NOTES ON THE UNAUDITED INTERIM FINANCIAL REPORT

(Expressed in Hong Kong dollars)

1 Significant accounting policies

(a) Basis of presentation

This interim financial report is unaudited, but has been reviewed by KPMG in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports", issued by the Hong Kong Society of Accountants ("HKSA"). KPMG's independent review report to the board of directors is included on page 6.

The interim financial report has been prepared in accordance with the requirements of the Main Board Listing Rules of The Stock Exchange of Hong Kong Limited ("SEHK"), including compliance with the Statement of Standard Accounting Practice ("SSAP") 25 "Interim financial reporting" issued by the HKSA.

The financial information relating to the financial year ended 31 December 2002 included in the interim financial report does not constitute the company's statutory financial statements for that financial year but is derived from those financial statements. Statutory financial statements for the year ended 31 December 2002 are available from the company's registered office or website www.dream-i.com.hk. The auditors have expressed an unqualified opinion on those financial statements in their report dated 8 April 2003.

The same accounting policies adopted in the 2002 annual financial statements have been applied to the interim financial report except as disclosed under note 1(b) below.

The notes on the interim financial report include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the group since the 2002 annual financial statements.

(b) Adoption of new accounting policy on deferred tax

The HKSA issued SSAP 12 "Income taxes" in August 2002, which supersedes the previous SSAP 12 "Accounting for deferred taxes". The new standard became effective for accounting periods beginning on or after 1 January 2003. The group has therefore adopted the new standard for preparation of the group's interim financial report for the six months ended 30 June 2003.

In prior years, deferred tax liabilities were provided using the liability method in respect of the taxation effect arising from all material timing differences between the accounting and tax treatments of income and expenditure, which were expected with reasonable probability to crystallise in the foreseeable future. Deferred tax assets were not recognised unless their realisation was assured beyond reasonable doubt. With effect from 1 January 2003, in order to comply with SSAP 12 (revised) issued by the HKSA, the group adopted a new policy for deferred tax.

Under SSAP 12 (revised), deferred tax assets and liabilities arise from deductible and taxable temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax bases respectively. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. The limited exceptions are temporary differences arising from goodwill not deductible for tax purposes, negative goodwill treated as deferred income, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

The new accounting policy has been adopted retrospectively, with the opening balance of retained profits and reserves and the comparative information adjusted for the amounts relating to prior periods as disclosed in the consolidated statement of changes in equity. These effects are summarised as follows:

		Net movements in deferred income taxes		
	Balance as at 1 January 2002 *$'000*	Six months ended 30 June 2002 *$'000*	Six months ended 31 December 2002 *$'000*	**Balance as at 1 January *2003*** ***$'000***
Retained profit as previously reported	238,577			**301,947**
Prior period adjustments in respect of:				
Deferred tax	4,819	(896)	494	**4,417**
Retained profit as restated	243,396			**306,364**

2 Segment reporting

Segment information is presented in respect of the group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the group's internal financial reporting.

Business segments

The group comprises two main business segments:

– manufacture and sale of plush stuffed toys; and

– manufacture and sale of steel and plastic toys.

	Plush stuffed toys Six months ended 30 June		Steel and plastic toys Six months ended 30 June		Unallocated Six months ended 30 June		Consolidated Six months ended 30 June	
	2003	2002	**2003**	2002	**2003**	2002	**2003**	2002
	$'000	*$'000*	***$'000***	*$'000*	***$'000***	*$'000*	***$'000***	*$'000*
Revenue from external customers	**366,854**	312,316	**21,772**	27,710	**-**	–	**388,626**	340,026
Other revenue from external customers	**982**	2,913	**-**	79	**7,053**	1,780	**8,035**	4,772
Total	**367,836**	315,229	**21,772**	27,789	**7,053**	1,780	**396,661**	344,798
Segment result	**61,167**	48,838	**3,384**	5,491	**-**	–	**64,551**	54,329
Contribution from operations							**64,551**	54,329
Finance costs							**(34)**	–
Share of losses of associates							**(579)**	–
Taxation							**(5,544)**	(5,418)
Profit attributable to shareholders							**58,394**	48,911

Geographical segments
The group participates in four principal economic environments.

