlled entities are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the jointly controlled entities, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognizing its share of further losses. An additional share of losses is provided for and a liability is recognized only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

When a group entity transacts with a jointly controlled entity of the Group, unrealized profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealized losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognized.

Revenue recognition

Revenue is measured at the fair values of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, value-added tax and other sales related taxes.

Sales of goods are recognized when goods are delivered and title has been passed.

Interest income is accrued on a timely basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Revenue recognition *(Continued)*

Dividend income from investments is recognized when the shareholders' rights to receive payment have been established.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases, including interest in land use right, are charged to profit or loss on a straight line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognized as a reduction of rental expense over the lease term on a straight line basis.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognized in profit or loss in the period in which they arise, except for exchange differences arising on a monetary item that forms part of the Group's net investment in a foreign operation, in which case, such exchange differences are recognized in equity in the consolidated financials statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognized directly in equity, in which cases, the exchange differences are also recognized directly in equity.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Company (i.e. RMB) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognized as a separate component of equity (the translation reserve). Such exchange differences are recognized in profit or loss in the period when the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising from an acquisition of a foreign operation are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognized in the translation reserve.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

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

Government grants

Grants relating to depreciable assets are presented as a deduction from the carrying amount of the relevant asset and released to income over the useful lives of the assets. Grants related to expense items are recognized in the same period as those expenses are charged to the income statement and are reported separately as other operating income.

Where government grants are given for the purposes of immediate financial support to the Group with no further related cost to be incurred, the grants are recognized as income when they become receivable.

Retirement benefits costs

Payments to defined contribution retirement benefits schemes and state-managed retirement benefit schemes are charged as an expense as they fall due.

Taxation

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

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognized on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences arising on investments in subsidiaries and associates and interest in joint ventures, except where the Group as a parent or a venturer is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Taxation *(Continued)*

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on tax rates that have been enacted on substantively enacted by the balance sheet date. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Property, plant and equipment

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

Construction in progress is stated at cost which includes all construction costs and other direct costs attributable to such projects. It is not depreciated until completion of construction. Costs of completed construction works are transferred to the appropriate categories of property, plant and equipment.

Depreciation is provided to write off the cost of property, plant and equipment other than construction in progress over their estimated useful lives and after taking into account their estimated residual value, using the straight line method.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of asset. Any gain or loss arising from derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognized.

Intangible assets

Costs incurred in the acquisition of computer software are capitalized and amortized on a straight line basis over their estimated useful lives of five years from the date of acquisition.

Internally-generated intangible assets – research and development expenditure

Expenditure on research activities is recognized as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from the Group's development activities is recognized only if all of the following conditions are met:

- an asset is created that can be identified (such as software and new processes);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Internally-generated intangible assets are amortized on a straight line basis over their estimated useful lives. Where no internally-generated intangible asset can be recognized, development expenditure is charged to profit or loss in the period in which it is incurred.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Impairment of tangible and intangible assets with definite useful lives

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimation of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognized as income immediately.

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is calculated using the weighted average cost method.

Financial instruments

Financial assets and financial liabilities are recognized on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

The Group's financial assets are classified into one of the three categories, including financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss including financial assets held for trading. At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognized directly in profit or loss in the period in which they arise.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Loans and receivables

Loans and receivables (including trade and other receivables, amounts due from related companies and bank deposits) are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables are carried at amortized cost using the effective interest method, less any identified impairment losses. An impairment loss is recognized in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognized, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated or not classified as any of the other categories. At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognized in equity, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognized in equity is removed from equity and recognized in profit or loss. Any impairment losses on available-for-sale financial assets are recognized in profit or loss. Impairment losses on available-for-sale equity investments will not reverse through profit or loss in subsequent periods. For available-for-sale debt investments, impairment losses are subsequently reversed if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

For available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, they are measured at cost less any identified impairment losses at each balance sheet date subsequent to initial recognition. An impairment loss is recognized in profit or loss when there is objective evidence that the asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount of the asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses will not reverse in subsequent periods.

Financial liability and equity

Financial liabilities and equity instruments by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

Financial liabilities

Financial liabilities including bank and other borrowings, trade, bills and other payables and amounts due to related parties are subsequently measured at amortized cost, using the effective interest rate method.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Convertible loan notes

Convertible loan notes are regarded as compound instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is determined using the prevailing market interest rate of similar non-convertible debts. The difference between the proceeds of issue of the convertible loan notes and the fair value assigned to the liability component, representing the embedded call option for the holder to convert the loan notes into equity of the Company, is included in equity.

In subsequent periods, the liability component of the convertible loan notes is carried at amortized cost using the effective interest method. The equity component, represented by the option to convert the liability component into ordinary shares of the Company, will remain in equity reserve until the embedded option is exercised (in which case the balance stated in equity reserve will be transferred to share premium). Where the option remains unexercised at the expiry date, the balance stated in equity reserve will be released to the retained earnings. No gain or loss is recognized in profit or loss upon conversion or expiration of the option.

Transaction costs that relate to the issue of the convertible loan notes are allocated to the liability and equity components in same proportion of the allocation of the proceeds. Transaction costs relating to the equity component are charged directly to equity. Transaction costs relating to the liability component are included in the carrying amount of the liability portion and amortized over the period of the convertible loan notes using the effective interest method.

Equity instruments

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

4. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future and other key sources of uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment loss recognized in respect of trade receivables

The policy for allowance of bad and doubtful debts of the Group based on the evaluation of collectability and aging analysis of accounts and on management's estimate. In determining whether impairment is required, the Group takes into consideration the aging status and likelihood of connection, specific allowance is only made for receivable that are unlikely to be collected and is recognized on the difference between the estimated future cash flow expected to receive discounted using the original effective interest rate and the carrying value.

4. KEY SOURCES OF ESTIMATION UNCERTAINTY *(Continued)*

Impairment loss on goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual cash flows are less than expected, a material impairment loss may arise. As at December 31, 2005, the carrying amount of goodwill is approximately RMB181 million. Details of the recoverable results are disclosed in note 13.

Allowances for inventories

The management of the Group reviews inventories on a product-by-product basis at each balance sheet date, and makes allowance for obsolete and slow-moving inventory items identified that are no longer suitable for use in production. The management estimates the net realizable value for such finished goods and work-in progress based primarily on the latest invoice prices and current market conditions.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include borrowings, trade receivables, trade payables and bank deposits. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Interest rate risk

The Group's exposure to fair value interest rate risk relates primarily to the fixed rate bank and other borrowings. The Group has not entered into any interest rate hedging contracts. This directors monitor the Group's exposure on going basis and will consider hedging interest rate risk should the need arise.

Foreign currency risk

The Group's exposure to foreign currency risk related primarily to the turnover and costs that denominated in US dollars. The Group has not entered into any forward contracts to hedge the exposures. The directors monitor the Group's exposure on going basis and will consider hedging the currency risk should the need arise.

Credit risk

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of impairment loss on trade receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment.

In addition, more than 30% of the Group's sales is attributable to five major customers and therefore the Group has concentration of credit risk arisen from exposure to certain major customers.

The Group trades only with recognized creditworthy third parties. It is Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

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

Credit risk *(Continued)*

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

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

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and the flexibility through the use of bank and other borrowings. After the initial public offering of the Company's shares, the cash flow of the Group has been improved.

