



KASEN INTERNATIONAL HOLDINGS LIMITED

(卡森國際控股有限公司)

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

(Stock Code: 496)

ANNUAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED DECEMBER 31, 2006

The board of directors of Kasen International Holdings Limited (the “Company”) is pleased to announce the results of the Company and its subsidiaries (the “Group”) for the year ended December 31, 2006, as follows:

CONSOLIDATED INCOME STATEMENT

For the year ended December 31, 2006

	Notes	2006 RMB'000	2005 RMB'000
Turnover	3	3,916,513	3,475,457
Cost of sales		<u>(3,489,136)</u>	<u>(2,927,194)</u>
Gross profit		427,377	548,263
Other income		71,230	42,675
Distribution costs		(107,908)	(81,524)
Administrative expenses		(171,115)	(113,180)
Other expenses		(29,997)	(4,915)
Share of profit (loss) of associates		937	(1,114)
Finance costs	4	<u>(85,390)</u>	<u>(111,540)</u>
Profit before taxation	5	105,134	278,665
Taxation	6	<u>(21,707)</u>	<u>(18,311)</u>
Profit for the year		<u>83,427</u>	<u>260,354</u>
Attributable to:			
Equity holders of the Company		64,143	265,699
Minority interests		<u>19,284</u>	<u>(5,345)</u>
		<u>83,427</u>	<u>260,354</u>
Dividend	7	114,258	–
Earnings per share	8		
Basic		<u>6 cents</u>	<u>41 cents</u>
Diluted		<u>6 cents</u>	<u>34 cents</u>

CONSOLIDATED BALANCE SHEET

At December 31, 2006

	Notes	2006 RMB'000	2005 RMB'000
NON-CURRENT ASSETS			
Goodwill		157,958	181,006
Property, plant and equipment		1,173,599	1,281,230
Prepaid lease payment – non-current portion		131,860	142,812
Investment properties		32,901	–
Intangible assets		1,485	1,077
Investments in associates		26,728	9,127
Investment in a jointly controlled entity		2,614	811
Available-for-sale investments		310	310
		<u>1,527,455</u>	<u>1,616,373</u>
CURRENT ASSETS			
Inventories		1,326,216	1,378,842
Trade and other receivables	9	633,848	795,665
Prepaid lease payment – current portion		2,904	3,543
Amounts due from related companies	11	36,596	21,253
Taxes recoverable		3,315	13,624
Pledged bank deposits		163,221	240,112
Bank balances and cash		380,973	372,278
		<u>2,547,073</u>	<u>2,825,317</u>
TOTAL ASSETS		<u>4,074,528</u>	<u>4,441,690</u>
CURRENT LIABILITIES			
Trade, bills and other payables	10	604,036	783,992
Amounts due to related companies	11	19,467	60,287
Bank and other borrowings – due within one year		1,246,689	1,191,246
Taxes payable		10,959	7,807
		<u>1,881,151</u>	<u>2,043,332</u>
NET CURRENT ASSETS		<u>665,922</u>	<u>781,985</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>2,193,377</u>	<u>2,398,358</u>
NON-CURRENT LIABILITIES			
Bank and other borrowings – due after one year		10,400	100,492
		<u>10,400</u>	<u>100,492</u>
NET ASSETS		<u>2,182,977</u>	<u>2,297,866</u>
CAPITAL AND RESERVES			
Share capital		1,227	1,256
Reserves		2,107,638	2,198,304
		<u>2,108,865</u>	<u>2,199,560</u>
Equity attributable to equity holders of the Company		2,108,865	2,199,560
Minority interests		74,112	98,306
		<u>2,182,977</u>	<u>2,297,866</u>
Total equity		<u>2,182,977</u>	<u>2,297,866</u>

Notes:

1. GENERAL

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

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

2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

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

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

IAS 1 (Amendment)	Capital Disclosures ¹
IFRS 7	Financial Instruments: Disclosures ¹
IFRS 8	Operating Segments ²
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies ³
IFRIC 8	Scope of IFRS 2 ⁴
IFRIC 9	Reassessment of Embedded Derivatives ⁵
IFRIC 10	Interim Financial Reporting and Impairment ⁶
IFRIC 11	IFRS2: Group and Treasury Shares Transactions ⁷
IFRIC 12	Service Concession Arrangements ⁸

¹ Effective for annual periods beginning on or after January 1, 2007.

