Management Discussion and Analysis

RESULTS

For the year ended 31st December, 2004, Matrix Holdings Limited (the "Company") and its subsidiaries (collectively, the "Group") attained yet another successful year and achieved record turnover and net profit. Turnover for the year reached HK$686,684,000 (2003: HK$500,357,000), a surge of 37.2% from that in the preceding year. Net profit for the year rose by 15.7% to HK$151,810,000 (2003: HK$131,166,000), which in turn resulted diluted earnings per share to HK$0.26 (2003: HK$0.23).

This commendable performance was mainly attributable to the significant increase in contribution from the second plant in Vietnam which made its first full-year contribution to the Group in 2004. Increasing demand from the Group's loyal customers and new customers cultivated during the year were also key drivers behind its outstanding results.

On the other hand, similar to its manufacturing peers, the Group's profit margin was inevitably undermined by the incessant rise in global commodity prices in the year of 2004. However, with the Group's stringent cost control and enjoying considerable economies of scale, the Group was enable to achieve competitive raw material prices.

DIVIDENDS

During the year, the Company paid an interim dividend of HK8 cents (2003: HK8 cents) and declared a special dividend of HK3 cents (2003: HK3 cents) per share to the shareholders. The Directors recommended the payment of a final dividend of HK9 cents (2003: HK9 cents) per share in respect of the year ended 31st December, 2004 (Based on 584,720,000 shares in an amount of HK$52,625,000). Together with the interim dividend and special dividend paid and declared of HK8 cents and HK3 cents per share respectively, the total dividend per share for the year is HK20 cents (2003: HK20 cents). Subject to the approval of the shareholders at the forthcoming annual general meeting, the proposed final dividend will be paid on or about 26th April, 2005.

BUSINESS REVIEW

With the global economy steadily recovering since the beginning of 2004, the Group was able to finish the year with significant growth in its operating and financial results. During the year under review, the Group's efforts to further develop its OEM premium toy manufacturing business yielded positive results, as reflected by the increased contribution from the second plant in Vietnam. Also, its stringent cost control measures augmented the Group's encouraging performance.

During the year under review, the Group acquired a business promotional company in the PRC to further tap into the PRC market. Towards the beginning of 2005, the Group made a strategic move into the ODM toy market with the acquisition of the well-established US-based companies of Shelcore, Inc., Shelcore Hong Kong Limited, Shelcore Canada Limited and Shelcore UK Limited (together referred to as "Shelcore Companies"). The management strongly believes that these two acquisitions will open up new opportunities for the Group's future business growth.

With its healthy financial position as its foundation, added onto that its remarkable financial and management track record, the Group is well positioned to reach even greater heights moving forward, when the newly merged Matrix Group emerges.

Management Discussion and Analysis

TOY MANUFACTURING OPERATION

Zhongshan, the PRC

PRC

Located in Zhongshan, the PRC, the Group's manufacturing plant is well-equipped with fully-integrated and centralized facilities for molding, welding, spray painting, printing and assembly. Given its sizeable production scale, the Group's Zhongshan plant is able to enjoy considerable economies of scale with the procurement of bulk raw materials at competitive prices and enjoyment of relatively lower production costs in the PRC. In addition, the Group also managed to maintain a stable labour supply and workforce during the year.

Being fully aware that technological advancements are critical to advancing its production pace, the Group also implemented an Enterprise Resources Planning (ERP) System starting in Zhongshan plant to systematically integrate and consolidate the Group's entire manufacturing process as a whole.

In order to cope with the increasing orders and improve the handling efficiency, the Group is now in the process of constructing a new warehouse with a total gross floor area of approximately 5,000 square metres.

Danang City, Vietnam
– First plant

Danang City, Vietnam
– Second plant

Embroidery Department
Danang City, Vietnam – Plant

Vietnam

Being one of the first movers in the Asian regional toy industry to set up a manufacturing plant in Vietnam, the Group has since set up its second plant in Danang City, Vietnam focusing on the production of high-quality plush toys with its first plant engaged in the production of plastic toys, which becomes the Group's major production base.

