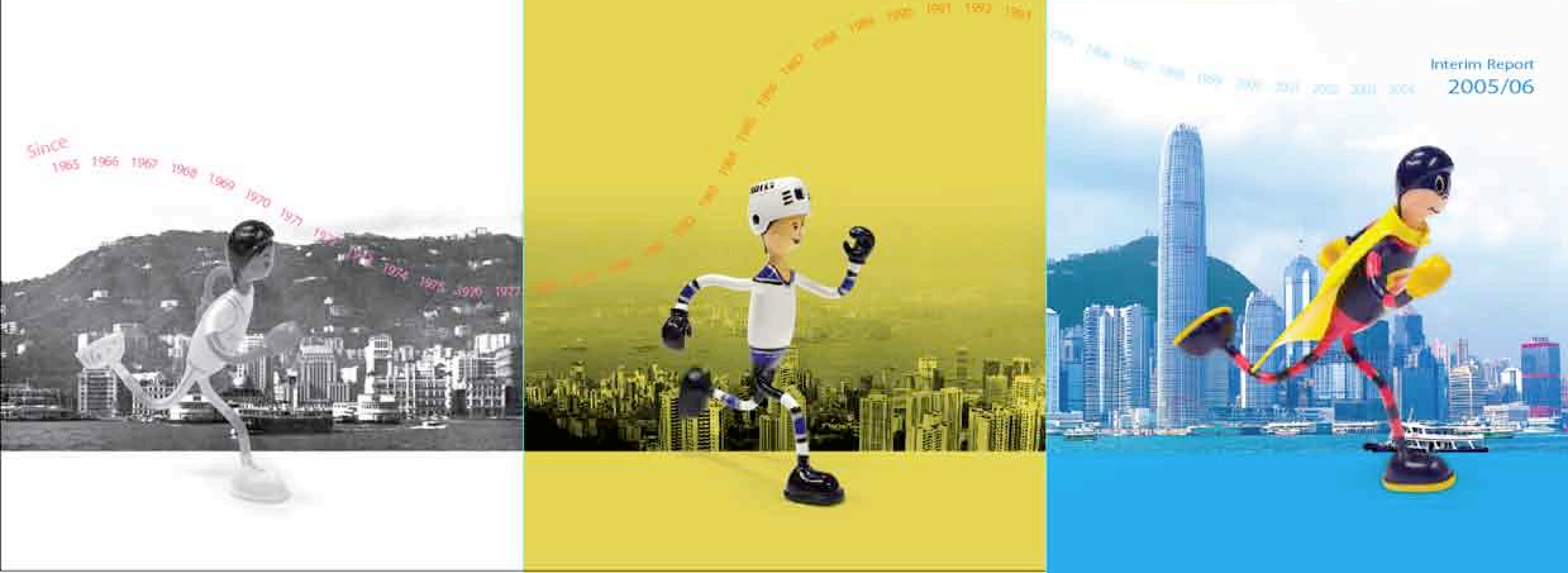
Lung Cheong International Holdings Limited

(Incorporated in the Cayman Islands with limited liability)

Interim Report 2005/06



CORPORATE INFORMATION

Executive Directors
Mr. Leung Lun *(Chairman)*
Mr. Leung Chung Ming *(Managing Director)*
Mr. Zhong Bing Quan
Ms. Cheng Yun Tai
Mr. Wong Tze On, Andy

Independent Non-executive Directors
Mr. Wong Lam, O.B.E., J.P.
Mr. Ye Tian Liu
Mr. Lai Yun Hung

Non-executive Director
Mr. Ko Peter, Ping Wah

Company Secretary
Mr. Mak Yee Chuen, Vincent

Auditors
PricewaterhouseCoopers

Audit Committee
Mr. Ye Tian Liu *(Chairman)*
Mr. Wong Lam, O.B.E., J.P.
Mr. Ko Peter, Ping Wah
Mr. Lai Yun Hung

Remuneration Committee
Mr. Leung Lun
Mr. Leung Chung Ming
Mr. Wong Tze On, Andy
Mr. Wong Lam, O.B.E., J.P.
Mr. Ye Tian Liu
Mr. Lai Yun Hung
Mr. Ko Peter, Ping Wah