² Effective for annual periods beginning on or after January 1, 2009.

³ Effective for annual periods beginning on or after March 1, 2006.

⁴ Effective for annual periods beginning on or after May 1, 2006.

⁵ Effective for annual periods beginning on or after June 1, 2006.

⁶ Effective for annual periods beginning on or after November 1, 2006.

⁷ Effective for annual periods beginning on or after March 1, 2007.

⁸ Effective for annual periods beginning on or after January 1, 2008.

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

3. BUSINESS AND GEOGRAPHICAL SEGMENTS

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

Business segment

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

- Upholstered furniture, comprising leather and fabric upholstered furniture and furniture covers;
- Furniture leather;
- Automotive leather;
- Leather garments (*Note*); and
- Others (including sale of wooden frame and others)

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

Segment information about these businesses is presented below:

Consolidated Income Statement

	Upholstered furniture <i>RMB'000</i>	Furniture leather <i>RMB'000</i>	Automotive leather <i>RMB'000</i>	Others <i>RMB'000</i>	Eliminations <i>RMB'000</i>	Total <i>RMB'000</i>
2006						
Turnover						
External sales	3,122,953	615,104	150,141	28,315	–	3,916,513
Inter-segment sales	<u>603,005</u>	<u>2,249,976</u>	<u>–</u>	<u>126,818</u>	<u>(2,979,799)</u>	<u>–</u>
2005						
Turnover						
External sales	2,755,003	593,121	126,907	426	–	3,475,457
Inter-segment sales	<u>640,091</u>	<u>1,599,461</u>	<u>–</u>	<u>98,347</u>	<u>(2,337,899)</u>	<u>–</u>

Inter-segment sales are charged at prevailing market prices.

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

Geographical segment

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

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

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

4. FINANCE COSTS

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

5. PROFIT BEFORE TAXATION

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

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

6. TAXATION

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

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

PRC enterprise income tax is calculated at the applicable rates to the PRC subsidiaries. Certain subsidiaries of the Company operating in the PRC are eligible for certain tax holidays and concessions and were exempted from PRC income taxes for the years of 2006 and 2005 (“Tax Holidays”). The maximal of Tax Holiday is 5 years from the first taxable profit year.

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

7. DIVIDEND

Dividends recognised as distributions during the year:

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Final 2005 – HK7.59 cents per share	79,575	–
Interim 2006 – HK3.45 cents per share	34,683	–
	<u>114,258</u>	<u>–</u>

8. EARNINGS PER SHARE

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

Earnings

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

Number of shares

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

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

9. TRADE RECEIVABLES

The Group grants a credit period ranging from 30 days to 90 days to their trade customers. The aging analysis of trade receivables (net of allowance for doubtful debts) is as follows:

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

10. TRADE AND BILLS PAYABLES

The aging analysis of trade and bills payables is as follows:

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Aging:		
Within 60 days	286,950	321,512
60 – 90 days	20,807	33,685
91 – 180 days	13,080	49,869
181 – 365 days	10,907	15,974
1 – 2 years	8,719	6,643
Over 2 years	6,445	3,206
	<u>346,908</u>	<u>430,889</u>
Total trade payables		
Aging:		
Within 60 days	61,156	81,026
60 – 90 days	26,937	58,959
91 – 180 days	54,386	43,418
	<u>142,479</u>	<u>183,403</u>
Total bills payables		

11. AMOUNTS DUE FROM (TO) RELATED COMPANIES

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

	2006 Amounts due from related companies <i>RMB'000</i>	2006 Amounts due to related companies <i>RMB'000</i>	2005 Amounts due from related companies <i>RMB'000</i>	2005 Amounts due to related companies <i>RMB'000</i>
Aging:				
Within 60 days	10,421	(12,621)	4,588	(14,484)
60 – 90 days	5,619	(6,105)	3,900	(544)
91 – 180 days	12,067	(706)	12,100	(45,259)
181 – 365 days	6,303	(35)	665	–
1 – 2 years	2,186	–	–	–
	<u>36,596</u>	<u>(19,467)</u>	<u>21,253</u>	<u>(60,287)</u>

12. SHARE OPTION

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

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

The share options could be exercised during the following periods:

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

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

	Number of share options
Granted on March 9, 2006 and outstanding as at December 31, 2006	29,800,000
No share option has been exercised during the year.	