In presenting information on the basis of geographical segments, segment turnover is based on the geographical destination of delivery of goods.

	Turnover Six months ended 30 June	
	2003	2002 (restated)
	$'000	*$'000*
North America	**130,532**	126,158
Japan	**199,237**	149,950
Asia (other than Japan)	**15,292**	44,851
Europe	**43,491**	19,067
Others	**74**	–
	388,626	340,026

There is no major disparity in the ratios between turnover and profit in relation to the above geographical locations, hence no analysis is given of the profit contributions from the above geographical locations.

3 Other revenue and net loss

	Six months ended 30 June	
	2003	2002
	$'000	*$'000*
Other revenue		
Interest income from bank deposits (including related option premium income on structured dual currency) option deposits)	**7,053**	1,780
Commission income	**331**	1,376
Sales of samples and scrap materials	**192**	654
Sundry income	**459**	962
	8,035	4,772
Other net loss		
Net gain/(loss) on sale of fixed assets	**201**	(16)
Net exchange gain	**333**	13
Others	**(921)**	–
	(387)	(3)

4 Profit from ordinary activities before taxation

Profit from ordinary activities before taxation is arrived at after charging/(crediting):

	Six months ended 30 June	
	2003	2002
	$'000	*$'000*
(a) Finance costs:		
Interest on bank advances and other borrowings wholly repayable within five years	**34**	–
(b) Other items:		
Cost of inventories *(note (i))*	**283,751**	246,599
Staff costs (including retirement costs of $3,915,000 (2002: $987,000)) *(note (i))*	**77,924**	73,907
Depreciation *(note (i))*	**8,551**	7,875
Operating lease charges: minimum lease payments *(note (i))* – property rentals	**10,348**	11,116
Commission expenses	**4,597**	2,151
Amortisation of positive goodwill on acquisition of:		
– subsidiary	**44**	44
– associate *(note (ii))*	**358**	–
Amortisation of negative goodwill	**(795)**	(795)
Bad debts recovered *(note (iii))*	**(5,090)**	–

Notes:

(i) Cost of inventories includes $77,390,000 (2002: $76,300,000) relating to staff costs, depreciation expenses and operating lease charges, which amount is also included in the respective total amounts disclosed separately above for each of these types of expenses.

(ii) Amortisation of positive goodwill in respect of associate is included in the share of losses of associates for the period.

(iii) Bad debts recovered are included in administrative expenses for the period.

5 Taxation

Income tax for the period comprises current and deferred taxes.

Taxation in the consolidated income statement represents:

	Six months ended 30 June	
	2003	2002 (restated)
	$'000	*$'000*
Provision for Hong Kong Profits Tax for the period	**4,714**	3,390
Deferred tax expense relating to the origination and reversal of temporary differences	**575**	896
Effect of increase in tax rate on deferred tax balances at 1 January	**(407)**	–
PRC taxation	**662**	1,132
	5,544	5,418

The provision for Hong Kong Profits Tax is calculated at 17.5% (2002: 16%) of the estimated assessable profits for the six months ended 30 June 2003.

In accordance with the relevant regulations and the Enterprise Income Tax Law applicable in the People's Republic of China ("PRC"), the PRC subsidiaries are exempted from Enterprise Income Tax for two years starting from the first profit-making year and thereafter subject to Enterprise Income Tax at 50% of the standard tax rate for the following three years. During the period ended 30 June 2003, the PRC subsidiaries are subject to Enterprise Income Tax at 50% of the standard tax rate.

Deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. In March 2003, the Hong Kong Government announced an increase in the Profits Tax rate applicable to the group's operations in Hong Kong from 16% to 17.5%, which was passed by the Legislative Council in July 2003. This increase is taken into account in the preparation of this interim financial report.

6 Dividends

	Six months ended 30 June	
	2003	2002
	$'000	*$'000*
Dividend paid		
2001 final dividend of $0.048 per share approved and paid in 2002	**–**	31,200
2002 final dividend of $0.064 per share approved and paid in 2003	**41,885**	–
	41,885	31,200
Dividend declared		
Interim dividend declared after the balance sheet date of $0.030 (2002: $0.024) per share *(note)*	**19,749**	15,600

note: The interim dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date. The calculation of 2003 interim dividend is based on the number of ordinary shares outstanding at the date of this report.

