

Management Discussion and Analysis

Dear Shareholders:

FINANCIAL RESULTS

As a result of disciplined cost management and focused efforts to enrich its product mix, the Group's combined gross profit margin rose by 1.4% to 23.2% with a combined gross profit of HK\$192.8 million. This outstanding achievement set a new record for the Group.

For the year ended 31 December 2001, the combined turnover recorded a decrease of 5.0%, from HK\$874.4 million to HK\$830.9 million. The Group's combined profit attributable to shareholders reached HK\$98.5 million, growing 11.6% over last year and representing a 5.2% increase

over the profit estimated in the prospectus dated 29 January, 2002, where a profit of not less than HK\$93.6 million was estimated. This outstanding performance was mainly attributed by our long-term relationship with ultimate customers and mass retailers, cost effective vertical integration system and prudent financial management. The Group is committed to maintaining a healthy and debt free financial position. As at 31 December 2001, the Group's cash balance increased to HK\$126.1 million (2000: HK\$94.2 million).

DIVIDEND

The Directors has recommended a final dividend of HK4.8 cents per share to be paid on or before 31 May 2002, subject to shareholders' approval at the forthcoming annual general meeting to be held on 13 May 2002. The dividend, as stated in the dividend policy of the prospectus of the Company dated 29 January 2002, represents an annual dividend yield of approximately 4% on the issue price of HK\$1.20 per share.

BUSINESS REVIEW

Although market sentiment was not favorable during the year under review, the impact on Dream International was insignificant due to our established and solid customer base, scalable production facilities and prudent financial cost control systems. We recorded an overall increase in our combined profit arising from the two core businesses - plush stuffed toys (91% of combined turnover) and steel and plastic toys (9% of combined turnover). There was no material change in turnover of segmental business in either product line or geographical region for the years 2001 and 2000.



Mr. C.H. Min

President and Chief Executive Officer



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A number of factors contributed to the success of the Group. Orders were secured by many international well-known ultimate customers, including character licensors, such as Disney, SEGA Corporation, Banpresto Co., Ltd, Warner Bros. and Bandai Co. Our long-standing relationship with these world famous brandnames reinforce our quality production and capabilities, helping to secure orders and stimulate business growth. Building on this established reputation, we also signed a two-year non-exclusive manufacturing agreement with WBCP on 19 September 2001 for the production of certain licensed products such as Looney Tunes and Tom & Jerry for distribution to WBCP-appointed distributors worldwide, excluding the US and Canada.

We believe that strategic alliances with the world's leading brands will effectively enhance our competitiveness, forming strong foundations for the Group's sales and marketing areas. We will further strengthen these strategic partnerships to create ongoing mutually rewarding solutions and broaden future developments.

Headquartered in Hong Kong, we are backed by a total of eight production bases in the PRC, strategically located in Shenzhen, Shanghai and near Suzhou area, to benefit from low production costs in the PRC. During the year under review, the production capability reached 67 million pieces and the average production capacity for the plants exceeded 90%.



Positioning ourselves as a "one-stop" manufacturer, which starts from the sourcing of raw materials to packaging, we are involved in every step of the process. This vertical integration allows us to flexibly allocate and commit resources among our various production bases enabling the mass manufacturing of products, to meet tight delivery schedules and to shorten production lead times, while also maximizing economies of scale. Furthermore, to enhance cost effectiveness and cater for substantial orders received during peak seasons such as Christmas and New Year; we subcontracted part of our production to maximise cost-efficiencies and maintain flexibility in our daily operations.

In 2001, our factory in Shenzhen, the PRC was awarded ISO 9001 certification by AOQC Moody International, Inc. for achieving the ISO 9001:1994 standards. This is an accreditation for our product quality and quality management systems. Inspections are routinely performed after each of the production stages such as cutting, sewing, stuffing and finishing. The finished products are then subject to further quality assurance tests to ensure compliance with the Group's quality standards. All of the Group's products bear the relevant safety marks or comply with the relevant safety requirements defined in US and Japan. As such, together with our high quality control standards, the Group's products are well received by customers. Currently, we are in the process of applying for approval for compliance to ISO 9002.



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Research and development is a crucial factor in the success of the Group. During the year under review, approximately HK\$7.5 million was spent on product research and development. We have been placing emphasis on developing new design functions and models in accordance with prevailing markets trends, such as digital and interactive toys. ODM business including Caltoy, an innovation from our research and development team, was well received and accounted for 5.0% of the Group's turnover in 2001.

Leveraging our quality products and an established reputation, we have built a diversified customer base consisting of 139 customers in over 13 countries. Currently, our major markets are focused on the US and Japan which accounted for approximately 49% and 37% of the Group's combined turnover respectively. In addition to these two major markets, we also exports to Europe where we are currently expanding our market share in view of the strong market potential in the region. We are aggressively enhancing our presence in existing markets; concurrently, we are attentive and prepared for any potential expansion in other markets.

PROSPECTS

The Group's orders book for the first quarter 2002 showed substantial increase as compared with that of last year. Meanwhile, we have just completed the installation dyeing facilities to expand its acrylic knitted fabric factory at Taicang. We are also looking into investing or acquiring plants for the spinning of yarns. These plans will further enhance the vertical integration of our production process, benefiting the Group with further cost reductions. We expect the overall performance of year 2002 should be much better than last year.

Since children are more sophisticated today and in view of the rising market demand for interactive products, the Group is committed to developing interactive products by incorporating technology and personal computer attributes into traditional plush stuffed toys which enables interaction with the environment through sight, touch, hearing and physical orientation.

We will be developing new products by enhancing creative and innovative designs and character products to cater for customers of all ages. We believe that this will allow us to explore and broaden new market segments.

We are considering increasing the portion of ODM operations and is moving into the character licensing business. We are also working into the acquisition of character licenses from the top entertainment character license companies to market and sell plush stuffed toys under our character brands directly to retailers in the US.



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Benefiting from the continuous steady growth of the toy industry, we will capitalise on our solid foundations and aim to expand our marketing and design capabilities in the US while exploring and expanding the use of plush materials into other product categories. Our market share in Japan and Europe has been growing steadily in the year under review. We foresee these markets will hold future growth potential, hence, the expansion of our marketing forces in Japan and the establishment of marketing channels in Europe are under serious consideration.

We believe that our market share in the US will be further expanded upon the rebounding of the US economy together with the PRC's entry into WTO. We are well positioned to further enhance our market penetration globally to establish a plush stuffed toy empire around the world.

LIQUIDITY AND FINANCIAL RESOURCES

The Group's liquidity and financial resources position continued to be strong and ungeared. The Group's cash and bank deposits at 31 December 2001 amounted to HK\$126.1 million (2000: HK\$94.2 million). The banking facilities amounting to HK\$4.8 million (2000: HK\$15.4 million) of the Group were secured by mortgages over fixed assets with an aggregate carrying value of HK\$4.4 million (2000: HK\$6.2 million). There was no bank borrowing as at the 31 December 2001.



The Group has made use of the financial risk management tool, such as forward contract, dual currency option attached deposit, to hedge the fluctuation of our Japanese Yen accounts receivable on selective basis.

APPRECIATION

Finally, I would like to take this opportunity to express my appreciation to the management and the staff of the Group for their wholehearted commitment and dedicated performance which has been so central to the successful development of the Group. I also wish to extend my sincere thanks to our business associates, customers, suppliers and shareholders for their continuous cooperation and support.

Chul Hong **Min**
President and Chief Executive Officer
Hong Kong, 10 April 2002