13. PLEDGE OF ASSETS

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

	2006 RMB'000	2005 RMB'000
Buildings	468,517	486,878
Prepaid lease payments	82,125	87,144
Bank deposits	163,221	240,112
	<u>713,863</u>	<u>814,134</u>

14. CAPITAL COMMITMENTS

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

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

15. POST BALANCE SHEET EVENTS

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

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

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

MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS OVERVIEW

Year 2006 has been a challenging period for the Group's operations. The sharp increase of raw material prices and other costs, the appreciation of Chinese currency (the RMB) versus the US dollar, and the reduction of tax rebates for export are major adverse factors. In addition, the slowdown of the US housing market and the associated weak demand of quality furniture, and the intense pricing competition resulted from overcapacity of this industry in China aggravate our business.

For the year ended December 31, 2006, the Group's turnover increased by 12.7% to RMB3,916.5 million (2005: RMB3,475.5 million), while its profit for the year decreased by 68.0% to RMB83.4 million (2005: RMB260.4 million). The profit attributable to equity holders of the Company for 2006 was RMB64.1 million, as compared to RMB265.7 million in 2005.

The Group's gross profit margin in 2006 was 10.9%, representing a decrease of 4.9 percentage points as compared to 2005.

The Group's principal raw materials are cowhides and wet blues, which accounted for approximately 44% of the total cost of sales in 2006. Other major raw materials include chemicals, foam, timber, and fabric.

Since the beginning of 2006, the prices of raw cowhides in the global market have increased by approximately 30%. This was the major contributor to the decline of the gross profit margin. In addition, due to the global inflation of commodities prices, costs of chemicals, foam, timber and, to a lesser extent, labor, also increased.

Approximately 84% of the Group's sales are denominated in US dollars. Although the Group has a natural hedge of approximately 50% by importing raw cowhides and chemicals, the appreciation of the RMB against the US dollar still had a significant impact on the Group's gross margin.

The Group's gross margin was also adversely affected by the provision of RMB9.4 million for obsolete inventory of chemicals. The amount was recorded as cost of sales.

OPERATING EXPENSES, TAXATION AND PROFIT ATTRIBUTABLE TO EQUITY HOLDERS

Under the FOB trading terms, the marine freight charges of almost all the exporting business of the Group were borne by the customers. However, the Group's sales of finished upholstered furniture increased by 22.1%, this has led to an increase of RMB20.4 million, or 31.3% in land transportation costs. In addition, the Group incurred an additional RMB14.7 million in credit insurance, commission and customer clearance charges. As a result, the Group's distribution costs for the period increased by 32.4% compared to last year, and the percentage of distribution costs to turnover rose slightly to 2.8% (2005: 2.3%).

The increase of 51.2% in administrative expenses was mainly due to: (1) a charge of RMB15.4 million on the Group's granting of share options to its executives and employees; (2) an increased provision of RMB10.6 million on trade receivables; (3) an increase of RMB6.0 million in travel and entertainment expenses; (4) an increased exchange loss of RMB3.4 million on the Group's trade receivables arising from the RMB appreciation; and (5) an increase of RMB2.5 million on professional fees.

The Group has gradually reduced its bank borrowings and has been successful in negotiating reduced interest rates on these borrowings. As a result, the Group's finance cost reduced by 23.4% compared to the same period of last year.

During the year under review, the Group assessed the recoverable amount of goodwill arising from previous acquisitions, and determined that goodwill associated with the Group's automotive leather operation and a non-operating subsidiary was impaired by an aggregate of RMB23 million (2005: Nil). This impaired amount was recorded as Other Expenses.

