

Management Discussion and Analysis

RESULTS

The Group's turnover for the financial year ended 31st December, 2002 amounted to approximately HK\$353 million, representing a decrease of 18% over that reported in the previous financial year. The loss attributable to shareholders in the financial year of 2002 is approximately HK\$40 million. (2001: loss of HK\$25 million).

There are two main factors leading to the drop in performance. Firstly, the global sluggish economy has adverse impact to the Group's toys business as well as our investment holdings in US. The hotel industry in US is greatly affected by the weak and unfavorable economic climate, and as a result, the Group's major US investment holding, the Resort at Squaw Creek ("the Resort") has suffered from a downward revaluation.

Secondly, a non-recurring expenditure has deteriorated the Group's overall performance. For the year under review, the Group has been involved in a litigation arising from the termination of the agency in relation to the management of the Resort. Although the performance of the Resort is going to improve because of the change in management, the Group has incurred a substantial amount (approximately HK\$11 million) of legal expenses in defending and protecting the Group's interest. The legal dispute has recently been settled, and no further material legal fee is expected to arise after the completion of the settlement agreement.

With the anticipation that the effect of the war in Iraq on the global economy would be a temporary one, the Group is confident that the performance for year 2003 will improve.

BUSINESS REVIEW

Toys

The turnover of the Group's OEM & ODM business for the year under review is HK\$90 million, a decrease of 52% as compared to last year.

During the year under review, the world's toys business is adversely affected by the sluggish global economy, and the Group is no exception. Consumer confidence is low, while unemployment rate is high. Retailers are cautious and hesitant in placing orders, usually with small quantities while the delivery time is short. The Middle East military action leads to fluctuation in the prices of raw materials like plastics, paper and copper etc. All these factors seriously hindered business growth and deteriorated profit margin. Furthermore, the port strike in US during the 4th quarter of year 2002 adversely affected the Group's business. The Group experienced substantial order cancellation due to delayed shipment.

Management Discussion and Analysis *(Continued)*

Although facing such harsh operating conditions, the Group is confident that the operating results will be improved in the coming year. Over the years, constant efforts have been invested in product technologies. Now, the Group has succeeded in strengthening its productivity in manufacturing electronic products, which are expected to dominate the toys market in the next few years. Tremendous achievement has also been gained in broadening the customer base; for example, the Group has secured noticeable sales orders in road racing products in the coming year. The Group has also placed substantial efforts in developing and designing its own brand name products, which have been receiving favorable response from customers. In the first quarter of year 2003, customer orders for our ODM projects have increased substantially. The Group is cautiously optimistic that all these efforts will bring substantial contribution to the Group's revenue in the medium and long term. Looking forward, the Group anticipates that both OEM and ODM businesses will have steady growth.

Model Trains

The turnover for the Group's model train business for year 2002 is approximately HK\$235 million, marking a steady increase in both turnover and profit. Over the years, the Group has invested considerable efforts in developing our own brand name product line, the Graham Farish, in the European market. The Group is going to enjoy its fruitful success in the coming year. During the year under review, Graham Farish achieved a positive contribution to the Group. The Group plans to continue this successful strategy by launching more new products in the coming year. We are looking forward to achieving good performance in the European market.

In US, our model trains continue its leading position as the most successful brand in the model train hobby industry. In year 2002, the "Bachmann Spectrum N Scale 2-8-0" was awarded Product of The Year in N Scale Locomotive, and "Bachmann Spectrum 1:20.3 Scale Narrow Gauge 2-8-0" was awarded Product of The Year in Large Scale Locomotive.

Looking ahead, we are confident that our leading position in the model train industry, our high quality products and the new product development will support us to strive for good performance.

Property Investment

The Group's rental income from investment properties for the year under review amounted to approximately HK\$28 million, which remains a steady contribution to the Group's revenue. The occupancy rate of the Group's Industrial Building in Kowloon Bay is steadily maintaining at over 80%. Apart from this, the Group has also managed to secure a group of stable tenants who usually committed to a medium to long-term tenancy agreement with us.

