Management Discussion and Analysis

RESULTS

The Group's turnover for the financial year ended 31st December, 2003 amounted to approximately HK$495.3 million, representing an increase of 40.3% over that reported in the previous financial year. The loss attributable to shareholders in the financial year of 2003 is approximately HK$5 million. (2002: loss of HK$39 million).

During last year, there were signs of gradual global economic recovery. In the United States, the economy recovered steadily, while in the PRC, there was rapid business growth and the economic climate was good. In Hong Kong, despite being adversely affected by the outbreak of the SARS epidemic in the first half of the year, the economy progressively recovered during the second half of the year. The Group, having its production plant based in the PRC, and its major customer base from the United States, benefited from such improved economic situations. Despite facing keen competition and harsh operational conditions, the Group achieved an increase of 40.3% in business turnover as compared to the corresponding period of the preceding year.

BUSINESS REVIEW

Toys

During 2003, the Group was operating under keen competition and harsh operational conditions. Raw material prices and other operational costs were high, while the PRC government had tightened the labor laws and custom policies that resulted in increased production costs. Despite all these unfavorable operating conditions, the Group recorded strong growth in OEM/ODM toys business. During the period under review, the turnover for the OEM/ODM toys business amounted to HK$198.8 million, an increase of 120% as compared to the corresponding period of last year.

During the outbreak of SARS in March 2003, the Group managed to keep the impact of the epidemic to minimal and maintained the production line in good performance level. When the time came for the economy to turnaround from the bottom, the Group is well prepared to meet the opportunity. During year 2003, business orders in the OEM/ODM toys business had increased tremendously, and the Group had successfully fulfilled its mission in producing high quality products under tight delivery lead-time and exercised tight cost control.

Model Trains

During the period under review, turnover in model trains increased by 15% as compared to the corresponding period of last year. The Group benefited from the recent economic growth in both Europe and the United States, as well as from the Group's continuous efforts in developing the Group's own brand name products. It is a global sign that there was growing demand for collectibles, and the Group's model trains were most welcome in the field of model train collectors in both Europe and the United States.

In Europe, the Group's own brand name product line, Graham Farish, is becoming more and more popular in the market. It is anticipated that business from Graham Farish will be steadily increasing.

Management Discussion and Analysis *(Continued)*

In the United States, several of the Group's Bachmann products continue to be "Award of the Year" in 2003, namely "Bachmann Spectrum Large Scale 2-6-0 Locomotive" was awarded Large Scale Locomotive of the Year; "Bachmann Spectrum On30 Two Truck Shay Locomotive" was the award of O-Scale Locomotive of the Year; "Bachmann Spectrum On30 Log Car, Woodside Dump Car, V Dump Car" was awarded Narrow Gauge Wagon of the Year; and lastly, the "Bachmann Spectrum Large Scale Heisler Locomotive" was awarded Large Scale Model of the Year. The Group is proud of its continuous leading position in the model train industry.

Looking ahead, the Group will focus on developing its own brand name products, widening product ranges and increasing market share.

Property Investment

During the period under review, the rental income of the Group dropped slightly, a decrease of 8% as compared to the corresponding period of last year. The drop is mainly due to the termination of several leases as a result of the adverse impact to Hong Kong's economy during the outbreak of the SARS epidemic in March 2003. However, the Group managed to secure new tenants and the occupancy rate maintained at around 80% as of 31st December, 2003.

During the year under review, the Group placed great efforts in upgrading its rental properties, studying various improvement plans, usage conversion plans etc., aiming to increase the development potential of the premises. With the recent remarkable signs of recovery in the property market, the Board anticipates the property investment will make a better contribution to the Group's revenue.

Investment Holding

During July 2002, the Group was brought into litigation arising from the termination of the agency in relation to the management of the Resort at Squaw Creek ("the Resort"). In March 2003, the Group reached a settlement with the disputing party, and in August 2003, the litigation ended. After the settlement, the disputing party's interest in the Resort was bought out, with funding from the Ting family, the majority shareholder of the Group. The directors agreed that the settlement was in the best interests of the Group.

During the year under review, the Resort had been operating under harsh conditions. Although the US economy has shown steady improvement in year 2003, the hotel industry had little benefit from this weak recovery. Consumer confidence was still weak while competition within the industry remained keen. Occupancy rate and room rates both deteriorated due to keen competition, these eventually lead to low profit margin and weak performance.

In April 2004, a new hotel operator, Destination Hotels & Resorts, was appointed to manage the Resort. Although the Resort did not provide contribution in year 2003, the Group has great confidence in the new management and believes that the performance of the Resort will improve under the management of the new hotel operator.