6. SEGMENT INFORMATION

For management purposes, the Group is currently organized into four operating divisions. These divisions are the basis on which the Group reports its primary segment information.

Business segment

During the year, the Group has presented its business by the following segments:

– Upholstered furniture, comprising leather and fabric upholstered furniture and furniture covers;

– Furniture leather;

– Automotive leather;

– Leather garments; and

– Others (including sale of wooden frame and others)

6. SEGMENT INFORMATION *(Continued)*

Segment information about these business is presented below:

Consolidated Income Statement

	Upholstered furniture RMB'000	Furniture leather RMB'000	Automotive leather RMB'000	Leather garments RMB'000	Others RMB'000	Eliminations RMB'000	Total RMB'000
2005							
Turnover							
External sales	**2,755,003**	**593,121**	**126,907**	**–**	**426**	**–**	**3,475,457**
Inter-segment sales	**640,091**	**1,599,461**	**–**	**–**	**98,347**	**(2,337,899)**	**–**
2004							
Turnovers							
External sales	2,033,173	491,839	127,451	130,811	69,117	–	2,852,391
Inter-segment sales	434,550	1,238,044	73	4,087	519,465	(2,196,219)	–

Inter-segment sales are charged at prevailing market prices.

	Year ended December 31, **2005** **RMB'000**	2004 RMB'000
Result		
Segment result		
– Upholstered furniture	**317,237**	255,551
– Furniture leather	**41,993**	47,263
– Automotive leather	**9,200**	11,005
– Leather garments	**–**	13,044
– Others	**(2,477)**	10,141
	365,953	337,004
Unallocated corporate income	**49,891**	24,634
Unallocated corporate expenses	**(23,145)**	(12,056)
(Loss) gain on disposals of subsidiaries	**(1,380)**	3,013
Share of loss of an associate	**(1,114)**	–
Finance costs	**(111,540)**	(95,419)
Profit before taxation	**278,665**	257,176
Taxation	**(18,311)**	(22,646)
Profit for the year	**260,354**	234,530

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

6. SEGMENT INFORMATION *(Continued)*

Other Information

	Year ended December 31,	
	2005	2004
	RMB'000	RMB'000
Impairment loss recognized in respect of trade and other receivables		
– Upholstered furniture	**2,152**	7,742
– Furniture leather	**1,718**	140
– Automotive leather	**1,343**	1,271
– Leather garments	**–**	454
– Others	**417**	361
	5,630	9,968
Allowances for inventories		
– Upholstered furniture	**306**	1,489
– Furniture leather	**3,226**	30,659
– Leather garments	**–**	125
	3,532	32,273
Capital additions		
– Upholstered furniture	**124,801**	446,823
– Furniture leather	**66,600**	195,300
– Automotive leather	**23,339**	555
– Leather garments	**–**	1,480
– Others	**16,728**	579
– Unallocated corporate items	**–**	94,821
	231,468	739,558
Depreciation and amortization		
– Upholstered furniture	**37,235**	16,179
– Furniture leather	**43,024**	30,333
– Automotive leather	**1,857**	64
– Leather garments	**–**	345
– Others	**5,583**	3,805
– Unallocated corporate items	**–**	10,542
	87,699	61,268

6. SEGMENT INFORMATION *(Continued)*

Balance Sheets

	As at December 31,	
	2005	2004
	RMB'000	RMB'000
ASSETS		
Segment assets		
– Upholstered furniture	**1,741,547**	1,111,436
– Furniture leather	**1,600,250**	1,635,120
– Automotive leather	**177,704**	110,428
– Leather garments	**–**	28,676
– Others	**82,598**	34,227
Unallocated corporate assets	**839,591**	1,117,057
	4,441,690	4,036,944
LIABILITIES		
Segment liabilities		
– Upholstered furniture	**525,898**	227,827
– Furniture leather	**206,128**	236,496
– Automotive leather	**12,204**	71,684
– Leather garments	**–**	6,328
– Others	**39,762**	19,149
Unallocated corporate liabilities	**1,359,832**	2,274,084
	2,143,824	2,835,568

Geographical segments

Most of the identifiable assets of the Group are located in the PRC.

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

	2005	2004
	RMB'000	RMB'000
United States	**2,383,797**	1,915,701
PRC, including Hong Kong	**727,001**	637,763
Russia	**563**	131,742
Europe	**119,709**	89,659
Australia	**187,543**	70,427
Others	**56,844**	7,099
	3,475,457	2,852,391

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

7. OTHER INCOME

Details of other income are as follows:

	2005 RMB'000	2004 RMB'000
Government grants		
Grants for technology development	**180**	5,918
Grants for export sales	**6,786**	3,031
Incentive for business development in Zhejiang Province	**4,500**	15,444
Other grants	**928**	2,000
	12,394	26,393
Sales of raw materials	**29,765**	138,868
Interest income	**7,487**	4,106
Discounts on acquisition of an additional interest in a subsidiary/Release of negative goodwill on acquisition of subsidiaries	**5,300**	518
Value added tax refund	**–**	13,903
Others	**7,339**	6,107
	62,285	189,895

During the year, the Group received government grants of RMB717,117 (2004: RMB25,007,000) which are related to the prepaid lease payment made by the Group for interest in land use rights. The amounts have been deducted from the prepaid lease payment.

8. FINANCE COSTS

	2005 RMB'000	2004 RMB'000
Interest on:		
Bank borrowings wholly repayable within five years	**94,245**	77,340
Other borrowings wholly repayable within five years	**3,536**	2,975
Other borrowings not wholly repayable within five years	**510**	205
Convertible loan notes	**13,249**	14,899
	111,540	95,419

9. PROFIT BEFORE TAXATION

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

	2005 RMB'000	2004 RMB'000
Amortization of intangible assets (included in administrative expenses)	**225**	113
Depreciation of property, plant and equipment	**87,474**	61,155
Total depreciation and amortization	**87,699**	61,268
Auditors' remuneration	**3,620**	2,255
Cost of sales of raw materials (included in other expenses)	**18,230**	128,163
Impairment loss recognized in respect of trade and other receivables	**5,630**	9,968
(Gain) loss on disposal of property, plant and equipment	**(26)**	833
Operating lease rentals in respect of land and buildings	**1,878**	1,290
Net foreign exchange losses	**15,263**	3,018
Release of prepaid lease payment	**3,436**	3,201
Research, design and product development	**26,399**	10,630
Allowances for inventories	**3,532**	32,273
Total employee benefit expenses	**237,063**	190,221

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

10. DIRECTORS AND EMPLOYEES' REMUNERATION

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

2005

	Zhu Zhangjin ("Mr. Zhu") RMB'000	Zhou Xiaosong RMB'000	Zhu Jianqi RMB'000	Sun Qiang Chang RMB'000	Lu Yungang RMB'000	Chow Joseph RMB'000	Shi Zhengfu RMB'000	Jiang Jianzhong RMB'000	Total RMB'000
Fees	–	–	–	–	–	–	–	–	–
Other emoluments									
Salaries and other benefits	220	196	196	–	–	–	–	95	707
Contributions to retirement benefits schemes	2	2	2	–	–	–	–	11	17
Total emoluments	222	198	198	–	–	–	–	106	724

2004

	Mr. Zhu RMB'000	Zhou Xiaosong RMB'000	Zhu Jianqi RMB'000	Sun Qiang Chang RMB'000	Lu Yungang RMB'000	Chow Joseph RMB'000	Shi Zhengfu RMB'000	Jiang Jianzhong RMB'000	Total RMB'000
Fees	–	–	–	–	–	–	–	–	–
Other emoluments									
Salaries and other benefits	100	88	88	–	–	–	–	74	350
Contributions to retirement benefits schemes	2	2	2	–	–	–	–	26	32
Total emoluments	102	90	90	–	–	–	–	100	382

Note: Mr. Jiang Jianzhong was resigned as director on June 17, 2005.

