Management Discussion and Analysis

RESULTS

The Group's turnover for the financial year ended 31st December, 2004 amounted to approximately HK$501.1 million, representing a slight increase of 1.17% over that reported in the previous financial year. The turnaround profit attributable to shareholders in the financial year of 2004 is approximately HK$3 million. (2003: loss of HK$5 million).

The economic recovery that started in 2003 continues to gain momentum in 2004. Global economic climate remains positive and Hong Kong continues to benefit from the strong economic situation in both the PRC and the United States.

While operating conditions remained difficult, with both labour cost in PRC and prices of raw materials kept increasing and sometimes fluctuating widely, the Group benefited internally from its implementation of various cost effective measures and externally from the weak US dollar that boosted exports.

BUSINESS REVIEW

Toys

During the year under review, the turnover for the OEM/ODM toys business amounted to HK$157.1 million, representing a decrease of 21% as compared to the corresponding period of last year.

The operating condition for manufacturers in 2004 was not much better than that in 2003. Fierce competition and difficult operating conditions had not improved. Raw material prices and other operational costs remained high. To improve profit margin, the Group remained prudent and cautious when taking proposed business orders. As a result, the turnover of OEM business dropped during the year under review. To cope with this situation and to remain competitive, the Group adopted strict policies on cost control, and strived to increase its market share of the OEM products with high profit margin.

Model Trains

The Group is proud to report that during the year under review, the model trains section achieved brilliant performance. Turnover in model trains increased by 18.20% as compared to the corresponding period of last year, amounting to HK$319.6 million.

During the year under review, the Group's model trains continued to be the most favourable products in the field of model train collectors in both the United Kingdom and the United States. In the European market, over the years, the Group has placed considerable efforts in developing its own brand name product lines, Bachmann Branchline, Graham Farish and Lilliput. As such, the Group's efforts have begun to bear fruit. The Graham Farish line, in particular, is well received in the market, and this product dominated 90% of the N-scale market in the United Kingdom. Looking ahead, efforts will continue to be placed in expanding all our product lines further, and enhancing the accessories to strengthen this expansion.

Management Discussion and Analysis *(Continued)*

Another exciting event the Group would like to report is that in 2004, our model train products succeeded in incorporating the latest digital technology into the Bachmann E-Z Command – Digital Command Control (DCC) System, which is both easy to use and affordable for novice and experienced hobbyists alike. The E-Z command allows modelers to digitally control speed, lighting, and direction of multiple locomotives on a single track. Also, unlike other complicated DCC systems, E-Z command simplifies the programming process by using main-track programming.

The Group is confident that the new range of products with this new technology will attract the youngsters to join the railroading fever together with traditional hobbyists. The Group is ambitious to have our railroading products ready to penetrate into the younger population group, thus foreseeing possible promising performance in the coming year.

Property Investment

During the year under review, the Group managed to secure new tenancies both for existing vacant premises and expired tenancies of Kader Building during the year. The occupancy rate increased to 85% as at the year-end as compared with 80% during the corresponding period of last year. One of the tactics to increase occupancy rate was to offer favourable rate to new tenants. This has slightly affected the Group's rental income. The rental income of the Group dropped by 6.98% as compared to the corresponding period of last year.

Following the recent upturn in Hong Kong's property market, the rental market for commercial/ industrial buildings, especially in the Kowloon Bay district, is edging up. The Group is confident that its rental income will grow at a steady pace and provide steadily improving revenue to the Group in the long run.

Benefiting from the recent improvements in the global economy, the Group recorded an appreciation on the valuation of the Group's investment properties. In Hong Kong, the recent auction of the crown land in Kowloon Bay was well received. For this reason, the Group's major rental property in Kowloon Bay, the Kader Building, also appreciated in value as compared with last year.

In Canada, the property market remained active in 2004 and the Group's rental properties in Vancouver also appreciated in value. The Group plans to sell a portion of its properties in Vancouver to take advantage of the active market. Lastly, the property market continues to grow in Shanghai, PRC. Both rental income and property value had increased. The Group decided to hold its properties in Shanghai as a long-term investment.

Management Discussion and Analysis *(Continued)*

Investment Holding

Following settlement of the litigation arising from the termination of the agency relating to the management of the Resort at Squaw Creek (the "Resort"), the Group's major investment in the United States, we have partnered with a reputable real estate and hospitality group.

With their expertise and ideas, the ownership was able to conduct a feasibility study on the opportunity for the condominium sale of existing hotel guest rooms. A decision was made thereafter to convert the Resort into a condominium hotel, where guest rooms will be structured as separate condominium units to be marketed and sold to individual owners. The condominium owners may then contribute their units to a rental program managed by the ownership.