FINANCIAL REVIEW

Liquidity and Financial Resources

As at 31st December, 2003, the Group's current ratio was 0.80 (2002: 0.83). The Group's total bank borrowings have decreased from approximately HK$278 million as reported last year to approximately HK$250 million as at year-end. The financial gearing of the Group, based on the total bank borrowings to the shareholder's equity was maintained at 57% (2002: 64%). There is no significant seasonality of borrowing requirements except during peak sales period when the Group's trade loans will be comparatively higher.

Capital Structure

During the year ended 31st December, 2003, there were no movements in the Company's share capital. The Group's capital instruments are mainly composed of bank loans and directors' support, which are in HK dollars, sterling and US dollars at prevailing market rates.

Charges on Group Assets

As at 31st December, 2003, certain investment properties, leasehold land and buildings and other assets of the Group with a total net book value of approximately HK$621 million (2002: 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, 2003. At the moment, there are no major plans for material investments or capital assets.

Exchange Rate Exposure

Major assets, liabilities and transactions of the Group are denominated either in sterling, U.S. dollars, Canadian dollars, Renminbi or Hong Kong dollars. During the year under review, the exchange rate of US dollars and Renminbi against Hong Kong dollars was relatively stable while sterling and Canadian dollars had appreciated. Both sterling and Canadian dollars formed part of the Group's revenue source, the Group benefited from the appreciation of these two currencies.

Contingent Liabilities

As at 31st December, 2003, the Group did not have significant contingent liabilities except:

(a) Around May 2003, a Group company was bought into litigation with a supplier of resin materials. The supplier has taken action against the Group company for settlement of a trading debt amounting to HK$643,980. However, the Group company has counter claimed for US$590,000 as the resin materials supplied did not meet the required specifications. The directors believe the Group will not suffer any material loss as a result of these claims.

Management Discussion and Analysis *(Continued)*

(b) During the last quarter of 2003, a Mexican company commenced a law suit in the State of Arizona against the Company based on their claims that the Company is a guarantor for a Lease Agreement of factory premises occupied by Siempre Novedoso De Mexico (Sinomex) S.A. de C.V. ("Sinomex") as tenant ("Litigation"). Sinomex was a member company of the Group that was disposed in mid 1996. The plaintiffs allege claims against Sinomex and the Company of approximately US$5,000,000 for unpaid obligations of Sinomex under the Lease Agreement.

In early January of 2004, the Company's legal counsel filed a Motion to Dismiss the complaint in the Litigation based upon the applicable law of Arizona and that of the location of the property, Hermosillo, Mexico. In that Motion, the Company argues that the Arizona court has insufficient subject matter and personal jurisdiction over the Company under the Guarantee for the case to continue in that court, and as such, the case should be dismissed against the Company. Plaintiffs have not responded to the Company's Motion to dismiss as of this date.

Management having considered the Litigation with legal counsel to the Company, the Directors believe that the Company's Motion to Dismiss plaintiffs' complaint is meritorious, and that the Company has valid defenses to the claims of the plaintiffs. As such, the Company intends to vigorously defend the matter. On that basis, the Company has not made provision in relation to this claim.

EMPLOYEES AND REMUNERATION POLICIES

As at 31st December, 2003, the Group employed approximately 4,800 (2002: 5,100) full time management, administrative and production staff in the United States, 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 forward, the Board anticipates that 2004 will be a year of recovery. As a matter of fact, the official forecast of Hong Kong's GDP growth is 6% for 2004. Total exports and imports of goods grew by 11.7% and 11.5% respectively in 2003. The fiscal deficit and the unemployment rate are expected to decline gradually. Local interest rates continue to stay at a low level, and the property market is steadily recovering. All these basic economic conditions strengthened the operating environment for Hong Kong's manufacturing and export business.

On the other hand, competition has remained keen. Orders received are getting smaller in terms of lot size, while shorter delivery lead-time is generally required. The Board also alerted the possible harm to the Group's profit margin caused by the recent price fluctuation on electronic components and raw materials, like plastics, zinc alloy and packaging materials, etc.

However, the Group is always well prepared to strive for challenges and will closely monitor the operational situation and adhere to cautious precaution policies. To reduce operational costs and stay competitive, the Group will focus its strategies on cost control, enhancing product quality and improving productivity. The Group also adopts a prudent approach on cash management and continues to reduce stock level. Besides strengthening the core business, the Group also aims to explore new products, deploying new knowledge and new technologies, as well as to widen customer base.

The Board is cautiously optimistic to the future economic development, and is confident in leading the Group to maintain its top position in the toys industry, to commit total satisfactory to the customers and to provide high quality products to the market.

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

Hong Kong, 16th April, 2004