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

Of the five individuals with the highest emoluments in the Group, three (2004: four) were directors of the Company whose emoluments are included in the disclosures as above. The emoluments of the remaining individuals was as follows:

	2005 RMB'000	2004 RMB'000
Basic salaries and other benefits	**650**	169
Contributions to retirement benefits schemes	**14**	8
	664	177

The emoluments of each of the five highest paid individuals are less than HK$1,000,000 (equivalent to approximately RMB1,040,000) for the year.

During the year, no emoluments were paid by the Group to the directors and five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

11. TAXATION

	2005 RMB'000	2004 RMB'000
Hong Kong Profits Tax		
– current year	**718**	–
– under-provision in previous year	**425**	–
PRC enterprise income tax		
– current year	**19,504**	22,646
– over-provision of income tax	**(2,336)**	–
	18,311	22,646

Hong Kong Profits Tax is calculated at 17.5% of estimated assessable profit for the year.

PRC enterprise income tax is calculated at the applicable rates to the PRC subsidiaries. Certain subsidiaries of the Company operating in the PRC are eligible for certain tax holidays and concessions and were exempted from PRC income taxes for the year ("Tax Holidays").

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

11. TAXATION *(Continued)*

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

	2005 **RMB'000**	2004 RMB'000
Profit before taxation	**278,665**	257,176
Tax rate applicable to the major operation of the Group	**26.4%**	26.4%
Tax at the applicable rate	**73,568**	67,894
Tax effect of income not taxable for tax purpose	**(1,460)**	(138)
Tax effect of expenses/losses not deductible for tax purpose	**3,129**	3,931
Tax effect of deferred tax assets not recognized	**147**	–
Tax effect of tax losses not recognized	**6,406**	9,897
Tax effect of share of result of an associate	**294**	–
Utilization of tax loss previously not recognized	**(1,464)**	–
Effect of Tax Holidays	**(61,184)**	(57,463)
Tax effect of different tax rates of subsidiaries operating with different tax regulations in the PRC and in Hong Kong	**786**	(1,475)
Over-provision in previous years	**(2,336)**	–
Under-provision in previous years	**425**	–
Taxation for the year	**18,311**	22,646

At December 31, 2005, the Group has unused tax losses of approximately RMB32,041,000 (2004: RMB45,432,000) available to offset against future profits. The unrecognized tax losses can be utilized to offset against future profits within five years from the date of incurrence.

In the opinion of the directors of the Company, no deferred tax asset has been recognized in 2005 and 2004 as the effect to the Group's financial statement was immaterial.

12. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share attributable to the equity holders of the Company is based on the following data:

Earnings

	2005 **RMB'000**	2004 RMB'000
Earnings for the purposes of basic earnings per share, being profit attributable to equity holders of the Company	**265,699**	225,701
Effect of dilutive potential ordinary shares: Interest on convertible loan notes	**13,249**	14,899
Earnings for the purposes of diluted earnings per share	**278,948**	240,600

Number of shares

	2005	2004
Weighted average number of ordinary shares for the purposes of basic earnings per share	**645,419,597**	476,675,977
Effect of dilutive potential ordinary shares: Convertible loan notes	**179,512,056**	207,951,216
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**824,931,653**	684,627,193

The weighted average number of ordinary shares for the purpose of calculating basic and diluted earnings per share attributable to the equity holders of the Company for the year has been retrospectively adjusted for the effect of the share consolidation completed during the year.

13. GOODWILL

	RMB'000
GROSS AMOUNT	
At January 1, 2004	–
Arising on acquisition of an additional interest in subsidiaries during the year ended December 31, 2004	181,006
At December 31, 2004 and December 31, 2005	181,006

Goodwill arose from the Group's acquisition of SFT International Pty. Ltd. ("SFT") in September 2004 (see note 32).

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. Before recognition of impairment losses, the carrying amount of goodwill had been allocated under 'upholstered furniture' segment and 'automotive leather' segment.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

13. GOODWILL *(Continued)*

	2005 **RMB'000**	2004 RMB'000
Upholstered furniture	**176,899**	176,899
Automotive leather	**4,107**	4,107
	181,006	181,006

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next three years and extrapolates cash flows for the following five years based on an estimated growth rate of 10%. This rate does not exceed the average long-term growth rate for the relevant markets. The rate used to discount the forecast cash flows is 5%.

The directors considered no impairment loss on goodwill is necessary at December 31, 2005.

14. NEGATIVE GOODWILL

	RMB'000
GROSS AMOUNT	
At January 1, 2004 and at December 31, 2004	5,186
RELEASED TO INCOME	
At January 1, 2004	273
Released to income	518
At December 31, 2004	791
CARRYING AMOUNT	
At December 31, 2004	4,395
Derecognized upon the application of IFRS	(4,395)
At January 1, 2005	–

Prior to January 1, 2005, the negative goodwill was released to income on a straight line basis over ten years.

15. PROPERTY, PLANT AND EQUIPMENT

	Buildings RMB'000	Plant and equipment RMB'000	Motor vehicles RMB'000	Furniture, fixtures and equipment RMB'000	Construction in progress RMB'000	Total RMB'000
COST						
At January 1, 2004	253,181	237,159	16,509	21,970	269,320	798,139
Additions	37,007	174,098	9,503	11,700	506,489	738,797
Disposals	(13)	(4,512)	(17)	(192)	(17,632)	(22,366)
Disposal of subsidiaries	(139,539)	(48,306)	(3,611)	(1,298)	(35,541)	(228,295)
Transfers	540,821	22,002	206	1,380	(564,409)	–
At January 1, 2005	691,457	380,441	22,590	33,560	158,227	1,286,275
Additions	12,923	77,539	4,076	14,187	122,346	231,071
Disposals	(11,262)	(8)	–	–	–	(11,270)
Transfers	190,571	17,186	162	18	(207,937)	–
At December 31, 2005	**883,689**	**475,158**	**26,828**	**47,765**	**72,636**	**1,506,076**
DEPRECIATION						
At January 1, 2004	26,525	55,661	6,941	5,578	–	94,705
Provided for the year	22,567	30,900	3,321	4,367	–	61,155
Disposal of subsidiaries	(6,990)	(7,751)	(769)	(222)	–	(15,732)
Eliminated on disposals	–	(644)	(4)	(117)	–	(765)
At January 1, 2005	42,102	78,166	9,489	9,606	–	139,363
Provided for the year	38,133	37,751	3,838	7,752	–	87,474
Eliminated on disposals	(1,991)	–	–	–	–	(1,991)
At December 31, 2005	**78,244**	**115,917**	**13,327**	**17,358**	**–**	**224,846**
CARRYING AMOUNTS						
At December 31, 2005	**805,445**	**359,241**	**13,501**	**30,407**	**72,636**	**1,281,230**
At December 31, 2004	649,355	302,275	13,101	23,954	158,227	1,146,912

The buildings are located on the land leased under medium-term land use rights in the PRC.