7 Earnings per share

(a) Basic earnings per share

The calculation of basic earnings per share is based on the profit attributable to shareholders of $58,394,000 (2002: $48,911,000, as restated) and the weighted average number of 651,280,178 (2002: 616,781,768) ordinary shares in issue during the period.

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on the profit attributable to shareholders of $58,394,000 (2002: $48,911,000, as restated) and the weighted average number of 656,662,167 (2002: 621,601,933) ordinary shares outstanding during the period, adjusted for the effects of all dilutive potential ordinary shares.

(c) *Reconciliations*

	Six months ended 30 June	
	2003	2002
	Number of shares	Number of shares
Weighted average number of ordinary shares used in calculating basic earnings per share	**651,280,178**	616,781,768
Deemed issue of ordinary shares for no consideration	**5,381,989**	4,820,165
Weighted average number of ordinary shares used in calculating diluted earnings per share	**656,662,167**	621,601,933

8 Fixed assets

Land and buildings of the group were revalued by professional valuers at 30 November 2001. The directors of the company, who are not qualified valuers, have reviewed the carrying value of the land and buildings as at 30 June 2003 with reference to the relevant market indices. In their opinion, there have been no significant changes in the value of land and buildings since 31 December 2001.

9 Inventories

	At 30 June	At 31 December
	2003	2002
	$'000	*$'000*
Raw materials	**80,747**	56,856
Work in progress	**21,493**	25,105
Finished goods	**28,340**	21,592
Goods-in-transit	**3,505**	–
	134,085	103,553

Raw materials included in inventories that are stated net of a general provision of $3,146,000 (31 December 2002: $3,146,000), made in order to state these inventories at the lower of their cost and estimated net realisable value.

10 Trade and other receivables

	At 30 June 2003 $'000	At 31 December 2002 $'000
Amount due from ultimate holding company	**33,221**	29,176
Amounts due from fellow subsidiaries	**2,510**	8,576
Amounts due from associates	**3,411**	3,396
Trade debtors, bills receivable, deposits and prepayments	**73,115**	114,293
	112,257	155,441

Included in trade and other receivables are trade debtors and bills receivable (net of specific allowances for bad and doubtful debts) with the following ageing analysis.

	At 30 June 2003 $'000	At 31 December 2002 $'000
Current	**21,262**	51,446
1 to 3 months	**15,037**	25,864
More than 3 months but less than 12 months	**2,799**	7,579
More than 12 months	**1,790**	–
	40,888	84,889

Trade receivables, which generally have terms of 14 to 90 days, are recognised and carried in the balance sheet at original invoice amounts less provisions for overdue debts which are considered by the directors to be doubtful.

11 Pledged bank deposits

As at 30 June 2003, the group's long-term bank deposits of $84,846,000 (31 December 2002: $78,000,000) were pledged to the extent of 141% of the outstanding long-term bank loans which amounted to $32,803,000 at that date (31 December 2002: $33,054,000).

12 Cash and cash equivalents

	At 30 June 2003 $'000	At 31 December 2002 $'000
Deposits with banks and other financial institutions	**229,834**	193,511
Cash at bank and in hand	**22,578**	44,572
	252,412	238,083

During the period, the company entered into various structured dual currency option deposit contracts with certain banks and consequently was exposed to foreign exchange risk to the extent of the amount invested for such deposits. As at 30 June 2003, the company had placed deposits under such contracts in the amounts of US$16,849,830 (equivalent to HK$131,414,087), JPY430,768,363 (equivalent to HK$28,086,097) and EUR6,247,345 (equivalent to HK$49,970,462) with banks.

In the opinion of the directors, these structured dual currency option deposits were placed to enhance the return on the company's surplus cash while the exchange risk in relation to the deposits was within an acceptable level.