Registered Office
Ugland House
South Church Street
P.O. Box 309
George Town
Grand Cayman
Cayman Islands
British West Indies

Head Office and Principal Place of Business
Lung Cheong Building
1 Lok Yip Road
Fanling
Hong Kong
Tel: (852) 2677 6699
Fax: (852) 2677 6857

Principal Bankers
ABN AMRO Bank N.V.
Bank of China (Hong Kong) Limited
Bank of East Asia, Limited
Bank of Tokyo-Mitsubishi
BNP PARIBAS
DBS Bank (Hong Kong) Limited
Hang Seng Bank Limited
ICBC (Asia) Limited
ING Bank N.V.
KBC Bank N.V.
Rabobank, Hong Kong Branch
Standard Chartered Bank

Legal Advisers on Hong Kong Law
Chiu & Partners

Legal Advisers on Cayman Islands Law
Maples and Calder Asia

Principal Share Registrar and Transfer Office
Bank of Bermuda (Cayman) Limited
P.O. Box 513 G.T.
3rd Floor, British American Tower
Dr. Roy's Drive
George Town
Grand Cayman
Cayman Islands
British West Indies

Branch Share Registrar and Transfer Office in Hong Kong
Abacus Share Registrars Limited
Ground Floor, BEA Harbour View Centre
56 Gloucester Road
Wanchai
Hong Kong

Listing Information
The Stock Exchange of Hong Kong Limited
Stock Code: 348

The board of directors (the "Directors") of Lung Cheong International Holdings Limited (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (the "Group") for the six months ended 30 September 2005 together with comparative figures for the corresponding period in 2004. These interim consolidated accounts have not been audited but have been reviewed by the Company's Audit Committee.

CONDENSED CONSOLIDATED INCOME STATEMENT

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2005

		Unaudited Six months ended 30 September	
	Note	**2005 HK$'000**	2004 HK$'000
Turnover	2	**369,013**	389,280
Cost of sales		**(268,955)**	(281,192)
Gross profit		**100,058**	108,088
Other revenues	2	**1,619**	938
Selling and distribution expenses		**(20,004)**	(14,719)
Administrative expenses		**(63,487)**	(60,795)
Operating profit	3	**18,186**	33,512
Finance costs	4	**(7,069)**	(4,150)
Profit before taxation		**11,117**	29,362
Taxation	5	**(1,113)**	(2,964)
Profit for the period attributable to equity holders of the Company		**10,004**	26,398
Dividends	6	**—**	2,419
Earnings per share — Basic	7	**2.07 cents**	5.46 cents

CONDENSED CONSOLIDATED BALANCE SHEET

AS AT 30 SEPTEMBER 2005

	Note	**Unaudited 30 September 2005 HK$'000**	Audited 31 March 2005 HK$'000 (Restated)
Non-current assets			
Goodwill		**18,456**	19,240
Fixed assets	8	**310,575**	315,981
Lease premium for land		**22,724**	22,958
Available-for-sale investments		**32,459**	31,936
Deferred tax assets		**1,529**	1,055
		385,743	391,170
Current assets			
Inventories		**254,176**	224,730
Trade receivables	9	**181,739**	182,901
Other receivables, deposits and prepayments		**23,526**	34,924
Lease premium for land		**469**	469
Investments held for trading		**—**	8,574
Bank balances and cash		**64,648**	168,669
		524,558	620,267
Current liabilities			
Trade payables and deposits received	10	**50,357**	67,187
Other payables and accrued charges		**22,992**	46,625
Trust receipt bank loans		**64,106**	95,902
Short-term bank loans		**68,000**	133,323
Current portion of long-term liabilities	12	**53,277**	—
Taxation payable		**8,189**	8,576
		266,921	351,613
Net current assets		**257,637**	268,654
Total assets less current liabilities		**643,380**	659,824
Financed by:			
Share capital	11	**48,373**	48,373
Other reserves		**111,984**	114,710
Retained profits		**254,347**	244,343
Equity attributable to equity holders of the Company		**414,704**	407,426
Minority interest		**1,202**	—
Total equity		**415,906**	407,426
Long-term liabilities	12	**227,474**	252,398
		643,380	659,824