The above items are depreciated on a straight line basis at the following rates per annum:

Buildings	shorter of the lease term or useful life
Plant and machinery	10-15 years
Motor vehicles	5 years
Furniture, fixtures and equipment	5-10 years

Construction in progress are not depreciated until completion of construction and are ready for their intended use.

The Group has pledged its buildings with a net book value of approximately RMB486,878,000 (2004: RMB209,150,000) to secure general banking facilities granted to the Group.

As at December 31, 2005, the title deeds of the buildings in amount of RMB49 million (2004: RMB475 million) has not been obtained. The directors believe that the relevant title deeds will be granted in the due course and the absence of official certificate does not impair the value of the relevant properties of the Group.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

16. PREPAID LEASE PAYMENTS

The prepaid lease payments made by the Group are interest in land use rights under medium-term lease in the PRC and an amount of approximately RMB87,144,000 (2004: RMB27,575,000) had pledged to banks to secure the borrowings of the Group granted by the banks.

	2005	2004
	RMB'000	RMB'000
Analysed for reporting purposes as:		
Non-current asset	**142,812**	140,801
Current asset	**3,543**	3,436
	146,355	144,237

	2005	2004
	RMB'000	RMB'000
Without title deeds	**17,911**	30,864
With temporary title deeds	**9,500**	86,433
With formal title deeds	**118,944**	26,940
	146,355	144,237

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

17. INTANGIBLE ASSETS

	RMB'000
COST	
At January 1, 2004	316
Additions	761
At January 1, 2005	1,077
Additions	397
At December 31, 2005	**1,474**
ACCUMULATED AMORTIZATION	
At January 1, 2004	59
Provided for the year	113
At January 1, 2005	172
Provided for the year	225
At December 31, 2005	**397**
CARRYING AMOUNT	
At December 31, 2005	**1,077**
At December 31, 2004	905

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

18. INTEREST IN AN ASSOCIATE

The interest in an associate represents a 25% interest in 海寧美景海綿有限公司(Future Foam Asia, Inc.) ("Future Foam"), an equity joint venture established in the PRC in 2004. The associate was established for the principal purpose of manufacturing foam used in sofa production and has commenced business in 2005.

	2005 RMB'000	2004 RMB'000
Cost of investment in associates	**10,241**	5,173
Share of post-acquisition loss	**(1,114)**	–
	9,127	5,173
Summarized financial information relating to the associate		
Total assets	**59,664**	28,455
Total liabilities	**(23,156)**	(5)
Net assets	**36,508**	28,450
Group's share of net assets of associates	**9,127**	5,173
Revenue	**6,639**	–
Loss for the year	**(4,456)**	–
Group's share of associate's loss for the year	**(1,114)**	–

19. INTEREST IN A JOINTLY CONTROLLED ENTITY

The interest in a jointly controlled entity represents a 50% interest in 海寧市卡森-美如可思皮革有限公司 (Haining City Kasen-Melx Leather Co., Ltd.) ("Kasen-Melx"), an equity joint venture established in the PRC. The jointly controlled entity was established for the principal purpose of trading leather and other furniture products and has commenced business in August 2005.

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

	2005 RMB'000	2004 RMB'000
Cost of unlisted investments in jointly controlled entities	**811**	–

The jointly controlled entity had a loss of approximately RMB8,000 since date of incorporation to December 31, 2005.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

20. AVAILABLE-FOR-SALE INVESTMENTS

The amount represents investments in unlisted equity securities issued by private entities incorporated in the PRC. As a range of reasonable fair value estimates is so significant, the directors of the Company are of the opinion that the fair value of these investments cannot be measured reliably. The amount is measured at cost less impairment at each balance sheet date.

During the year, an amount of approximately RMB2,100,000 of investments had been disposed of by the Group and the gain on disposal was approximately RMB305,000.

21. INVENTORIES

	2005 **RMB'000**	2004 RMB'000
Raw materials	**389,974**	377,089
Work in progress	**823,296**	866,750
Finished goods	**165,572**	148,899
	1,378,842	1,392,738

22. TRADE AND OTHER RECEIVABLES

	2005 **RMB'000**	2004 RMB'000
Trade receivables	**549,341**	296,908
Less: accumulated impairment loss	**(34,908)**	(26,360)
	514,433	270,548
Prepayments	**154,247**	108,018
Other receivables	**136,490**	163,323
Less: accumulated impairment loss	**(9,505)**	(12,423)
	795,665	529,466

22. TRADE AND OTHER RECEIVABLES *(Continued)*

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

	2005 RMB'000	2004 RMB'000
Aged:		
Within 60 days	**355,407**	226,629
60-90 days	**51,342**	12,903
91-180 days	**63,429**	18,189
181-365 days	**43,139**	11,344
1-2 years	**1,116**	1,483
Total trade receivables, net of impairment loss	**514,433**	270,548

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

23. HELD FOR TRADING INVESTMENTS

	2005 RMB'000	2004 RMB'000
Equity securities listed in the PRC, at fair value	**–**	3,505

The fair values have been determined by reference to bid prices quoted in active markets.

The equity securities had been disposed of in 2005.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

24. AMOUNTS DUE FROM (TO) RELATED COMPANIES

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

	Name of related companies	Notes	2005 RMB'000	2004 RMB'000
(a)	**Operating in nature**			
	海寧宇潔物資回收有限公司 Haining Yujie Material Recycling Co., Ltd. ("Yujie")	(i), (ii)	**2,705**	14,355
	伊犁霍爾果斯皮革有限公司 Yili Horgos Leather Co., Ltd. ("Yili Horgos")	(i), (ii), (iii)	**(47,219)**	1,521
	白銀卡森皮革有限公司 Baiyin Kasen Leather Co., Ltd. ("Baiyin Kasen")	(i), (ii), (iii)	**(2,130)**	(37,118)
	克孜勒蘇新蓉皮革有限公司 Kezilesu Xinrong Leather Co., Ltd. ("Kezilesu Xinrong")	(i), (ii), (iii)	**(848)**	3,832
	白銀白利斯皮革有限公司 Baiyin Palace Leather Co. Ltd. ("Baiyin Palace")	(i), (iii)	**–**	591
	Starcorp Corporation Pty. Ltd ("Starcorp")	(i), (ii)	**17,963**	3,083
	Kasen UK Co. Ltd.	(iv)	**–**	2,985
	海寧萬盛絲綢噴織有限公司 Haining Wansheng Silk Weaving Co., Ltd. ("Wansheng Silk")	(ii), (vi)	**(5,960)**	(9,971)
	上海森橋皮業有限公司 Shanghai Sunbridge Leather Industry, Co., Ltd. ("Subridge Leather")	(i)	**–**	5,431
	Future Foam	(ii)	**(3,532)**	–
	Kasen-Melx	(ii)	**(339)**	–
	上海思達傢俱有限公司(Shanghai Star Furniture Co., Ltd)	(i), (ii)	**(259)**	–
(b)	**Non-operating in nature**			
	周慧敏	(v), (vii)	**59**	–
	孫時良	(v), (vii)	**526**	–
	浙江森橋實業集團有限公司 Zhejiang Sunbridge Industrial (Group) Co., Ltd. ("Sunbridge")	(iv)	**–**	141,997
	海寧富華皮件有限公司 Haining Fuhua Leather Co., Ltd. ("Haining Fuhua")	(vi)	**–**	(13,000)
	海寧長虹進出口有限公司 Haining Changhong Import and Export Co., Ltd. ("Changhong I&E")	(vi)	**–**	(5,620)
	海寧長虹皮件有限公司 Haining Changhong Leather Co., Ltd. ("Changhong Leather")	(vi)	**–**	(8,580)
			(39,034)	99,506
	Represented by:			
	Amounts due from related companies, included in current assets		**21,253**	173,795
	Amounts due to related companies, included in current liabilities		**(60,287)**	(74,289)
			(39,034)	99,506

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

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

	2005		2004	
	Amounts due from related companies RMB'000	**Amounts due to related companies RMB'000**	Amounts due from related companies RMB'000	Amounts due to related companies RMB'000
Aging:				
Within 60 days	**4,588**	**(14,484)**	24,310	(12,661)
60 – 90 days	**3,900**	**(544)**	1,084	(10,680)
91 – 180 days	**12,100**	**(45,259)**	3,944	(18,138)
181 – 365 days	**80**	**–**	2,460	(5,610)
	20,668	**(60,287)**	31,798	(47,089)

Details of the operating transactions with the related parties are set out in note 39.