Since the main structure of the hotel is already in place, a preliminary launch was planned during Spring 2005 and a second launch to occur in the Fall 2005. At the time of this report, the preliminary launch was extremely successful during which over 60% of the units were sold on the first day of the launch.

The condominium conversion strategy would reduce operating risk for the Resort and provides significant liquidity to the ownership.

Management Discussion and Analysis *(Continued)*

FINANCIAL REVIEW

Liquidity and Financial Resources

As at 31st December, 2004, the Group's current ratio was 1.00 (2003: 0.80). The Group's total bank borrowings were reduced from approximately HK$250 million as reported last year to approximately HK$214 million as at year-end. The financial gearing of the Group, based on the total bank borrowings to the shareholder's equity, was reduced to 42% (2003: 57%). 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, 2004, 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 pound, US dollars and Canadian dollars at prevailing market rates.

Charges on Group Assets

As at 31st December, 2004, certain investment properties, leasehold land and buildings and other assets of the Group with a total net book value of approximately HK$659 million (2003: HK$621 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, 2004. 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 pound, U.S. dollars, Canadian dollars, Renminbi or Hong Kong dollars. During the year under review, the majority of the Group's sales proceeds were in Hong Kong dollars, U.S. dollars and sterling pound while the majority of its raw materials and equipment purchases were required to be settled in HK dollars. As at 31st December, 2004, the Group was not exposed to material exchange risk.

Contingent Liabilities

As at 31st December, 2004, the Group did not have any significant contingent liabilities except:–

a) As reported in the Group's 2003 Annual Report, around May 2003, a Group company was brought 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 claimed against the supplier for US$590,000 as the resin materials supplied did not meet the required specifications. No trial dates have been fixed. The directors believe the Group will not suffer any material loss as a result of these claims.

b) As reported in the Group's 2003 Annual Report, during the last quarter of 2003, a Mexican company commenced a law suit in the State of Arizona against the Company on the ground 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 (the "Litigation"). Sinomex was a member company of the Group. It was disposed of 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 plus interest (in the amount of 2% per month, or 24% annually), court costs and attorney fees.

   In early January of 2004, the Company's legal counsel filed a Motion to Dismiss the complaint in the Litigation based upon the applicable laws of Arizona and those of the location of the property, Hermosillo, Mexico. In the Motion, the Company primarily argued that the Arizona court does not have sufficient 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 in favour of the Company.

   On 24th January, 2005, the Arizona court denied the initial motion submitted by the Company. The Company plans to continue to vigorously defend the Litigation, and to assert the defences available to it. This would eliminate or at least significantly reduce the exposure of the Company if those defences prove to be successful.

   Having considered the Litigation with legal counsel to the Company, the management and the Board believe that the Company's opposition to the plaintiffs' complaint, and its defenses, including defenses to the amount of damages awardable, are meritorious. As such, the Company intends to continue to vigorously defend the Litigation. In addition, the Company has filed counterclaims against the plaintiff and a cross-claim against Sinomex in the Litigation. On that basis, the Company has not made provision in relation to the Litigation.

EMPLOYEES AND REMUNERATION POLICIES

As at 31st December, 2004, the Group employed approximately 5,150 (2003: 4,800) 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 practices. In the area of staff training, the Group encourages and supports staff to engage and participate in continuing studies and self-enhancement courses.

AUDIT COMMITTEE

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

Management Discussion and Analysis *(Continued)*

PROSPECTS

The year of 2004 witnessed relatively favourable global economic conditions. During the year, the Group managed to achieve its goal in delivering a good performance. In 2005, most determinants of the short-term prospects remain positive, though the rising interest rates may bring new challenges to keep up the economic growth. Fluctuating prices in crude oil and raw materials, together with shortage of labour and electricity in the Guangdong Province, are other challenges that may affect costing significantly. To meet these challenges, the Group will adhere to prudent precautionary policies on cost control, product quality enhancement and productivity improvements. The Group will also continue the strategy of adopting prudent approach on cash management and reducing stock level. While the Group will strengthen its core business, it will continue its drive to develop its own product designs and brand name further, explore new business opportunities and broaden its customer base.

The Board is cautiously optimistic that 2005 will be another prosperous year and is committed to achieving good performance. The ultimate goal is to lead the Group to fulfill its pledge in providing high quality products and maintaining the leading position in the toys industry.

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

Hong Kong, 12th April, 2005