The overall effective tax rate of the Group increased to 20.6% (2005: 6.6%) because: (1) the provisions for share based payment expenses, goodwill impairments, foreign exchange losses etc. are made at consolidation level while income tax is calculated based on profitability at subsidiary level; (2) tax reliefs for the Group's two major profit making subsidiaries have expired; and (3) the provisions made at subsidiary level for bad debts and inventory are non-deductible expenses for PRC tax computation. As a matter of prudence, deferred tax assets have not been recognized in respect of temporary differences arising from the provisions set out above.

For reasons mentioned above, profit attributable to equity holders of the Company decreased by approximately 75.9% to RMB64.1 million (2005: RMB265.7 million).

SALES ANALYSIS BY PRODUCTS

The table below shows the total turnover by product category for the year under review:

	2006		2005		Y-O-Y Change
	<i>RMB' Million</i>	%	<i>RMB' Million</i>	%	%
Upholstered furniture					
Leather Sofa	1,841.5	47.0%	1,550.5	44.6%	18.8%
Fabric Sofa	408.1	10.4%	292.4	8.4%	39.6%
Leather Cut-and-Sew	626.2	16.0%	542.2	15.6%	15.5%
Fabric Cut-and-Sew	247.1	6.3%	370.0	10.7%	(33.2%)
Furniture Leather	615.1	15.7%	593.1	17.0%	3.7%
Automotive Leather	150.1	3.8%	126.9	3.7%	18.3%
Others	28.4	0.8%	0.4	0.0%	N.M.
Total	<u>3,916.5</u>	<u>100%</u>	<u>3,475.5</u>	<u>100%</u>	<u>12.7%</u>

N.M. – Not meaningful.

Upholstered Furniture

The upholstered furniture (including leather and fabric sofas, leather and fabric cut-and-sew) remained the core products of the Group, and its sales accounted for 79.7% of the total turnover in 2006 (2005: 79.3%). The Group's sales of sofa cut-and-sew kits remained largely unchanged as major OEM customers have opted to place more orders on finished sofas. During the year, leather sofa sales increased by 18.8% and fabric sofa sales increased by 39.6%.

Furniture Leather

The Group's priority in furniture leather production is to meet the internal leather requirement of its growing upholstered furniture division. Due to the increase in raw cowhide price and the shortage in cowhide supply pipeline, the Group's external sales of furniture leather only recorded a modest growth of 3.7%.

Automotive Leather

The automotive leather operation, although achieved an 18.3% increase in turnover, continued to be under-performing. Through major US automotive seating companies, such as Intier Automotive and Johnson Controls, we were able to secure supply contract for some major US automotive models. However, due to the reduction in tax rebates for finished leather exports, our price advantage was undermined, which led to less than expected sales volume.

SALES ANALYSIS BY REGIONS

The table below shows the total turnover by geographical market for the year under review:

	2006		2005		Y-O-Y Change
	<i>RMB' Million</i>	%	<i>RMB' Million</i>	%	%
USA	2,825.8	72.2%	2,383.8	68.6%	18.5%
Europe	160.3	4.1%	120.3	3.5%	33.3%
Australia	122.3	3.1%	187.5	5.4%	(34.8%)
PRC, including HK	736.1	18.8%	727.0	20.9%	1.3%
Others	72.0	1.8%	56.9	1.6%	26.5%
Total	<u>3,916.5</u>	<u>100.0%</u>	<u>3,475.5</u>	<u>100.0%</u>	<u>12.7%</u>

The Group continued to expand its markets in the US during the year. In line with the ongoing outsourcing trend of consumption products in the US, the Group's sales increased strongly in this market. After years of efforts, the Group has established long term cooperation with five of the top ten upholstered furniture manufacturers. The Group's sales in the US increased by 18.5% and, as a percentage to the total sales, the turnover in the US accounted for 72.2%.

The Group's expansion into the European market is still at its initial state. The 33.3% increase for this segment is mainly from a one-off sales of finished leather to Russia. As for upholstered furniture, although the total volume remained unchanged, the Group was able to consolidate its customer base by establishing stronger relationships with some major customers.

