CHINABERRY INC.

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April 2004

Dear Shareholders,

Last year gave us remarkable challenges and at the same time, just as remarkable triumphs. As is often the case in life, as we dealt with adversity, we found our strengths.

The slumping economy, the war in Iraq, and the competitive bookselling environment were our main roadblocks to profitability in 2003. On the other hand, dealing with the effects of these situations made us look wherever we could within the company to streamline our operations and to cut costs. In doing so, we eliminated two executive positions. With these changes in place, we are positioned to move forward with more strength when the economy rebounds.

All in all, despite the challenges – or perhaps because of them – we are excited and honored to be working with such a competent and committed team. Each employee at Chinaberry is working hard with enthusiasm and loyalty, as we strive to become a stellar company that is a benchmark for impeccable service and sustainable profitability.

These are exhilarating times that are keeping us on our toes. As you read this report, you will see our successes as well as our setbacks. You, as shareholders, are in this together with us and we appreciate your commitment.

Ann S. Ruethling
Founder, Chinaberry Inc.

Our Company

Each department within Chinaberry Inc. worked to make its area of responsibility as streamlined and as effective as possible while keeping costs to a minimum. In every case, we can proudly say that we not only maintained the service for which Chinaberry Inc. has become well-respected but improved it as we worked to reduce expenses. It is successes like this that made the often-frustrating year of 2003 seem fruitful. Below are some of the highlights of the year for each department.

Customer Service

Our call center concentrated, with noticeable results, on up-selling, cross-selling and the liquidation of inventory. This resulted in a decrease of aged inventory from $274,000 in 2002 to $159,000 in 2003.

Additional efforts (sales, email campaigns, more attention to store layout) to make our outlet store more sustainable resulted in 30% higher sales for 2003 from 2002.

Warehouse

Our Shipping and Receiving error prevention incentive program resulted in our maintaining a high standard of only one error per thousand orders shipped in 2003.

We strive to have the best delivery service possible for our customers. As UPS rates continue to increase, it is much more challenging to maintain quality service without raising our own shipping rates too much. We are continually having to weigh the benefits of optimum, error-free customer service against the costs such stellar service entails.

Marketing

Since the cost of paper is a big percentage of our marketing expenses, we were pleased to secure a new paper supplier, allowing us to get better quality paper at a lower price.

Mailing list rental income continued to grow, increasing to $135,000 in 2003 from $101,500 in 2002.

Late in 2003 we decided to host our own web servers and moved the websites to Spring Valley. Web sales grew by 19%, exceeding $2 million for the first time. In 2002, 24% of our sales came through the websites while 28% of our sales came through our websites in 2003.

Merchandising

One of the most exciting developments was the improvement in our Gross Profit, resulting in an increase of $18,000 on $319,000 fewer sales.

More in-depth merchandise analysis than ever before provided us with the tools necessary to exploit the strengths of previous catalogs. This allowed the merchandisers to look for appropriate product with an eye toward what sells well during certain seasons and at what price points.

Purchasing

We continued to negotiate for the best possible costs from our vendors and lowered our Cost of Sales from 39.8% in 2002 to 37.6% in 2003.

Accounting

We improved our management of total inventory investment and cash. Our investment in inventory decreased $160,000 from $1,135,000 to $975,000. In 2002, we used our line of credit of $600,000. In 2003 we used a line of credit of $300,000, plus a new loan of $62,000 from Ann Ruethling, Founder, director, shareholder and officer. This loan has a maturity date of April 2004, and will be extended for one year. Both this loan and a previous $80,000 note from Ann Ruethling are unsecured and accrue interest at 12% per annum. Currently, the notes are interest only.

Our Dunn and Bradstreet rating continued to improve during 2003 to 80 (an average of paying bills on time or 0 days late) from 77 (an average of paying bills 5 days past terms)

Our Catalogs

The Chinaberry Catalog: Total revenue for 2003 was down $510,700 or 10.7% to $4,258,300 from $4,769,000 in 2002. This was below our sales forecast. Chinaberry is in a very competitive marketplace with discount booksellers and we are expanding our catalog's product mix to improve financial results.

The Isabella Catalog: Total revenue for 2003 was $3,454,300 up $191,600 or 5.9% from $3,262,700 in 2002 thanks to a growing and loyal customer base and growing web sales. This catalog enjoys a more diverse market with less direct competition.

The Chinaberry Book Fair Catalog: Total revenue for 2003 was $452,600 down $58,100 or 11.4% from $510,700 in 2002. As bookfairs continued to bring less profit per man hour spent, we chose to devote our resources to our two other catalogs.

Our Products

During 2003 we continued adjusting our product mix to match customer demand. This resulted in an improved merchandise balance in our catalogs and on our websites. We also began featuring seasonally appropriate merchandise during the year.

Exclusive merchandise is playing a more important role for us. Exclusive items now account for close to 7% of Chinaberry items compared with 6% in 2002. Average gross margin on these items is nine percentage points higher than that on off-the-shelf items. More than 30% of Isabella merchandise is now exclusive to us - up from 14% in 2002.

Our Web Sites

Early in 2003, we began automatic updates of online inventory. Every hour, a new inventory upload is sent to our websites. This new system in conjunction with minimum stock levels gives customers the confidence that every item displayed on our websites is available when they place their orders.

Near-real-time processing of web orders that began in late 2002 was further refined in early 2003. This system continued to run smoothly throughout the year.