The Group's second Vietnam plant has commenced full scale operation of plush toy manufacturing during the year, and has also installed a number of new embroidery machines to boost its production of plush toys. Along with its 4,600 sewing machines in 2004, this Vietnam plant has become one of the largest scale manufacturers of plush toys in the world. During the year, a number of experts were recruited to improve the existing plush toys operation.

Management Discussion and Analysis

PRINTING OPERATION

During the year under review, the printing operation had primarily served as the Group's internal consumption, supplementing the packaging function in the overall production process. This printing arm had achieved Matrix's goal on vertical integration functionally and enabled the Group to deliver the products to clients effectively. To further maximize the use of the printing machines, the Group had utilized the excess capacity to develop the network of external customers and bring in a new source of revenue to the Group.

As the Group believes the demand from external users will be increasing, complemented by the Group's internal demand, this operation will have a positive contribution to the Group's bottom-line in the forthcoming years.

MARKETING AND PROMOTIONAL OPERATION

Without missing a beat, strategic acquisitions were undertaken by the Group to spearhead its business growth through gradual expansion. During the year under review, the Group acquired 深圳智又盈投資顧問有限公司 (formerly known as 深圳市智又盈投資顧問有限公司) – a business promotional company in the PRC to capture the explosive growth momentum of the mainland market and serve as the Group's marketing arm in the PRC market. This company serves many renowned clients from various business sectors such as oil, banking, information technology, telecommunications, media, manufacturing, etc.

FINANCIAL REVIEW

Borrowing and Gearing

During the year under review, the Group was granted banking facilities in a total of HK$5,000,000 (2003: HK$42,000,000) secured by a fixed deposit. The Group's gearing ratio was 0% (2003: 4.9%), representing the total debt divided by total shareholders' fund and convertible loan stock. As at 31st December, 2004, the Group had cash and bank balances of HK$94,699,000 (2003: HK$83,243,000).

Capital Expenditure

The total capital expenditure during the year amounted to HK$14,790,000 (2003: HK$30,564,000) to expand and upgrade the production capacity. These capital expenditure were funded mainly by internal resources.

Shareholders' Funds and Share Capital

Shareholders' funds as at 31st December, 2004 increased 19.2% (2003: 44.8%) to approximately HK$282,975,000 (2003: HK$237,298,000). There had been an increase in the issued share capital from HK$46,272,000 to HK$58,472,000 due to the conversion of HK$12,200,000 convertible loan stock during the year.

Liquidity

The Group maintained a strong financial position for this year. Net cash generated from operating activities amounted to approximately HK$151,000,000 (2003: HK$117,000,000).

Assets and Liabilities

As at 31st December, 2004, the Group had total assets of HK$454,007,000 (2003: HK$363,748,000), total liabilities of HK$170,900,000 (2003: HK$126,450,000) and shareholders' equity of HK$282,975,000 (2003: HK$237,298,000).

Management Discussion and Analysis

Contingent Liabilities

The Company had given guarantees to a bank in respect of general facilities granted to its subsidiary which had not been utilized at the balance sheet date.

Exchange Rate Risk

The assets and liabilities of the Group are mainly denominated either in Hong Kong dollar, United States dollar, Renminbi or Vietnamese dong.

A majority of the Group's inventory purchases was made in Hong Kong dollar and Vietnamese dong whereas majority of sales were denominated in United States dollar. Theoretically, the Group was subject to foreign exchange risk exposure in Hong Kong dollar against United States dollar for trust receipts loan borrowing plus any uncovered inventory position to fulfill sales contracts. With the strong support from the government to maintain the peg system in Hong Kong, the exchange rate for the United States dollar should be relatively stable and the Group's potential risk exposure in United States dollar should thus be minimal in the foreseeable future. The Group will continue to monitor closely the exchange risks by requesting United States dollar settlement from customers and hedging the exposure with the appropriate use of forward contracts and applicable derivatives where necessary.

HUMAN RESOURCES

As at 31st December, 2004, the Group had a total of approximately 15,000 (2003: 12,000) employees in Hong Kong, Macau, PRC and Vietnam. The Group provides its employees with competitive remuneration packages commensurate to the level of pay established by the market trend in comparable businesses. A mandatory provident fund scheme and share option scheme are also in place.