The Group's strategy of working with retail customers in Australia had caused the termination of supply relationship with a major OEM customer, as a result, the Group's sales to Australia recorded a decrease of 34.8% in 2006.

The Group's sales to the PRC domestic market mainly involved furniture leather and automotive leather, the turnover of which represented 18.8% of its total sales. Business in this segment increased by 1.3% in 2006.

CAPITAL EXPENDITURES

Capital expenditure in 2006 decreased by 53.7% to RMB107.3 million (2005: RMB231.5 million), as most of the expansion for manufacturing facilities was completed prior to 2005. The capital expenditure in 2006 was mainly used in (1) addition of property, plant and machinery for the Higher Point operations; (2) maintenance and replacement of machinery for furniture leather production; and (3) purchase of land. The principal expenditure for these items were approximately RMB44.9 million, RMB28.6 million and RMB33.5 million respectively.

In addition to the above, the Group spent RMB49.9 million in 2006 to acquire the minority interests in two Higher Point subsidiaries.

FINANCIAL RESOURCES AND LIQUIDITY

Net Borrowings

As at December 31, 2006, the Group's net borrowings amounted to RMB1,257.1 million (December 31, 2005: RMB1,291.7 million). The Group's net borrowings primarily comprise of (1) short-term borrowings of RMB1,246.7 million provided by local banks, bearing an interest rate ranging from 4.65% to 8.78% per annum; and (2) government debt of RMB10.4 million, bearing an interest rate of 2.55% per annum.

Turnover Period, Liquidity and Gearing

The Group's inventory primarily represented raw cowhides and wet blues used for production, accounting for approximately 44.7% of the total inventory of RMB1,326.2 million (2005: RMB1,378.8 million). In 2006, the Group endeavoured to control inventory level and managed to decrease its inventory turnover period to 139 days (2005: 172 days).

In 2006, the Group continued to maintain a strict credit policy, resulting in a decrease in account receivables turnover days to 46 days (2005: 54 days).

The Group attempted to shorten the accounts payable credit term so as to cut the purchase costs. As a result, the accounts payable turnover days decreased to 51 days (2005: 77 days).

As at December 31, 2006, the Group's current ratio and quick ratio decreased slightly to 1.35 (December 31, 2005: 1.38) and 0.65 (December 31, 2005: 0.71), respectively. The Group's cash and cash equivalent balance was RMB381.0 million (December 31, 2005: RMB372.3 million). This represents a gearing ratio of 57.1% (December 31, 2005: 55.8%) and a net debt-to-equity ratio of 39.7% (December 31, 2005: 39.6%). The gearing ratio is based on bank borrowings to shareholders' equity and the net debt-to-equity ratio is based on bank borrowings net of cash and cash equivalent to shareholders' equity.

The Group had drawn down a syndicated loan in aggregate of HK\$125,000,000 arranged by CITIC Capital Markets Limited in January 2006. The syndicated loan, with a term of three years, bears interest at 2.00% over 12-month Hong Kong Interbank Offering Rate per annum. In late September 2006, the Group repaid the full amount of loan principal and interest payable to the borrowers of the syndicated loan arrangement.

FOREIGN EXCHANGE EXPOSURE

Starting from July 2005, the Chinese government changed its policy of pegging the value of the RMB to the US dollar. Under the new policy, the RMB has fluctuated within a narrow and managed band against a basket of certain foreign currencies. As a result of this policy change, the RMB appreciated approximately 2.5% and 3.4% against the US dollar in 2005 and 2006, respectively. It is possible that the Chinese government could adopt a more flexible currency policy, which could result in a more significant fluctuation of the RMB against the US dollar.

Considering the limited alternatives of hedging instruments and the restricted currency convertibility of the RMB, the Group neither used any financial instrument for hedging purposes during the year, nor had any hedging instrument outstanding as at December 31, 2006.

The Group's businesses are principally export-related and transactions are primarily denominated in US dollars (approximately 84%). Although a substantial portion of the Group's procurements is denominated in US dollars, management considers that the Group is still exposed to foreign exchange fluctuation risks. Therefore, in the long term our strategies would tend to minimize the mismatch between the US dollar revenue and the RMB costs.