13 Trade and other payables

	At 30 June 2003	At 31 December 2002
	$'000	*$'000*
Creditors and accrued charges	**86,211**	83,581
Amount due to ultimate holding company	**575**	3,742
Amounts due to fellow subsidiaries	**–**	181
Amount due to associate	**15**	1,924
	86,801	89,428

Included in creditors and accrued charges are trade creditors and bills payable with the following ageing analysis:

	At 30 June 2003	At 31 December 2002
	$'000	*$'000*
Within 1 month	**30,550**	22,845
After 1 month but within 3 months	**3,896**	1,346
After 3 months but within 6 months	**440**	1,346
After 6 months but within 1 year	**1,000**	953
	35,886	26,490

14 Share capital

	Note	No. of shares '000	Amount $'000
Authorised:			
Ordinary shares of US$0.01		5,000,000	390,000
Issued and fully paid:			
At 1 January 2002	*(i)*	140,000	10,794
New issue on public offer	*(ii)*	162,500	12,675
Capitalisation issue	*(iii)*	347,500	27,105
At 31 December 2002		650,000	50,574
Shares issued under share option scheme	*(iv)*	4,456	348
At 30 June 2003		654,456	50,922

Notes:

(i) Pursuant to a written resolution passed by the shareholders on 22 January 2002, the authorised share capital of the company was increased from US$1,400,000 to US$50,000,000 by creating a further 4,860,000,000 ordinary shares of US$0.01 each.

(ii) In February 2002, 162,500,000 ordinary shares were issued at an issue price of $1.20 each upon the listing of the company's shares on the SEHK.

(iii) Pursuant to a written resolution passed by the shareholders on 22 January 2002, US$3,475,000 standing to the credit of the share premium account (after taking into account the share premium arising from the new issue and placing of the company's shares pursuant to the listing of the company's shares on the SEHK) was applied in paying up in full at par 347,500,000 shares of US$0.01 each for allotment and issue to the shareholders in proportion to their then holdings.

(iv) The company has a share option scheme which was adopted on 22 January 2002 whereby the directors of the company are authorised, at their discretion, to invite employees of the group, including directors of any company in the group, to take up options to subscribe for shares of the company.

On 13 May 2003, options were exercised to subscribe for 4,456,000 ordinary shares in the company at a consideration of $5,258,000, of which $348,000 was credited to share capital and the balance of $4,910,000 was credited to the share premium account. 1,950,000 new options were granted during the period to a director. At 30 June 2003, the outstanding options were:

Date option granted	Period during which options are exercisable	Exercise price	Number of options outstanding
7 February 2002	7 February 2003 to 7 February 2012	$1.18	22,454,000
15 April 2003	15 April 2004 to 15 April 2013	$1.43	2,600,000

15 Reserves

	Share premium $'000	General reserve fund $'000	Revaluation reserve– Land use rights and buildings $'000	Retained profits $'000	Total $'000
At 1 January 2002 as previously reported	20,817	8,204	701	238,577	268,299
Prior period adjustment in respect of deferred tax *(note 1(b))*	–	–	–	4,819	4,819
At 1 January 2002 as restated	20,817	8,204	701	243,396	273,118
Dividend approved in respect of the previous year	–	–	–	(31,200)	(31,200)
Transfer between reserves	–	3,758	–	(3,758)	–
Realisation of revaluation reserve	–	–	(37)	37	–
Premium on shares issued under public offer	182,325	–	–	–	182,325
Public offer expenses	(19,759)	–	–	–	(19,759)
Capitalisation issue	(27,105)	–	–	–	(27,105)
Profit for the year, as restated	–	–	–	113,489	113,489
Dividends declared in respect of the current year	–	–	–	(15,600)	(15,600)
At 31 December 2002	156,278	11,962	664	306,364	475,268
At 1 January 2003 as previously reported	**156,278**	**11,962**	**664**	**301,947**	**470,851**
Prior period adjustment in respect of deferred tax *(note 1(b))*	**–**	**–**	**–**	**4,417**	**4,417**
At 1 January 2003	**156,278**	**11,962**	**664**	**306,364**	**475,268**
Dividends approved in respect of the previous year	**–**	**–**	**–**	**(41,885)**	**(41,885)**
Transfer between reserves	**–**	**1,192**	**–**	**(1,192)**	**–**
Realisation of revaluation reserve	**–**	**–**	**(18)**	**18**	**–**
Shares issued under share option scheme	**4,910**	**–**	**–**	**–**	**4,910**
Profit for the period	**–**	**–**	**–**	**58,394**	**58,394**
At 30 June 2003	**161,188**	**13,154**	**646**	**321,699**	**496,687**