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2005

	Unaudited Six months ended 30 September 2005 HK$'000	2004 HK$'000
Net cash outflow from operating activities	**(50,239)**	(30,352)
Net cash outflow from investment activities	**(15,728)**	(22,778)
Net cash outflow from financing activities	**(38,345)**	(16,877)
Decrease in cash and cash equivalents	**(104,312)**	(70,007)
Cash and cash equivalents at 1 April	**168,669**	137,592
Effect on foreign exchange rate changes	**291**	3,288
Cash and cash equivalents at 30 September	**64,648**	70,873
Bank balances and cash	**64,648**	70,873

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2005

	Unaudited							
	Share capital HK$'000	**Share premium HK$'000**	**Exchange fluctuation reserve HK$'000**	**Capital reserve HK$'000**	**Investment revaluation reserve HK$'000**	**Fixed assets revaluation reserve HK$'000**	**Retained profits HK$'000**	**Total HK$'000**
At 1 April 2005	**48,373**	**112,967**	**(48,570)**	**27,828**	**—**	**22,485**	**244,343**	**407,426**
Exchange difference arising from translation of accounts of overseas subsidiaries	**—**	**—**	**(830)**	**—**	**—**	**—**	**—**	**(830)**
Gain on investment revaluation	**—**	**—**	**—**	**—**	**523**	**—**	**—**	**523**
Profit for the period	**—**	**—**	**—**	**—**	**—**	**—**	**10,004**	**10,004**
Dividends	**—**	**(2,419)**	**—**	**—**	**—**	**—**	**—**	**(2,419)**
At 30 September 2005	**48,373**	**110,548**	**(49,400)**	**27,828**	**523**	**22,485**	**254,347**	**414,704**

	Unaudited							
	Share capital HK$'000	Share premium HK$'000	Exchange fluctuation reserve HK$'000	Capital reserve HK$'000	Investment revaluation reserve HK$'000	Fixed assets revaluation reserve HK$'000	Retained profits HK$'000	Total HK$'000
At 1 April 2004	48,373	112,967	(52,066)	27,081	—	22,485	230,857	389,697
Exchange difference arising from translation of accounts of overseas subsidiaries	—	—	2,354	(1)	—	—	—	2,353
Profit for the period	—	—	—	—	—	—	26,398	26,398
Dividends	—	—	—	—	—	—	(3,628)	(3,628)
At 30 September 2004	48,373	112,967	(49,712)	27,080	—	22,485	253,627	414,820

NOTES TO THE CONDENSED INTERIM ACCOUNTS

1. BASIS OF PRESENTATION AND PRINCIPAL ACCOUNTING POLICIES

The unaudited condensed consolidated interim financial statements are prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants and Appendix 16 of the Rules Governing the Listing of Securities ("Listing Rules") on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The accounting policies and basis of preparation adopted in the preparation of the interim financial statements are consistent with those used in the annual financial statements for the year ended 31 March 2005, except that in relation to the following new and revised Hong Kong Financial Reporting Standards ("HKFRSs", which also include HKASs and Interpretations) that affect the Group and are adopted for the first time for the current period's financial statements:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenues
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKFRS 2	Share-based Payment
HKFRS 3	Business Combinations
HKFRS 5	Non-current Assets Held for Sale and Discontinued Operations
HKAS-Int 21	Income Taxes — Recovery of Revalued Non-Depreciable Assets
HK-Int 4	Leases — Determination of the Length of Lease Term in respect of Hong Kong Land Leases

The adoption of HKASs 1, 2, 7, 8, 10, 12, 14, 16, 18, 19, 21, 23, 24, 27, 33, 37, HKFRS 5, HKAS-Int 21 and HK-Int 4 has had no material impact on the accounting policies of the Group and the methods of computation in the Group's condensed consolidated financial statements. The impact of adopting the other HKFRSs is summarised as follows:

(a) Leasehold land and buildings held for own use (HKAS 17 — Leases)

In prior years, leasehold land and buildings held for own use or under construction were included in property, plant and equipment and stated at revalued amounts or cost less accumulated depreciation and accumulated impairment losses. Movements of revaluation surpluses or deficits were normally taken to the fixed assets revaluation reserve.

