

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 recently responded to the Company's Motion to Dismiss refuting the positions of the Company based upon submitted documentation. The Company is in the process of replying to the plaintiffs' Response.

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 30th June 2004, the Group employed approximately 7,500 (at 31st December 2003: 4,800) full time management, administrative and production staff in the United States, Europe, the 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.

PROSPECTS

During the period under review, Hong Kong economy has exhibited a broad-based upturn. There are signs that Hong Kong's fiscal deficit is gradually declining, consumer confidence is returning, the property market is heating up, deflation is expecting to subside and unemployment rate is falling. The launching of the Closer Economic Partnership Arrangement ("CEPA") not only brought business opportunities for the retailing sector but to manufacturing industry as well. Moreover, the States has shown good signs of economic recovery. With the coming of the peak season for toys industry, the Board anticipates that the Group's performance for the second half of the year would be better.

However, adverse factors still exist. For instance, the Board is concerned about the fluctuation of raw material prices and shortage of labour in Guangdong Province. The possibility of a drastic increase in interest rates and the price fluctuation in crude oil also hinder global economic growth. All these unfavourable factors will increase production costs and reduce manufacturers' profits.

The Board will closely monitor the operational situation and adhere to cautious business policies. Meanwhile, measures and policies have been carried out in materials control and planning, cost control, as well as in labour efficiency. Every effort will be made to achieve our goal of enhancing product quality and improving productivity.