



**Mr. Leung Lun**  
Chairman of the Group

To all shareholders,

Two years ago the Board embarked on expanding its Mainland China ("Mainland") market by entering into a notable licensing agreement for the production and distribution of our very first television animation character namely "Hikarian", a transforming toy that changes from a train into an action figure. This year, again we took on the initiative in licensing another transforming figure, "Mado King Granzort". Not unlike these animation characters, Lung Cheong is going through a period of transformation from sole manufacturing into designing, developing, engineering and marketing the toys it produces.

This process of change is done with the objective of creating a leading toy company that fully utilizes our technical capabilities, production facilities as well as distribution network. We believe this strategy, if undertaken successfully, will generate growing shareholder value. The Board remains confident of the direction and is much encouraged by the progress to date and we will begin to see the benefits from the transformation in the coming years.

As Chairman of Lung Cheong International Holdings Limited ("the Company") and its subsidiaries (collectively referred to as "the Group"), I am pleased to present the Group's audited results for the year ended 31 March 2001.

For the financial year 2000/01 the Group recorded a turnover of HK\$647 million, a modest decrease compared to HK\$660 million in the previous year. Profit attributable to shareholders amounted to HK\$23 million against last year's figure of HK\$27 million, a decrement partly due to a revaluation deficit of HK\$4 million on leasehold land and buildings not covered by previous surplus.

The Board has recommended a final dividend of HK0.25 cent (2000: HK0.5 cent) per ordinary share for this year subject to the approval of shareholders at the forthcoming annual general meeting of the Company (the "AGM"). Together with the interim dividend of HK0.5 cent (2000:HK0.5 cent), total dividends per ordinary share for the year under review will amount to HK0.75 cent (2000: HK1.0 cent).

## Business Review

2000/01 has been a challenging year for the Group. With our dedicated and relentless efforts in exploring new horizons in business development, the Group made a number of healthy progresses in several aspects of the business during the year under review.

During the year under review, the Group devoted increased effort in the strengthening of working relationships with its major original equipment manufacturing ("OEM") customers. Resources were also distributed amongst continued expansion of the original design manufacturing ("ODM") business and the expansion of the Mainland market by adopting the strategy to market licensed products.

The consistent performance of our radio control toys during the year further validated and strengthened the Group's position as a leading player in that category.

In line with the strategy of strengthening our ODM business, the Group acquired Standard Tooling and Products Co. Limited ("STP") which is engaged in the design, manufacture and sale of tooling and moulds to enhance our research and development ("R&D") capabilities. Combining STP with our engineering department was completed within



a very short period. The successful relocation, although at a cost, allowed it to operate with minimal interruption.

The ODM business was our prime focus of development. The Group committed a great deal of resources and effort to developing ODM products with value-added features. Apart from toys, the Group's non-toy products such as digital cameras and baby monitors also received encouraging market reaction. The success of digital cameras marked a milestone in the Group's ODM business development. Several sophisticated models of digital cameras were developed and launched to the European and Japanese markets, receiving overwhelming response from customers.

By adopting the strategy to market licensed cartoon characters from popular TV series, the sale of our Hikarian product was greatly boosted. The second series of the animated cartoon Hikarian commenced broadcasts on the Mainland television stations in December 2000. We were excited by the encouraging performance of Hikarian during the telecasting period. With the cross-country promotion in conjunction with the cartoon broadcasts, sales of this Japanese licensed toy have so far exceeded 2 million units since its launch.

For the year ended 31 March 2001, the Group's interactive section did not deliver a positive growth in revenue as earlier anticipated. Specifically, the announcement by Sega to terminate the Dreamcast ("DC") game console had some impact on DC

accessory sales but our exposure from an inventory standpoint is insignificant.

Calendar year 2000 was a transition year for the peripherals business as the industry waited for the introduction of new Sony Playstation 2 ("PS2") platform. However, the delay in shipment of PS2 game consoles had greatly reduced accessory sales at retail level and continued softness of the game market resulted in our inability to achieve expected target this new platform would bring. The Group responded by diverting its attention to gaming accessories for personal computers ("PC").

The supply shortage of electronic integrated circuit chips restricted the sales potential of the Group's interactive digital products and led to limited sales quantities.

## Prospects

In the coming year, we have set for ourselves specific objectives designed to enhance shareholder value. These objectives include increasing our overall market share in the Mainland through intensified penetration of retail stores; extending the ODM product line by introducing innovative toys and peripherals; improving



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- margins by monitoring manufacturing and component costs; and getting our message across to institutional investors.

In view of the tremendous success of our ODM digital products in the European market, the Group is developing new models with more innovative functions and intends to diversify into the North America market ("US"). We are confident that the sale of digital cameras will reinforce sustained growth. The current state of the market also leads us to believe that component shortages will not be a factor in the financial year 2001/02.

Considering that radio control products are the main revenue contributors, the Group will continue to leverage wireless technologies to develop more sophisticated products. A newly designed radio control bicycle was launched in May 2001 and response to date has been overwhelming. The Group believes innovative products like this will add excitement and stimulate sale of products in this category. Further, the Group received orders from a top-notch hobby company to produce additional range of premium price, high quality hobby grade transmitters.

We continued to identify with our successful experience in licensed cartoon series and toy figures suitable for the Mainland market. The Group entered into licensing agreements with Sunrise Inc., a leading animation producer and Takara Co. Ltd., one of Japan's largest toy company on March 2001. The agreements provide the Group with the license to broadcast on Mainland the animated cartoon series "Mado-King Granzort" and the manufacturing and selling rights of its animated figures in the Mainland.

Given the proven result of our marketing strategy in promoting the licensed toy Hikarian, we are confident that the sale of the newly





licensed Granzort will be even more successful. We will utilize marketing channels in place to promote the recently licensed products. Based upon the experience and sales record achieved with Hikarian, we strongly believe that Granzort will reach a greater section of the Mainland market and bring in promising return. In the meantime, our outgoing search for additional licenses continues.

The Group's existing alliances with local distributors, wholesalers and retailers to date have expanded our distribution network to over 300 outlets. We intend to continue enlarging the marketing channels and will actively pursue the direct retail opportunity that China's eventual entry into the World Trade Organization brings. This upfront retailing method is one of the alternatives that substantially reduces the credit risk as encountered by most companies selling on the Mainland.

Conscious of the potential slowdown of the US economy, the management of the Group has responded positively in tackling with the situation. As it has been in the previous years, the Group will actively pursue the commercial opportunities of its European and Japanese customers whom accounted for 29% and 17% of total turnover for the year ended 31 March 2001 respectively.

The expected introduction of two major new platforms, the upcoming launch of Nintendo's GameCube and Microsoft's Xbox combined with the increased availability of PS2, should drive overall demand and push new accessory sales forward. We are working hard to ensure that when these new gaming platforms are launched, the Group will have developed plenty of topnotch accessories for the console as well as PC games.

The Group's push forward plans has been further strengthened by the recent signing of a three year transferable loan agreement with a group of banks in respect of a loan in an amount of HK\$150 million. With the medium term funding in place, the Group is in a better position to achieve the goals we are transformed to accomplish.

## Appreciation

I would like to extend my sincere gratitude to my fellow directors and colleagues for their dedication towards the ambition of the Group throughout the year. I would also like to take this opportunity to express my appreciation to our shareholders, investors and financiers for their continued belief in Lung Cheong and our strategy for the future.

**Leung Lun**

*Chairman*

17 July 2001