Notes:

(i) Mr. Zhu has influence and beneficial interests in these companies through Sunbridge.

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

(iii) The companies ceased to be subsidiaries of the Company since December 2004.

(iv) Mr. Zhu has influence and beneficial interests in these companies.

(v) The individuals are directors of the non-wholly owned subsidiaries of the Company.

(vi) A director of a non-wholly owned subsidiary has influence and beneficial interests in these companies.

(vii) The amounts are unsecured, interest-free and repayable on demand.

The directors consider that the carrying amount of amounts due from (to) related companies approximates their fair value.

25. BANK BALANCES AND CASH

(a) Pledged bank deposits

The amount mainly represents deposits pledged to banks to secure the bills payable issued by the Group and the bank facilities granted to the Group.

The deposits carry an average interest rate of 0.72%. The pledged bank deposits will be released upon the settlement of relevant bills payables and bank borrowings. The fair value of the bank deposits at December 31, 2005 approximates the carrying amount.

(b) Bank balances and cash

Bank balances and cash comprised of bank deposits with short maturity at market interest rate and cash on hand.

The fair value of the bank balances and cash at December 31, 2005 approximates the carrying amount.

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

26. TRADE, BILLS AND OTHER PAYABLES

The aging analysis of trade payables is as follows:

	2005 RMB'000	2004 RMB'000
Aged:		
Within 60 days	**321,512**	339,688
60-90 days	**33,685**	61,320
91-180 days	**49,869**	40,140
181-365 days	**15,974**	12,032
1-2 years	**6,643**	6,160
Over 2 years	**3,206**	630
Total trade payables	**430,889**	459,970
Bills payables (note)	**183,403**	214,838
Other payables and accrued liabilities	**169,700**	198,574
	783,992	873,382

Note:

The aging analysis of bills payable is follows:

	2005 RMB'000	2004 RMB'000
Aged:		
Within 60 days	**81,026**	214,838
60-90 days	**58,959**	–
91-180 days	**43,418**	–
	183,403	214,838

During the year of 2003, the local government paid approximately RMB53 million to the Group for the construction of certain infrastructure and public facilities on local government's behalf in a location which is under-developed. The Group applied the amount received from the government to the construction of such facilities and entered into various construction contracts. Up to December 31, 2005, the Group recorded a balance of approximately RMB21 million which had not been utilized in the constructions and was included in other payables and accrued liabilities. Details of the capital commitments of the Group relating to the construction contracts at the balance sheet dates are set out in note 38.

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

27. BANK AND OTHER BORROWINGS

	2005 **RMB'000**	2004 RMB'000
Bank borrowings	**1,281,338**	1,564,917
Other borrowings	**10,400**	10,400
Total	**1,291,738**	1,575,317
Analyzed as:		
Secured	**502,038**	202,470
Unsecured	**789,700**	1,372,847
	1,291,738	1,575,317
Denominated in United States Dollars ("US dollars")	**94,246**	53,383
Denominated in Renminbi ("RMB")	**1,197,492**	1,521,934
	1,291,738	1,575,317
The bank and other borrowings are repayable as follows:		
Within one year or on demand	**1,191,246**	1,472,825
In the one to second year	**90,092**	2,000
In the second to third year	**–**	90,092
After five years	**10,400**	10,400
	1,291,738	1,575,317
Less: Amount due within one year shown under current liabilities	**(1,191,246)**	(1,472,825)
Amount due after one year	**100,492**	102,492

All the bank borrowings of the Group are fixed-rate borrowings and carry interests ranging from 4% to 8% per annum.

Other borrowings represent loans advanced by independent third parties and carry fixed interests of 2.55% per annum.

The borrowings were guaranteed by group companies, related parties and independent third parties and were also secured by the assets owned by the Group. Details of the assets pledged by the Group and the corporate guarantees given by related parties in favour of the Group's borrowings are set in notes 36 and 39(b), respectively.

The directors consider that the carrying amount of bank and other borrowings approximates their fair value.

According to the loan agreement with Citic Ka Wah Bank Limited, Orix Asia Limited and China Citic Bank, Hangzhou Branch (hereinafter refer to as "the Lenders") dated on December 30, 2005, the Lenders provide a subsidiary of the Company a loan facility of up to an aggregate principal amount of HK$125,000,000 with an annual interest rate of HIBOR plus 2%. The loan facility of HK$125,000,000 has been fully drawn down in January 2006.

28. CONVERTIBLE LOAN NOTES

In 2003 and 2004, the Company issued convertible loan notes and details of the notes are set out as follows:

Date of issue	Loan amount	Conversion price	Number of ordinary shares for conversion	Terms
July 2, 2003	US$21,739,130.43	US$0.1	217,391,304 ordinary shares (equivalent to 144,927,536 Consolidated Shares)	Due within one year
January 9, 2004	US$15,000,000.00	US$0.15	100,000,000 ordinary shares (equivalent to 66,666,667 Consolidated Shares)	Due within one year

The loan notes are converted into an aggregate of 317,391,304 Preferred Shares and ultimately to convert into an aggregate of 317,391,304 ordinary shares (equivalent to 211,594,203 Consolidated Shares) of the Company.

If the above loan notes have not been converted, they will be redeemed on the assigned date according to the agreements at par. The loan notes bear interest at a prime lending rate charged by a bank until repayment or the conversion of the entire loan amount.

Upon the maturity dates of the above loan notes, the Company and the loan notes holder had entered into supplemental extension agreements to extend the maturity dates.

On August 5, 2005, the Group and the loan notes holder entered into the supplemental agreement and the number of shares for conversion was changed from an aggregate of 317,391,304 ordinary shares (equivalent to 211,591,203 Consolidated Shares) to an aggregate of 386,959,713 ordinary shares (equivalent to 257,973,142 Consolidated Shares).

On October 20, 2005, the Company completed the loans notes conversion and were converted into an aggregate of 257,973,142 Consolidated Shares of US$0.00015 each and credited as fully paid. (see note 29(ix))

According to the terms of the loan notes, upon conversion of the loan amount, any accrued but unpaid interest on the loan notes shall cease to be payable. Upon conversion, the accrued but unpaid interest, included in the other payables, amounted to approximately US$3,942,000 (equivalent to approximately RMB32,823,000) and had credited as share premium of the Company.

The convertible loan notes contain two components, liability and equity elements. The convertible loan notes were split between the liability and equity elements upon issue. The equity element is presented in equity heading "equity reserve".