Publicity and Media

We received the following media exposure in 2003:

“The Book Fairies" - February 2003
Feature article regarding the creation of Chinaberry in Victoria magazine.

“Nurturing the Joys of Childhood” - March 25, 2003
Ann Ruethling was interviewed for this feature article in The San Diego Union Tribune.
“Threat of War with Iraq Tough for Parents to Discuss with Children” - March 16, 2003
The Pittsburgh Post-Gazette says that “Chinaberry offers some wonderfully reassuring advice for parents and children about coping with ‘unsettled times.’”

“Once Upon a Time” - March 15, 2003
In a feature article, The Seattle Times says that the Chinaberry catalog has been sorting out the top children's book for 21 years.

Hawaii Woman reviews Chinaberry - September 2003
Featured article states that “the secret to Chinaberry's success is its ability to remain intimate with its recommendations and recognize the shared vision of many parents in raising their children to respect themselves, others, and the world around them.”

“When is the Best Time to Begin Reading to Your Child?” - September 2003
A selection of books available through Chinaberry are promoted in this article written for ePregnancy magazine.

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Accountant's Report

To the Shareholders of
Chinaberry Inc.
Spring Valley, California

We have compiled the accompanying balance sheet of Chinaberry Inc. as of December 31, 2003, and the related statements of income, changes in shareholders' equity, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

Weiss + Company

March 22, 2004

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Balance Sheet
Chinaberry Inc.

		December 31, 2003
Assets		
Current assets:		
Cash and cash equivalents	$	1,030,232
Accounts receivable		10,103
Inventory		975,169
Prepaid expenses and other current assets		99,376
Direct response advertising costs		97,085
Total current assets		**2,211,965**
Property and equipment (net of accumulated depreciation of $273,800)		139,830
Other assets (net of accumulated amortization of $165,751)		172,118
Total assets	**$**	**2,523,913**
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$	761,547
Unearned revenue		48,774
Note payable-current		211,111
Current portion of long-term debt		50,000
Other current liabilities		82,472
Total current liabilities		**1,153,904**
Long-term debt		46,382
Notes payable to a shareholder		133,189
Total liabilities		**1,333,475**
Shareholders' equity:		
Common stock, no par value: 10,000,000 shares authorized; 1,850,186 shares issued and outstanding		649,758
Paid-in capital		594,585
Stock subscriptions receivable		(6,468)
Accumulated deficit		(47,437)
Total shareholders' equity		**1,190,438**
Total liabilities and shareholders' equity	**$**	**2,523,913**

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Statement of Income
Chinaberry Inc.

		Year ended December 31, 2003
Revenues	$	9,464,040
Cost of sales		3,557,184
Gross profit		**5,906,856**
Fulfillment		1,980,046
Marketing		2,162,754
		4,142,800
Administrative expenses:		
Salaries, wages, and related benefits		1,256,085
Rent, maintenance, telephone, and utilities		243,917
Depreciation and amortization		128,308
Insurance		86,790
Outside services		70,637
Office expenses		68,518
Other		36,745
		1,891,000
Loss from operations		**(126,944)**
Other income (expense):		
Mailing list rentals		134,630
Interest income		5,880
Interest expense		(54,872)
		85,638
Net loss before provision for income taxes		**(41,306)**
Provision for income taxes		(5,000)
Net loss		**(46,306)**
Accumulated deficit at the beginning of the year		(1,131)
Accumulated deficit at the end of the year	$	**(47,437)**

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Statement of Changes in Shareholders' Equity
Chinaberry Inc.

	Common Stock	Paid-in Capital	Stock Subscriptions Receivable	Retained Earnings	Total
Balance at December 31, 2002	$ 656,480	$ 594,585	$ (30,326)	$ (1,131)	$ 1,219,608
Net loss				(46,306)	(46,306)
Payments received on stock subscriptions			7,888		7,888
Issuance of 9,248 shares of common stock	9,248				9,248
103,488 shares relinquished in lieu of payment on stock subscription receivable	(15,970)		15,970		
Balance at December 31, 2003	$ 649,758	$ 594,585	$ (6,468)	$ (47,437)	$ 1,190,438

See accountant's report

Statement of Cash Flows
Chinaberry Inc.

		Years ended December 31, 2003
Cash Flows from Operating Activities		
Net loss	$	(46,306)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization		128,599
Changes in certain assets and liabilities:		
Accounts receivable		5,903
Inventory		159,451
Prepaid expenses and other current assets		12,001
Direct response advertising costs		199,029
Deposits		(4,667)
Accounts payable and accrued expenses		(52,108)
Deferred revenue		13,809
Other current liabilities		5,460
Net cash provided by operating activities		**421,171**
Cash Flows from Investing Activities		
Cash paid for purchase of equipment and software		(4,420)
Cash paid for website development costs		(4,650)
Net cash used by investing activities		**(9,070)**
Cash Flows from Financing Activities		
Proceeds from issuance of common stock		9,248
Collections on stock subscriptions receivable		7,888
Proceeds from borrowings on shareholder note payable		62,000
Principal payments on notes payable		(133,333)
Principal payments on capital lease obligations		(63,194)
Repayment of loan from shareholder		(4,496)
Net cash used by financing activities		**(121,887)**
Net increase in cash and cash equivalents		290,214
Cash and cash equivalents at the beginning of the year		740,018
Cash and cash equivalents at the end of the year	**$**	**1,030,232**
Supplemental Disclosures		
Cash paid for interest	$	50,000
Cash paid for income taxes	$	5,000

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