With adoption of HKAS 17 as from 1 April 2005, the leasehold interest in the land held for own use is accounted for as being held under an operating lease where the fair value of the interest in any buildings situated on the leasehold land could be separately identified from the fair value of the leasehold interest in the land at the time the lease was first entered into by the Group, or taken over from the previous lessee, or at the date of construction of those buildings, if later. In case the two elements cannot be allocated reliably, the entire lease is classified as a finance lease and carried at cost less accumulated depreciation and accumulated impairment losses.

With adoption of HKAS 17, leasehold land and land use rights are reclassified as lease premium for land which are carried at cost and amortised on a straight-line basis over the lease term which applied retrospectively. Amortisation charge for the period is recognised in the profit and loss account. As a result of adopting this new policy, the premiums for land use right of HK$23,193,000 as at 30 September 2005 (31 March 2005: HK$23,427,000) have been reclassified from property, plant and equipment as lease premium for land.

(b) Financial instruments (HKAS 32 — Financial Instruments: Disclosure and Presentation and HKAS39 — Financial Instruments: Recognition and Measurement)

The adoption of HKAS 32 and HKAS 39 has resulted in a change in the accounting policy for recognition, measurement and classification of financial assets and liabilities.

Club memberships, trading and non-trading securities

In prior years, investments in club memberships and non-trading securities were classified as "other investments" and stated at cost less any accumulated impairment losses, while trading securities were measured at fair value, with unrealised gains or losses included in the profit and loss account.

With effect from 1 April 2005, the Group classifies and measures its investments in club memberships, trading and non-trading securities in accordance with HKAS 39. Under HKAS 39, financial assets are classified as "financial assets as fair value through profit or loss", "available-for-sale investments", "loans and receivables", or "held-to-maturity financial assets". The classification depends on the purpose for which the assets are acquired. "Financial assets at fair value through profit or loss" and "available-for-sale investments" are carried at fair value, with fair values recognised in the profit and loss account and equity respectively. "Loans and receivables" and "held-to-maturity financial assets" are measured at amortised cost using the effective interest method. On 1 April 2005, the Group's investments in club memberships and non-trading securities were redesignated as available-for-sale investments while trading securities were redesignated as investments held for trading. HKAS 39 does not permit to recognise, derecognise and measure financial assets and liabilities on a retrospective basis, the comparative figures have not been restated.

Investments in life insurance contracts

In prior years, investments in life insurance contracts were stated at cash surrender value that could be realised under life insurance contracts at the balance sheet date. The change in the cash surrender or contract value during the year was an adjustment of premium paid and was recognised as an expense or income in the profit and loss account.

On 1 April 2005, the Group's investments in life insurance contracts at cash surrender value of HK$28,238,000 were reclassified to available-for-sale investments. Available-for-sale investment is included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

No adjustment is made to the change in cash surrender value in the aggregate of HK$605,000 previously credited to profit and loss account. Further revaluation gain of HK$511,000 has been credited to investment revaluation reserve in the current period.

(c) Share option scheme (HKFRS 2 — Share-based Payment)

In prior years, no amounts were recognised when employees were granted share options over shares on the Company. If the employees chose to exercise the options, the nominal amount of share capital and share premium were credited only to the extent of the option's exercise price receivable.

With effect from 1 January 2005, HKFRS 2 was introduced. In accordance with this HKFRS, the fair value of share options is recognised as an expense in the income statement, or as an asset, if the cost qualifies for recognition as an asset under the Group's accounting policies.

Upon application of HKFRS 2, the Group has taken advantage of the transitional provisions under which the new accounting policies are not applicable to those share options granted on or before 7 November 2002 and those granted after 7 November 2002 but which had vested before 1 January 2005. Since the existing employees' share options were granted before 7 November 2002, this HKFRS has no effect on the Group at 1 April 2005.

(d) Amortisation of goodwill (HKFRS 3 — Business Combinations and HKAS 36 — Impairment of assets)

In prior years, goodwill was amortised on a straight-line method over its estimated useful life of 15 years.

With effect from 1 April 2005, in accordance with HKFRS 3 and HKAS 36, the Group no longer amortises goodwill. Such goodwill is tested annually for impairment, including in the year of its initial recognition, as well as when there are indications of impairment losses are recognised when the carrying amount of the cash generating unit to which the goodwill had been allocated exceeds its recoverable amount.