The movement of the liability component of the convertible loan notes for the year is set out below:

	2005 **RMB'000**	2004 RMB'000
Liability component at the beginning of the year	**304,934**	304,934
Converted into ordinary shares	**(304,934)**	–
	–	304,934

29. SHARE CAPITAL

	Number of ordinary shares	Number of series A preferred shares	Number of series B preferred shares	
				US$'000
Authorized share capital of the Company				
At January 1, 2004	399,782,608,696	217,391,304	–	40,000
Changes during the year ended December 31, 2004 (note vi)	(100,000,000)	–	100,000,000	–
At January 1, 2005	399,682,608,696	217,391,304	100,000,000	40,000
Shares consolidation (note vii)	(133,227,536,232)	–	–	–
Shares re-designation and re-classification (note x)	211,594,202 $^{2}/_{3}$	(217,391,304)	(100,000,000)	–
At December 31, 2005	**266,666,666,666 $^{2}/_{3}$**	**–**	**–**	**40,000**

	Number of ordinary shares	Number of series A preferred shares	Number of series B preferred shares		Equivalent to
				US$	RMB'000
Issued and fully paid ordinary shares of the Company					
At January 1, 2004	231,095,052	–	–	23,110	192
Issued during the year ended December 31, 2004	598,799,678	–	–	59,880	497
At January 1, 2005	829,894,730	–	–	82,990	689
Shares consolidation (note vii)	(276,631,577)	–	–	–	–
Issued upon conversion of convertible loan notes	–	176,693,933	81,279,209	38,696	321
Conversion of preference shares to ordinary shares (note ix)	257,973,142	(176,693,933)	(81,279,209)	–	–
Issued on public floatation (note x)	202,809,074	–	–	30,421	246
At December 31, 2005	**1,014,045,369**	**–**	**–**	**152,107**	**1,256**

29. SHARE CAPITAL *(Continued)*

During the year, the changes in share capital of the Company are as follows:

(i) On January 21, 2004, 16,666,666 ordinary shares of US$0.0001 each were allotted and issued to investors for US$2,500,000.

(ii) On September 16, 2004, 362,319 ordinary shares of US$0.0001 were allotted and issued to a then employee for US$36,232.

(iii) On September 16, 2004, 144,025,170 ordinary shares of US$0.0001 were allotted and issued to Mr. Zhu for acquisition of a subsidiary.

(iv) On September 16, 2004, 16,666,667 ordinary shares of US$0.0001 were allotted and issued to Mr. Zhu for assumption of a loan of US$2,500,000 which was originally owed by the Group to SFT which Mr. Zhu has beneficial interests.

(v) On September 16, 2004, 421,078,856 ordinary shares of US$0.0001 were issued to the shareholders of Zhejiang Kasen Industrial Co., Ltd., a subsidiary of the Company at an aggregate consideration of US$20,485,160 for the purpose of the group reorganization that completed at the same date.

(vi) On September 28, 2004, the authorized share capital of the Company was further amended by adoption of the second amended and restated memorandum of association through special resolution of members to US$40,000,000 divided into 399,682,608,696 ordinary shares of US$0.0001 each and 217,391,304 series A Preferred Shares of US$0.0001 each and 100,000,000 series B Preferred Shares of US$0.0001 each ("collectively termed as "Preferred Shares").

(vii) On September 24, 2005, every 1.5 ordinary shares in the capital of the Company of US$0.0001 each were consolidated into 1 ordinary share of US$0.00015 each ("Consolidated Share"). Such that the authorized share capital of the Company consisted of 266,455,072,464 ordinary shares of US$0.00015 each, 217,391,304 series A Preferred Shares of US$0.0001 each and 100,000,000 series B Preferred Shares of US$0.0001 each.

(viii) On September 26, 2005, a total of $5^{1}/_{3}$ ordinary shares of US$0.00015 each arising from the share consolidation stated in (vii) above were transferred for free to an employee, of which $^{1}/_{3}$ share was immediately repurchased by the Company from that employee and then cancelled.

(ix) On October 20, 2005, loans in the aggregate amount of US$36,739,130.43 owing by the Company were converted into an aggregate of 317,391,304 Preferred Shares which were allotted to the loan notes holder conditionally upon the listing of Company's share in the Stock Exchange. All such Preferred Shares had been converted in full into an aggregate of 257,973,142 Consolidated Shares on the same date.

29. SHARE CAPITAL *(Continued)*

(x) On October 20, 2005, 202,809,074 Consolidated Shares were issued to the public at a price of approximately US$0.327 (equivalent to HK$2.55) for cash. The excess of the issued price over the par value of the Consolidated Shares was credited to share premium account of the Company. The authorized share capital of the Company was re-designated by the adoption of the third amended and restated memorandum of association through special resolution of members passed on September 24, 2005 as US$40,000,000 divided into 266,666,666,666$^{2}/_{3}$ ordinary shares of US$0.00015 each.

30. SHARE OPTION SCHEME

A share option scheme was adopted by the Company pursuant to a resolution passed on September 26, 2005 (the "Scheme") for the primary purpose of providing incentives to directors and eligible employees. The Scheme became effective on October 20, 2005 and the options issued pursuant to the Scheme will expire no later than 10 years from the date of grant of the option. Under the Scheme, the board of directors of the Company may grant options to any employees of the Company or any of its subsidiaries to subscribe shares of the Company.

For any options granted to directors, chief executives or substantial shareholders of the Company, options to be granted shall be approved by the independent non-executive directors (excluding any independent non-executive director who is the proposed grantee of options).

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company on October 20, 2005 (representing 101,404,536 shares of the Company) without prior approval from the Company's shareholders. The number of shares issued and to be issued in respect of options granted and may be granted to any individual in any one year is not permitted to exceed 1% of the total shares of the Company in issue at any point in time, without prior approval from the Company's shareholders.

The amount payable on acceptance of an option is HK$1.00. The exercise price is determined by the directors of the Company, and will not be less than the higher of (i) the closing price of the Company's shares on the date of grant, (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share.

No share option has been granted during the year since the date of adoption of the Scheme.

Subsequent to the balance sheet date, 30,200,000 share options granted to certain directors and employees of the Group.

31. STATUTORY AND SPECIAL RESERVES

(a) The statutory reserve represents amounts appropriated from the profits after tax of certain subsidiaries of the Company established in the PRC to comply with the PRC laws and regulations.

(b) The special reserve represents the difference between the nominal value of the share capital issued by the Company and the nominal value of the share capital of Zhejiang Kasen acquired pursuant to the reorganization completed in 2004.

32. PURCHASE OF SUBSIDIARIES

On September 16, 2004, the Group acquired a 100% interest in SFT from Mr. Zhu. SFT owned a number of equity investments in the subsidiaries of the Company and these subsidiaries are engaged in the business segment of upholstered furniture and automotive leather. These transactions have been accounted for by purchase method of accounting:

	2004 Fair value and carrying amount RMB'000
Net assets acquired:	
Amount due from a related company	20,750
Trade and other payables	(81)
	20,669
Minority interests, representing acquisition of additional interests in subsidiaries	85,613
Goodwill arising on acquisition	181,006
	287,288
Satisfied by:	
Issue of shares, at fair value (Note)	287,288

Note: In connection with the acquisition of SFT from Mr. Zhu, the Company issued Mr. Zhu an aggregate of 160,691,837 ordinary shares, of which 16,666,667 ordinary shares were issued to exchange a loan of US$2,500,000 which was originally owed by the Group to SFT. In determining the fair value of the 160,691,837 ordinary shares issued, an analysis of other publicly traded companies that are comparable to the Company was performed by the management. The estimation of fair value was primarily based on a market approach where prevailing market conditions as at of the date of issuance of the ordinary shares and in particular quoted prices for the shares of those comparable publicly traded companies were considered.