FUTURE PLANS AND PROSPECTS

Looking forward, export-oriented manufacturers for household products in China will continue to face challenges as the RMB is expected to accelerate its appreciation and the Chinese government is under pressure to implement policies to manage the country's massive trade surplus. The Group is of the view that the current macro environment is not favorable to the Group's core businesses.

However, the Group will make every effort to strengthen its position as China's leading manufacturer of leather products and upholstered furniture. The Group aims to achieve its growth with the following initiatives:

Maintaining and strengthening our position as a major OEM partner for the US upholstered furniture industry

The US is currently the largest market for the Group's upholstered furniture products. The slowing down in the US home sales and residential remodeling expenditure has had adverse impact on the sales of residential furniture in 2006. This has in turn affected the Group's sales in the second half of 2006 as its US customers slowed down their orders. However, the Group maintains its view that US brand name furniture companies will continue to outsource their manufacturing to low cost countries.

Compared with other competitors, the Group has a unique advantage in its vertically integrated production and large scale manufacturing capabilities. These advantages were demonstrated by the Group's continued ability for timely delivery of high quality products at competitive prices during difficult times. The Group's reputation as a quality OEM partner and its business relationships with major US customers were strengthened. The Group will maintain its uncompromising commitment to customer value in order to achieve modest growth in both its North America sales and profitability.

Actively exploring market opportunities in Europe and other countries

With the low penetration rate of Chinese made furniture, the European market may offer greater potential to the Group's products. The Group has recently allocated more resources to this market segment by recruiting new personnel and by developing branded products more suited for this market.

Over the past few years, the Group has been able to accumulate product know-how, and design capabilities have improved significantly. The Group's own design accounted for more than 30% of the Group's total sales volume in 2006. The Group's design capabilities will enable the Group to meet the varying demands of the European customers who are operating under even more fragmented markets.

Improving operational efficiency and rationalizing costs

The Group has been expanding its capacities over the last few years, and it is now time to leverage on its economy of scale to improve profitability. The Group recognizes the importance of business process efficiency, and will continuously improve its raw material procurement and its supply chain management. In addition, the Group proposes to implement new incentive schemes to motivate its business units. The Group believes that these initiatives are important to maintain and to strengthen the Group's competitiveness.

The price hike of raw materials is unlikely to diminish in the near term, and as a result, the Group is undertaking actions to develop new products with alternative raw materials to reduce reliance on raw cowhides. Management strongly believes that rationalization of cost base would be able to partially mitigate the adverse effect of raw material price increases.

Establishing domestic presence to tap into China's growth potentials for consumption goods

The upholstery furniture market in China is currently very fragmented. Sofas are mainly being sold by small independent specialty stores within furniture malls. Customers not only have limited choices, but also have to bear additional costs arising from inefficient marketing channels. The Group believes that, with its fast growing economy, China's residential furniture market will be going through major changes in the next few years. The mid to higher end segments are likely to offer better growth potentials, while large players will emerge as stronger competitors in the market. The Group is planning to tap into China's growth potentials for mid to higher end residential furniture by opening large furniture malls in major cities in China. For the year of 2007, two to three flagships stores are to be opened in Shanghai and Hangzhou. These stores will be established through leasing arrangement, so the capital requirement will not exceed RMB20 million.

To further diversify its revenue sources and implement its domestic marketing plans, the Group has formed a joint venture company with Haining Leather Market, a well-known and experienced developer and operator of large leather product shopping malls in China, and Haining Zhengyang Trading. The joint venture company, in which the Group will have a 51% equity interest, will be looking for new sites in major cities to develop large specialized leather product shopping malls. On January 29, 2007, the joint venture partners, through Haining Higher Point, the Group's wholly-owned subsidiary, have successfully tendered a land of approximately 145,078 square meters in Changsha, Hunan province with a consideration of RMB253.75 million. The Group believes that, by leveraging on the Group's strong capabilities as leather product manufacturer and its joint venture partner's extensive knowledge and experience in successfully developing and operating leather product shopping malls, the Group will be able to establish a strong foothold in China's domestic leather product market.