The transitional provision of HKFRS 3 has required the Group to eliminate at 1 April 2005 the carrying amounts of accumulated amortisation with a corresponding entry to the cost of goodwill.

As a result of this change in accounting policy, no amortisation of goodwill has been charged in the current period. Comparative figures for 2004 have not been restated.

2. TURNOVER, REVENUE AND SEGMENTAL INFORMATION

The Group is principally engaged in the development, engineering, manufacture and sale of toys and moulds.

Revenues recognised during the periods are as follows:

	Unaudited Six months ended 30 September	
	2005 HK$'000	2004 HK$'000
Turnover		
Sale of goods	**358,035**	373,209
Mould income	**10,978**	16,071
	369,013	389,280
Other revenues		
Interest income	**312**	330
Other	**1,307**	608
	1,619	938
Total revenues	**370,632**	390,218

Primary reporting format — business segments

The Group's turnover and results are substantially derived from the manufacturing of toys. Accordingly, no analysis by business segment is presented.

Secondary reporting format — geographical segments

	Turnover Unaudited Six months ended 30 September	
	2005 **HK$'000**	2004 HK$'000
United States	**176,437**	181,822
Europe	**71,852**	75,079
Japan	**43,645**	52,995
Mainland China	**34,185**	40,797
Other	**42,894**	38,587
	369,013	389,280

No analysis of contribution to operating profit by geographical segment has been prepared as no contribution to operating profit from any of the above segments is substantially out of line with the normal ratio of profit to turnover.

The turnover derived from Europe represents sales of toys to multiple customers with goods shipped directly to Europe under the instruction of these customers. The respective trade receivables are included in the United States of America, Japan and Hong Kong segments.

3. OPERATING PROFIT

Operating profit is stated after crediting and charging the following:

	Unaudited Six months ended 30 September	
	2005 **HK$'000**	2004 HK$'000
Crediting:		
Bad debts written back	**—**	173
Charging:		
Depreciation of owned fixed assets	**21,261**	17,589
Operating lease charge on leasehold land	**234**	—

4. FINANCE COSTS

	Unaudited Six months ended 30 September	
	2005 **HK$'000**	2004 HK$'000
Interest on loans from banks and financial institutions and overdrafts	**6,577**	3,504
Interest on other loans	**200**	—
Arrangement fees on bank loans	**292**	646
	7,069	4,150

5. TAXATION

	Unaudited Six months ended 30 September 2005 HK$'000	2004 HK$'000
Current taxation		
Hong Kong profits tax	**1,100**	1,552
Mainland China enterprise income tax	**1,426**	4,430
	2,526	5,982
Deferred taxation	**(1,413)**	(3,018)
	1,113	2,964

Hong Kong profits tax has been provided at the rate of 17.5% (2004: 17.5%) on the estimated assessable profit for the period. Taxation on profits of Mainland China subsidiaries has been calculated on the estimated assessable profit for the period at the rates of taxation as applicable to the local subsidiaries. No provision for taxation of the subsidiaries in Indonesia and the United States has been made as they have tax losses as at 30 September 2005 and 30 September 2004.

6. DIVIDENDS

	Unaudited Six months ended 30 September 2005 HK$'000	2004 HK$'000
Ordinary shares		
Interim dividend — Nil (2004: HK0.50 cents per ordinary share)	**—**	2,419

The Board of Directors does not recommend the payment of an interim dividend for the six month ended 30 September 2005 (2004: HK0.50 cents per share).

7. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the Group's profit attributable to equity holders of the Company of HK$10,004,000 (2004: HK$26,398,000) and the weighted average number of 483,733,333 (2004: 483,733,333) ordinary shares in issue during the periods.

No dilutive earnings per share has been presented for the periods ended 30 September 2005 and 2004 as the exercise of share options would be anti-dilutive.