The subsidiaries acquired during the year ended December 31, 2004 contributed the profits attributable to equity holders of the Company of approximately RMB8,097,000.

33. DISPOSAL OF SUBSIDIARIES

On November 11, 2004, the Group disposed of certain subsidiaries to Sunbridge. During the year, the Group disposed of its interests in SFT.

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

	2005 **RMB'000**	2004 RMB'000
Property, plant and equipment	–	212,563
Prepaid lease payment	–	3,167
Amounts due from related companies	–	268
Inventories	–	98,311
Trade and other receivables	**1,381**	214,252
Bank balances and cash	–	71,587
Trade and other payables	–	(166,994)
Bank borrowings	–	(232,930)
	1,381	200,224
Minority interests	–	(7,690)
(Loss) gain on disposal	**(1,380)**	3,013
Total consideration	**1**	195,547
Satisfied by:		
Consideration receivable	**1**	195,547
Net cash outflow arising on disposal of subsidiaries:		
Cash consideration	–	–
Cash and cash equivalents disposed of	–	(71,587)
	–	(71,587)

34. MAJOR NON-CASH TRANSACTIONS

(a) During the year ended December 31, 2005, the convertible loan notes holder exercised its rights to convert the entire convertible loan notes into preferred shares and immediately converted to ordinary shares of the Company. Details of the transaction are set out in note 28.

(b) During the year ended December 31, 2004, the Company had issued an aggregate of 160,691,837 ordinary shares of US$0.0001 to Mr. Zhu for the consideration of the acquisition of a 100% interest in SFT (see note 32).

(c) During the year ended December 31, 2004, the Company had issued 362,319 ordinary shares of US$0.0001 to a then employee at a consideration of approximately RMB301,000 as an employee benefit. The amount had included in the staff costs of the Group.

35. RETIREMENT BENEFITS PLAN

The Group contributes to a local municipal government retirement scheme for all qualifying employees in the PRC. The employer and its employees are each required to make contributions to the scheme at the rates specified in the rules. The only obligation of the Group with respect to the retirement scheme is to make the required contributions under the scheme.

In addition, the Group operates a Mandatory Provident Fund ("MPF") Scheme for its qualifying employees in Hong Kong. The assets of the MPF Scheme are held separately from those of the Group, in funds under the control of trustees. The Group contributes at the lower of HK$1,000 or 5% of relevant payroll costs monthly to the MPF Scheme, which contribution is matched by employees.

The total cost charged to the consolidated income statement of approximately RMB8,273,000 (2004: RMB5,925,000) represents contributions payable to the above schemes by the Group in respect of the current accounting period. As at December 31, 2005, contributions of approximately RMB7,873,000 (2004: RMB4,774,000) due in respect of the reporting period had not been paid over to the above schemes.

36. PLEDGE OF ASSETS

At the balance sheet date, certain of the Group's assets have been pledged to secure the borrowings of the Group. The aggregate carrying amount of the assets of the Group at the balance sheet date is as follows:

	2005 **RMB'000**	2004 RMB'000
Prepaid lease payment	**87,144**	27,575
Buildings	**486,878**	209,150
Bank deposits	**240,112**	239,185
	814,134	475,910

37. LEASE ARRANGEMENTS

As lessee

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

	2005 **RMB'000**	2004 RMB'000
Within one year	**1,543**	1,053
In the second to fifth year inclusive	**1,440**	188
	2,983	1,241

The lease payments represent rentals payable by the Group for certain of its office properties. Leases are negotiated for an average term of three years and rentals are fixed for an average of three years.

38. CAPITAL COMMITMENTS

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

	2005 **RMB'000**	2004 RMB'000
Capital expenditure contracted for but not provided in the financial statements in respect of acquisition of property, plant and the equipment	**6,656**	108,365
Capital expenditure contracted for but not provided in the financial statements in respect of construction of certain infrastructure and public facilities in the PRC on behalf of the government (note 26)	**20,991**	33,200
	27,647	141,565

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

39. CONNECTED AND RELATED PARTY DISCLOSURES

Transactions between group companies have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below.

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

Related parties	Nature of transactions	Notes	2005 RMB'000	2004 RMB'000
Yili Horgos	Purchase by the Group		**108,522**	8,806
Baiyin Palace	Sales by the Group		**10,273**	1,130
	Sales of production wastes by the Group		**151**	–
Yujie	Sales of production wastes by the Group		**11,369**	8,739
Baiyin Kasen	Purchase by the Group		**148,680**	9,525
	Sales of production wastes by the Group		**2,259**	–
	Sales by the Group		**–**	1,976
Wansheng Silk	Interest expense charged to the Group		**282**	114
	Purchase by the Group		**9,895**	267
Starcorp	Sales by the Group		**57,443**	3,256
Sunbridge Leather	Sales by the Group		**2,531**	5,952
SFT	Interest expense charged to the Group		**–**	225
Changhong Leather	Interest expense charged to the Group		**436**	126
	Sales by the Group		**269**	–
Changhong I&E	Interest expense charged to the Group		**299**	65
Haining Fuhua	Interest expense charged to the Group		**420**	423
Sunbridge	Disposal of subsidiaries	(i)	**–**	181,997
	Disposal of property, plant and equipment		**4,255**	–

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

Related parties	**Nature of transactions**	Notes	**2005 RMB'000**	2004 RMB'000
Kezilesu Xinrong	Purchase by the Group		**35,981**	–
Future Foam	Purchase by the Group		**4,946**	–
Kasen-Melx	Expense charged to the Group		**403**	–
	Rental income charged by the Group		**6**	–
Mr. Zhu	Acquisition of additional interests in subsidiaries	(ii)	**–**	287,288
Shanghai Star Furniture Co., Ltd.	Purchase by the Group	(iii)	**852**	10
浙江吉恩仕服裝集團進出口有限公司 Zhejiang Jeans Clothing Group Import & Export Co., Ltd.	Purchase by the Group	(iv)	**–**	32,242
	Sales by the Group		**–**	5,149
海寧獵馬皮革服裝有限公司 Haining Liema Leather Garments Co., Ltd.	Purchase by the Group	(v)	**–**	159
	Sales by the Group		**–**	4,833
上海捷恩傢俱有限公司 JCH Home Furnishings Co., Ltd.	Sales by the Group	(iv)	**–**	3,415
浙江森橋進出口有限公司 Zhejiang Sunbridge Import and Export Co., Ltd. ("Sunbridge IPE")	Sales by the Group	(iii)	**–**	4,769
Kasen UK Co. Ltd.	Sales by the Group	(iii)	**–**	8,293
上海星瑩傢俱有限公司 Shanghai Xingying Furniture Co., Ltd.	Sales by the Group	(iii)	**–**	2,134

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

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

Notes:

(i) Details of the transaction are set out in note 33.

(ii) Details of the transaction are set out in note 32.

(iii) Mr. Zhu has beneficial interests in these companies through Sunbridge.

(iv) During the year, the company ceased to be a related party of the Group.