DIVIDENDS

An interim dividend of approximately RMB3.53 cents (equivalent to US0.44 cents or HK3.45 cents) per ordinary share amounting to RMB34.68 million (equivalent to HK\$34.16 million) was paid to the shareholders during the year. The directors do not recommend the payment of any final dividend for the year ended December 31, 2006.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from May 25, 2007 to May 29, 2007 (both days inclusive), during which period no transfer of shares in the Company will be effected. In order to qualify for the entitlement to attend and vote at the forthcoming annual general meeting, all transfers documents, accompanied by the relevant share certificates, must be lodged with the Company's Hong Kong branch registrar, Computershare Hong Kong Investor Services Limited, Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not later than 4:30 p.m. on May 24, 2007.

PURCHASE, SALE OR REDEMPTION OF SHARES

Pursuant to the general mandate granted by the shareholders of the Company, the Board of Directors resolved on July 31, 2006 to repurchase the Company's shares of up to 10% of the issued shares of the Company as at the date of May 30, 2006. During the year, the Company repurchased 23,997,000 ordinary shares on the Stock Exchange at an aggregate consideration of HK\$25,165,000. All of the shares were subsequently cancelled. The nominal value of the cancelled shares of RMB29,730 (equivalent to USD3,600) was debited to share capital and the excess of relevant aggregate consideration over nominal value was debited to the Company's share premium. Details of the repurchases are as follows:

Month of the repurchases	Total number of the ordinary shares repurchased	Highest price paid per share <i>HK\$</i>	Lowest price paid per share <i>HK\$</i>	Aggregate consideration <i>HK\$'000</i>
August 2006	23,997,000	1.0503	0.9986	25,165

The purchases were made for the benefit of the shareholders as a whole as they enhanced the net asset value and/or earnings per share of the Company.

Save as disclosed above, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities during the year.

EMPLOYEES AND EMOLUMENTS

As at December 31, 2006, the Group employed a total of approximately 14,800 full time employees (2005: 16,000) which included management staff, technicians, salespersons and workers. For the year ended December 31, 2006, the Group's total expenses on the remuneration of employees is RMB286,659,000 (2005: RMB237,063,000) and represents 7.32% (2005: 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 the provident fund scheme (according to 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.

CODE ON 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") for the year ended December 31, 2006, except for Mr. Zhu Zhangjin who had served as both the Chairman of the Board and the Chief Executive Officer of the Company.

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.

AUDIT COMMITTEE

An Audit Committee was established by the Company 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 to establish policies, review and determine the remuneration of the directors and the senior management. The Remuneration Committee, comprises the two independent non-executive directors and a non-executive director of the Company. Mr. Li Hui is the chairman of the Remuneration Committee.

SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the year ended December 31, 2006.

COMPLIANCE WITH CODE OF BEST PRACTICE

The Company has adopted the Model Code (Appendix 10 to the Listing Rules) as its own code of conduct regarding securities transactions by directors. Having made specific enquiry of all directors, all directors declared that they have complied with the Model Code for the year ended December 31, 2006.

PUBLICATION OF INFORMATION ON THE EXCHANGE'S WEBSITE

The annual report of the Company for the year ended December 31, 2006 containing all the information required by the Listing Rules will be dispatched to the Company's shareholders and published on the website of the Stock Exchange (www.hkex.com.hk) and the Company (www.irasia.com/listco/hk/kasen) in due course.

ANNUAL GENERAL MEETING

It is proposed that the annual general meeting of the Company will be held on May 29, 2007. Notice of the annual general meeting will be published in newspapers and issued to shareholders in due course.

By Order of the Board
**Kasen International Holdings
Limited**
Yiu Hoi Yan
Company Secretary

Hong Kong, April 16, 2007

As at the date hereof, the Executive Directors are Mr. Zhu Zhangjin, Mr. Zhou Xiaosong and Mr. Zhu Jianqi. The Non-executive Director is Mr. Li Hui. The Independent Non-executive Directors are Mr. Lu Yungang, Mr. Chow Joseph and Mr. Zhang Huaqiao.