CORPORATE GOVERNANCE

The Group strives for enhancing its standard of corporate governance for enhancing its corporate transparency and improving investor protection. The Company had voluntarily published its third quarterly results to the public during the year and has planned to adopt a code of corporate governance practices in the coming year to improve its corporate governance to meet with the increasing standard in Hong Kong.

INVESTOR RELATIONS

During the year under review, the Group has proactively enhanced its corporate transparency and communications with its shareholders and the investment community through its mandatory interim and final financial reports as well as voluntary third quarter financial results announcement. Through the timely distribution of press releases, the Group has also kept the public abreast of its latest developments. Regular meetings and plant visits have been organized to enhance the investors' understanding of the Group's business and production operations.

Management Discussion and Analysis

PROSPECTS

As we look forward, the outlook for the global toy market will remain competitive, despite the positive signs of recovery in the global economy since 2004. However, with our solid foundation laid on our core toy manufacturing operation and sound financial position, we are confident of accomplishing continued growth for our business in the year of 2005.

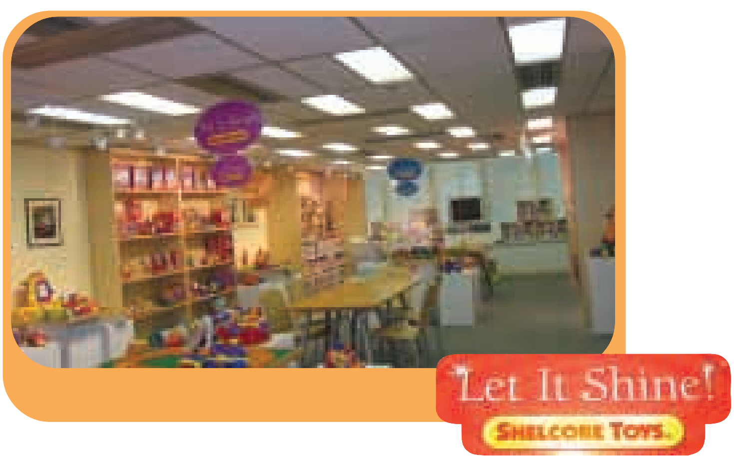
On 16th November, 2004, the Group entered into agreements to acquire certain assets of Shelcore, Inc. and Shelcore Hong Kong Limited and the entire issued share capital of each of the Shelcore Companies, well-established US-based toy companies specializing in the design, manufacturing and sales of plastic toys for infant and pre-school children, for a total consideration of US$8.5 million (approximately HK$66.3 million). This acquisition was successfully completed in January 2005.

Shelcore Companies was established almost 30 years ago in the US and sells its toy products both under its own brand name "Shelcore Toys" and its customers' private labels. It has now developed into a multi-national marketing organization with operating companies in the US, United Kingdom, Canada and Hong Kong, and a distribution network spanning over 60 countries worldwide. The Shelcore Companies' ISO 9002-certified production facility occupies a site area of approximately 280,000 square feet in Shenzhen, the PRC.

This acquisition allows the Group to take advantage of the Shelcore Companies' brand value to gain an established and significant market share in the global infant and pre-school children retail toy industry. Shelcore Companies also provides the Group with a widespread distribution network in the global marketplace, which will pave out channels for the Group to reach out to global customers. With an extensive global distribution network, the Shelcore operation has little customer concentration risk, which in turn diversifies the market risk of the newly merged Matrix Group. In return, the Group will be able to spread its superior cost management expertise to the Shelcore operations, so as to augment the ODM toy segment's contribution to the Group's bottom-line.

In the coming year, we will focus on the amalgamation of Shelcore operation into the Group. With the Shelcore acquisition completed in January 2005, we expect to bring improvement to the financial performance of the Shelcore operations. Combining the Shelcore Companies' strong marketing expertise and the Group's know-how in manufacturing and cost control, we believe that the newly merged Matrix Group will capture even more business opportunities in the increasingly competitive global toy market and achieve a new business height in the coming future.

ACQUISITION OF SHELCORE GROUP



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