(v) Director of a subsidiary of the Group has beneficial interest in this company.

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

	2005 RMB'000	2004 RMB'000
Wansheng Silk	**8,000**	2,500
孫建新 (Note)	**30,000**	–
Mr. Zhu and his spouse	**–**	30,000
	38,000	32,500

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

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

(d) Details of guarantees given by the Group in favour of banking facilities extended to the third parties are set out in note 40.

40. CONTINGENT LIABILITIES

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

	2005 RMB'000	2004 RMB'000
Guarantees given to banks in respect of banking facilities extended to		
– Independent third parties	**67,897**	261,663
– Sunbridge I&E	**–**	33,000
– Yili Horgos	**–**	80,000
	67,897	374,663

41. BALANCE SHEET OF THE COMPANY

The balance sheet of the Company as at December 31, 2005 is as follows:

	Note	2005 RMB'000	2004 RMB'000
Non-current assets			
Property, plant and equipment		**99**	79
Investments in subsidiaries		**377,038**	654,350
Loans to subsidiaries		**596,401**	78,850
		973,538	733,279
Current assets			
Trade and other receivables		**495**	1,216
Amounts due from subsidiaries		**–**	61,193
Bank balances and cash		**45,267**	7,694
		45,762	70,103
Current liabilities			
Trade and other payables		**10,499**	19,605
Amounts due to subsidiaries		**3,261**	16,029
Convertible loan notes		**–**	304,934
Tax payable		**425**	–
		14,185	340,568
Net current assets (liabilities)		**31,577**	(270,465)
		1,005,115	462,814
Equity			
Share capital	(a)	**1,256**	689
Share premium	(a)	**1,147,408**	308,191
Contributed surplus	(a)	**169,684**	169,684
Exchange reserve	(a)	**(14,460)**	–
Equity reserve	(a)	**–**	1,291
Accumulated losses	(a)	**(298,773)**	(17,041)
		1,005,115	462,814

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

41. BALANCE SHEET OF THE COMPANY *(Continued)*

Note:

(a) Statement of movements in equity

	Share capital RMB'000	Share premium RMB'000	Contributed surplus RMB'000	Exchange reserve RMB'000	Equity reserve RMB'000	Accumulated losses RMB'000
At January 1, 2004	192	–	7	–	1,291	(5,856)
Issue of shares	15	21,036	–	–	–	–
Increase in share issue for Reorganization	349	–	169,677	–	–	–
Acquisition of a subsidiary	133	287,155	–	–	–	–
Loss for the year	–	–	–	–	–	(11,185)
At January 1, 2005	689	308,191	169,684	–	1,291	(17,041)
Issue of shares on public flotation	246	539,000	–	–	–	–
Transaction costs attributable to issue of new shares	–	(38,511)	–	–	–	–
Issue upon conversion of convertible loan notes	321	337,437	–	–	–	–
Transfer to share premium upon conversion of convertible loan notes	–	1,291	–	–	(1,291)	–
Exchange differences arising from translation of functional currency to presentation currency of the Company	–	–	–	(14,460)	–	–
Loss for the year	–	–	–	–	–	(281,732)
At December 31, 2005	**1,256**	**1,147,408**	**169,684**	**(14,460)**	**–**	**(298,773)**

42. PRINCIPAL SUBSIDIARIES

The following table lists the subsidiaries of the Company as at December 31, 2005 which, in the opinion of the directors, principally affected the results or net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

Name of the company	Country of incorporation/ establishment and operations	Issued and fully paid share capital/ registered capital	Attributable equity interest of the Company Direct %	Indirect %	Principal activities
Haining Gaosheng Leather Co., Ltd. 海寧高盛皮革有限公司 (Note a)	PRC	RMB60,000,000	–	89	Production and processing of leather and tailored products
Haining Hainix Sofa Co., Ltd. 海寧吉恩仕沙發有限公司 (Note b)	PRC	US$6,000,000	–	50.5	Production and sale of sofas, dining chairs and other furniture products
Haining Hengsen Furniture Co., Ltd. 海寧恒森傢俱有限公司 (Note a)	PRC	RMB30,000,000	–	100	Production of furniture and glass fiber reinforced plastic products; wood processing
Haining Hidea Furniture Co., Ltd. 海寧慧達傢俱有限公司 (Note b)	PRC	US$5,000,000	–	50.5	Production and sale of sofas, dining chairs and other furniture products
Haining Higher Point Investment Development Co., Ltd. 海寧高點投資發展有限公司 (Note a)	PRC	RMB100,000,000	–	100	Investment holding
Haining Home Impression Furniture Co., Ltd. 海寧家美傢俱有限公司(Note b)	PRC	US$2,000,000	–	100	Production and sale of upholstered furniture
Haining Home Point Furniture Co., Ltd. 海寧家典傢俱有限公司(Note b)	PRC	US$5,000,000	–	100	Production and sale of upholstered furniture
Haining Kareno Furniture Co., Ltd. 海寧卡雷諾傢俬有限公司(Note b)	PRC	US$3,600,000	–	100	Production and sale of upholstered furniture
Haining Kasen Leather Co., Ltd. 海寧卡森皮革有限公司(Note b)	PRC	US$3,000,000	–	100	Production and sale of upholstered furniture

Notes to the Financial Statements (cont'd)

For the year ended December 31, 2005

42. PRINCIPAL SUBSIDIARIES *(Continued)*

Name of the company	Country of incorporation/ establishment and operations	Issued and fully paid share capital/ registered capital	Attributable equity interest of the Company Direct %	Attributable equity interest of the Company Indirect %	Principal activities
Haining Oyi May Sofa Co., Ltd. 海寧歐意美沙發有限公司(Note b)	PRC	US$5,000,000	–	50.5	Production and sale of upholstered furniture
Haining Schinder Tanning Co., Ltd. 海寧森德皮革有限公司(Note b)	PRC	US$1,000,000	–	100	Production and sale of automotive leather
Haining Wansheng Furniture Co., Ltd. 海寧萬盛沙發有限公司(Note b)	PRC	US$5,000,000	–	50.5	Production and sale of upholstered furniture
Haining Xieqiao Senbo Water Co., Ltd. 海寧市斜橋森博水務有限公司 (Note a)	PRC	RMB4,500,000	–	66.67	Collection and transportation of waste water
Richmond International Trading Limited 富華國際貿易有限公司 (Note a)	Hong Kong	HK$100	–	100	Trading of leather and other furniture products
Shanghai La Kassa Furniture Co., Ltd. 上海禾美傢俱有限公司 (Note b)	PRC	US$4,000,000	–	100	Production and sale of upholstered furniture
Zhejiang Kasen Industrial Co., Limited 浙江卡森實業有限公司 (Note c)	PRC	RMB896,240,000	–	100	Research, development, production and sales of furniture leather
Zhejiang Liema Furniture Co., Ltd. 浙江獵馬傢俬有限公司 (Note b)	PRC	US$7,000,000	–	50.5	Production and sale of upholstered furniture

Notes:

(a) The companies are limited liability companies.

(b) The companies are Sino-foreign owned enterprises.

(c) Zhejiang Kasen was established on June 12, 1995 in China as a domestic limited liability company, and was converted into a company limited by shares on August 24, 2001. On July 1, 2004, Zhejiang Kasen was converted to a sino-foreign joint venture enterprise. On August 9, 2004, Zhejiang Kasen became a sino-owned subsidiary of Kasen International Company Limited pursuant to the Reorganization.