Looking ahead, the Government has been taking various measures to stimulate the recovery of the property market. With the continuing trend for a low interest rate and the Government's intention to stabilise the property market, a further slump in properties prices is not expected in the coming year. It is anticipated that the Group's rental property will continue to generate steady revenue.

Management Discussion and Analysis *(Continued)*

During the year under review, the Group has completed the transaction of disposing a piece of land in Chashan, Dongguan Province of China. The land was acquired in the early 1990s, and was previously held for investment purposes. After the acquisition, the property market in China has been sluggish for quite some years. The Group was actively looking for a buyer during the past years and disposed of the land in year 2002 and re-directed the resources to the core business.

Investment Holding

Year 2002 was a very difficult year for the Resort. The continuing economic malaise experienced in the San Francisco Bay area had been the main factor leading to the Resort's relatively poor financial performance. In addition, the Middle East military action has added to the already weak US economy and has greatly affected the hotel industry. To face keen competition and challenges, the Resort has to reduce room rate and thus lowered its operating margin. The weak US economy will continue to have adverse impact on the Resort.

FINANCIAL REVIEW

Liquidity and Financial Resources

As at 31st December, 2002, the Group's current ratio was 0.83. The Group's total bank borrowings have decreased from approximately HK\$321 million as reported last year to approximately HK\$278 million as at year-end. The financial gearing of the Group, based on the total bank borrowings to the shareholders' equity was maintained at 61% (2001: 65%). No significant seasonality of borrowing requirements exists except during the peak sales period when the Group's trade loans will be comparatively higher.

Capital Structure

During the year ended 31st December, 2002, there were no movements in the Company's share capital. The Group's capital instruments are mainly composed of bank loans and director's support, which are in HK dollars, sterling and US dollars at prevailing market rates.

Charges on Group Assets

As at 31st December, 2002, certain investment properties, leasehold land and buildings and other assets of the Group with a total net book value of approximately HK\$502 million were pledged to banks to secure banking facilities granted to the Group.

Material Acquisitions and Disposals

There are no material acquisitions and disposals during the year ended 31st December, 2002. At the moment, there are no major plans for material investments or capital assets.

Management Discussion and Analysis *(Continued)*

Exchange Rate Exposure

Major assets, liabilities and transactions of the Group are denominated either in sterling, US dollars, Renminbi or Hong Kong dollars. As the exchange rate of sterling, US dollars and Renminbi against Hong Kong dollars was relatively stable during the year, the Group was not exposed to material exchange risk.

Contingent Liabilities

As at 31st December, 2002, the Group did not have significant contingent liabilities.

EMPLOYEES AND REMUNERATION POLICIES

As at 31st December, 2002, the Group employed approximately 5,100 full time management, administrative and production staff in USA, Europe, PRC and Hong Kong. The Group remunerates its employees based on their performance, experience and prevailing industry practice. In the area of staff training, the Group encourages and supports staff to engage and participate in continuing studies or self-enhancement courses.

AUDIT COMMITTEE

The Audit Committee has met with the management to review the year-end financial statements and consider the significant accounting policies, and to discuss with the management about the Group's internal control system.

PROSPECTS

Looking ahead, world economy will remain depressed while competition is expected to be keen under harsh operating environment. We are operating under thin profit margin with fluctuation in raw material prices; orders received are getting smaller while shorter delivery lead-time is generally required.

To face keen market competition and meet challenges ahead, the Group will continue the strategy of investing in new technologies; developing our own product designs; exploring new business opportunities and broadening our customer base. Also, the Group will strengthen and streamline our existing product lines in infant toys, electronic toys and stuffed toys. Furthermore, the Group will continue to focus on reducing operation cost. Our aim is to enhance our competitiveness in terms of productivity, quality and reliability.

We hold on to our mission of maintaining the leading position in the toys industry, and are committed to providing high quality products and services to the total satisfaction of our customers. We believe that once the Middle East Crisis has cleared out, there are hopes of economic recovery. There are still areas of economic uncertainty, but the Group is well prepared to face these challenges.

By the Order of the Board
Kenneth Ting Woo-shou
Managing Director

Hong Kong, 11th April, 2003