16 Commitments

(i) Capital commitments outstanding at 30 June 2003 not provided for in the group's financial statements:

	At 30 June 2003	At 31 December 2002
	$'000	*$'000*
Contracted for	**406**	2,921

(ii) During the period, the company entered into a long-term structured deposit contract with a bank and committed to place a total of US$15,000,000 (equivalent to HK$117,000,000) over a period of 3 years to July 2005. The structured deposits to be made give rise to a foreign exchange exposure; they include both a forward exchange contract element, as deposits are made in Japanese Yen, and also an option element on the forward Japanese Yen rate. At 30 June 2003, an aggregate amount of US$6,000,000 (equivalent to HK$46,800,000) was placed with the bank (31 December 2002: HK$39,000,000).

17 Material related party transactions

During the year, the group entered into the following transactions with its related parties:

	Six months ended 30 June	
	2003	2002
	$'000	*$'000*
(i) Sales to:		
The ultimate holding company:		
– C & H Co., Ltd. *(note 19(iii))*	**213,560**	195,951
Fellow subsidiaries:		
– C & H Lanka (P.V.T.) Ltd.	**–**	1,388
– Gina World Co., Ltd.	**5,720**	9,524
	219,280	206,863
Associate:		
– Sung Won Industries Inc.	**15,903**	–

		Six months ended 30 June	
		2003	2002
		$'000	*$'000*
(ii)	Purchases from:		
	The ultimate holding company:		
	– C & H Co., Ltd.	**36,602**	34,249
	Fellow subsidiaries:		
	– C & H Lanka (P.V.T.) Ltd.	**–**	986
	– JY Textile Co., Ltd.	**–**	1,455
		36,602	36,690
	Associate:		
	– Sung Won Industries Inc.	**1,070**	–
(iii)	Sales commission paid/payable to:		
	Ultimate holding company:		
	– C & H Co., Ltd.	**2,348**	576
(iv)	Sales commission received/receivable from ultimate holding company		
	– C & H Co., Ltd.	**330**	747
(v)	Processing fee paid/payable to:		
	Associate:		
	– Yuan Lin Toys (Suzhou) Co., Ltd.	**4,065**	–

The directors of the company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business on normal commercial terms.

18 Post balance sheet events

(i) On 18 July 2003, a subsidiary of the group entered into a conditional sale and purchase agreement with the shareholders of C & H Co., Ltd. ("C & H Korea") to acquire the entire share capital of Dream INKO Co., Ltd. ("Dream Korea") for a cash consideration of US$17 million (equivalent to HK$132.6 million). The principal activities of Dream Korea are the marketing, design and product development of plush stuffed toy business which were transferred from C & H Korea. The acquisition was approved by the shareholders, in an extraordinary general meeting held on 4 September 2003.

(ii) After the balance sheet date, the directors proposed an interim dividend. Further details are disclosed in note 6.

19 Comparative figures

(i) Comparative figures have been restated based on the requirement of the new accounting standard as set out in note 1(b) on the interim financial report.

(ii) The presentation of certain comparative figures in the segment reporting as disclosed in note 2 on the interim financial report has been reclassified to conform to the current period's presentation which the directors consider provide a better indication of the results of the group for the period.

(iii) As disclosed in the company's announcements dated 29 August 2003 and 8 September 2003, certain sales to C & H Korea for the year ended 31 December 2002 were mis-classified as sales to third parties and not disclosed as related party sales in note 30 on the 2002 financial statements of the company. The revised sales amount to C & H Korea of $195,951,000 for the six months ended 30 June 2002 has been included in note 17(i) on the interim financial report. The revised sales amount to C & H Korea for the year ended 31 December 2002 is $454,886,000.

20 Ultimate holding company

The directors consider the ultimate holding company at 30 June 2003 to be C & H Co., Ltd., which is incorporated in the Republic of Korea.

21 Approval of interim financial report

The interim financial report was approved by the board of directors on 23 September 2003.