

DISCUSSION AND ANALYSIS OF THE GROUP'S PERFORMANCE

Financial review

The Board of Directors of Dream International Limited (the "Company") is pleased to announce the unaudited results of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2002. Turnover increased by approximately 12.7%, from HK\$301.8 million to HK\$340.0 million. The Group achieved gross profit of HK\$93,427,000 (2001: HK\$73,720,000) representing a growth of 26.7% on a consolidated basis. This is mainly due to the Group's cost management measures and focused efforts to enrich the product mix.

The Group's consolidated profit attributable to shareholders reached HK\$49.8 million (2001: HK\$45.3 million) increasing 10.1% over the previous period on a consolidated basis. This positive performance was mainly attributable to the Group's well-established and long-term relationships with customers and mass retailers, cost effective vertical integration systems and prudent financial management. The Group also maintains a very healthy financial status with no gearing. The Group's cash and bank deposits at 30 June 2002 amounted to HK\$283 million. The Group's aim is to maintain a strong financial position, which accelerates its future growth and enables it to capture any arising opportunities.

Business review and prospects

For the six months ended 30 June 2002, plush stuffed toys and steel and plastic toys accounted for 91.9% and 8.1% respectively of the Group's total turnover. The sales of plush stuffed toys increased by 3.5%.

Over the years, prospering on its quality products and punctual delivery, the Group has established very sound relationships with many international and extremely well-known customers, securing significant orders as well as stimulating its business growth. During the period, the Group continued to receive ongoing orders from character licensors, including Disney, the SEGA Corporation, Banpresto Co., Ltd., Warner Bros. and Bandai Co. The Group's OEM customers accounted for 92.1% of its total turnover for the period ended 30 June 2002. In June 2002, the 2002 FIFA World Cup created a frenzy among football fans around the world. The Company was able to contribute to this exciting event by obtaining the manufacturing rights for the event's mascots. Given its established production capacity and just-in-time production, the Group secured HK\$4 million additional orders without involving additional marketing costs.

Currently, the Group is tapping into the character licensing business. It is seeking, and in several instances is negotiating with, the top entertainment character license companies to acquire character licenses to market and sell plush stuffed toys directly to retailers in the US under its character brands.

As stated in its prospectus, the Group is actively expanding its ODM business. Its success has been demonstrated by the substantial increase in the sale of its own brand, Caltoy. Caltoy sales have increased from HK\$9.2 million in the same period last year to HK\$26.8 million during the period under review this year. These figures provide strong evidence that the Group's ODM products are receiving a growing and overwhelming response from the market. During the period, its ODM business increased from 3.1% to 7.9% of total turnover, compared with the same period last year. Bolstered by this business growth, the Group has full confidence that it is on the right track in further developing its Caltoy products. To further realize this objective, the Group will enhance its research and development capabilities and expect to utilize allocated funds of HK\$23.4 million from IPO proceeds in the coming period for research and development.

The Board is pleased to report that all its eight production facilities, which are strategically located in the PRC to enjoy lower labor costs, reached annual production capacities of 67 million pieces during the period. The Group continues to be one of the world's largest plush stuffed toys manufacturer.

To cater for its increasing orders, the Group will be expanding its production capacities by renting a new manufacturing plant adjacent to its existing plant in Bao'an. With the additional capacity expected to commence operations by the end of this year, the Group expects to increase production to cater for the peak seasons, especially for Valentine's Day, and during the Easter and Christmas seasons.

To enhance vertical integration in its production process, the Group has established a dyeing facility and has plans to acquire a spinning mill. The Board believes that producing the major raw materials itself will further guarantee the quality of its products. This committed business strategy enhances quality control, shortens production lead times and maximizes the Group's economies of scale.

The USA and Japan remained the Group's major markets during the period, contributing 37% and 44% respectively to the Group's total turnover. In the first six months of 2002, the US economy remained unfavourable, and the pace of recovery was slower than expected. Since plush stuffed toys are among children's most popular toys, the management expects sales from the US market in the second half to gradually improve. In the meantime, the contribution from the Japanese market increased from 36% to 44% due to the increase in substantial orders from one of its major and most well-known international customers. The Group expects the growth momentum in Japan to continue.

To further expand its ODM business and to further enhance its presence in the US and European markets, the Group completed its acquisition of the marketing company – Sung Won Industries, Inc ("Sung Won"), subsequent to the review period, on 1 July 2002. Sung Won is a leading marketing company with a comprehensive distribution network in the US and Europe. The Group acquired a 60% equity interest in Sung Won at a consideration of US\$1 million. Under the terms of the acquisition, the Group will obtain the manufacturing rights for all orders secured by Sung Won, providing an additional revenue stream and marketing arm for the Group. The Board believes that the Group will be able to expand its design and marketing capabilities to cater for the demand, which is growing in sophistication and to synchronize with market trends.

The Group will expand its market share not only through acquisitions, but also by capitalizing on its existing marketing forces. In the months to come, the Group will further strengthen its stronghold in the Japanese and European markets with the expansion of its existing marketing forces and established marketing channels.

Over the years, the Group has maintained prudent cost control management. The Group's vertical integration allows it to flexibly allocate and commit resources among its various production bases, enabling the mass manufacturing of products, to meet tight delivery schedules, shortening production lead times while also maximizing economies of scale.

Employees

As at 30 June 2002, the Group employs approximately 11,000 employees in Hong Kong, mainland China and USA. The Group values human resources and recognizes the importance of attracting and retaining quality staff for its continuous success. Staff bonus and share options are awarded based on individual performance and job nature.

The Group regards its people as valuable resources who will help to drive its future growth. During the period, the Group used incentive methods to motivate both its existing and newly recruited staff. The strong morale among the staff led to higher efficiencies, which reassures the adoption of this right corporate strategy. For the first time, the Group recruited graduates from well-known universities in the PRC during the period. These new recruits have utilized their capabilities in their respective areas. The success has motivated the Group to embrace the concept of recruiting additional skilled staff with comparatively lower costs from PRC. This will further reduce manufacturing costs while increasing the Group competitiveness in future.

Liquidity and financial resources

At 30 June 2002, the Group had net current assets of HK\$394 million (2001: HK\$202 million). The Group's financial resources position continued to be strong and ungeared.

The Group continues to maintain a strong liquidity position with cash and bank balances at 30 June 2002 amounted to HK\$283 million (31 December 2001: HK\$126 million). There was no bank borrowing as at the 30 June 2002.

Treasury Policies

The Group continues to adopt a conservative approach in financial risk management. All the bank deposits are basically principal guaranteed. The Company makes use of various yield enhanced deposit products to hedge the fluctuation of Japanese Yen accounts receivable and to enhance return from our liquid assets within the controllable risk level.

Complementing on its well-established track record, the Group has been undertaking numerous initiatives to enhance its business structure, building solid foundations for future growth and positioning itself as a pre-eminent toy manufacturer. Ultimately, the Group will continue with its aggressive efforts to bring fruitful yield and continuous streams of profit to its shareholders.