8. FIXED ASSETS

	HK$'000
At 1 April 2005 (restated)	315,981
Additions	16,921
Depreciation	(21,261)
Exchange adjustment	(1,066)
At 30 September 2005	**310,575**

9. TRADE RECEIVABLES

The ageing analysis of the trade receivables was as follows:

	Unaudited 30 September 2005 HK$'000	Audited 31 March 2005 HK$'000
0 – 30 days	**112,705**	64,708
31 – 60 days	**37,931**	31,209
61 – 90 days	**8,100**	34,620
91 – 180 days	**3,525**	35,532
181 – 365 days	**17,720**	13,244
Over 365 days	**1,758**	3,588
	181,739	182,901

The Group's sales are on letter of credit or open account terms. Credit terms are reviewed on a regular basis. The normal trade term is between 30 to 90 days but business partners with strong financial background may be offered longer credit terms.

10. TRADE PAYABLES AND DEPOSITS RECEIVED

	Unaudited 30 September 2005 HK$'000	Audited 31 March 2005 HK$'000
Trade payables (Note)	**49,014**	66,920
Deposits received	**1,343**	267
	50,357	67,187

Note: The ageing analysis of the trade payables was as follows:

	Unaudited 30 September 2005 HK$'000	Audited 31 March 2005 HK$'000
0 – 30 days	**21,312**	21,410
31 – 60 days	**15,418**	14,380
61 – 90 days	**8,502**	13,173
91 – 180 days	**2,921**	16,274
181 – 365 days	**435**	1,324
Over 365 days	**426**	359
	49,014	66,920

11. SHARE CAPITAL

Authorised	Convertible cumulative redeemable preference shares of US$100,000 each No. of shares	US$'000	Ordinary shares of HK$0.10 each No. of shares (thousands)	HK$'000
At 31 March 2005 and 30 September 2005	40	4,000	1,000,000	100,000

Issued and fully paid	No. of shares	HK$'000 (equivalent)	No. of shares (thousands)	HK$'000
At 31 March 2005 and 30 September 2005	—	—	483,733	48,373

12. LONG-TERM LIABILITIES

	Unaudited 30 September 2005 HK$'000	Audited 31 March 2005 HK$'000
Loans from banks and financial institutions (Note (a))	**269,277**	240,000
Deferred taxation	**10,514**	11,427
Provision for long service payment	**960**	971
	280,751	252,398
Current portion of long-term liabilities	**(53,277)**	—
	227,474	252,398

(a) The loans from banks and financial institutions were repayable as follows:

	Unaudited 30 September 2005 HK$'000	Audited 31 March 2005 HK$'000
Within one year	**53,277**	—
In the second year	**115,200**	81,600
In the third year	**100,800**	124,800
In the fourth year	**—**	33,600
	269,277	240,000

13. CONTINGENT LIABILITIES

At 30 September 2005, the Group did not have material contingent liabilities.

14. COMMITMENTS

(a) Capital commitment for fixed assets

	Unaudited 30 September 2005 HK$'000	Audited 31 March 2005 HK$'000
Contracted but not provided for	**5,531**	17,398

(b) Commitments under operating leases

At 30 September 2005, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	Unaudited 30 September 2005 HK$'000	Audited 31 March 2005 HK$'000
Not later than one year	**3,815**	4,224
Later than one year and not later than five years	**12,318**	12,651
Over five years	**2,823**	4,362
	18,956	21,237

15. BANKING AND OTHER FACILITIES

At 30 September 2005, the Group's banking and other facilities are as follows:

(1) There was an outstanding bank loan of US$3,753,000 (HK$29,277,000) which was borrowed to finance the single lump sum payment for premiums of life insurance policies as mentioned in Note 15 to the accounts in the 2004/2005 annual report. The bank loan is secured by the three life insurance policies with a combined death benefit of US$25 million (HK$195 million) and a corporate guarantee executed by the Company; and

(2) Other general banking facilities of HK$401,383,000 utilized for working capital purposes are supported by a corporate guarantee executed by the Company.

INTERIM DIVIDEND

The Directors have resolved that no interim dividend will be paid to equity holders for the six months ended 30 September 2005 (2004: HK0.50 cents per share).

RESULTS, BUSINESS REVIEW AND PROSPECTS

Results

The Group's turnover for the six months ended 30 September 2005 was HK$369 million, representing a decrease of 5% as compared to HK$389 million recorded in the corresponding period in 2004. The gross profit margin for the six months ended 30 September 2005 was 27%, very much in line with the corresponding period in 2004. However, profit attributable to equity holders of the Group for the six months ended 30 September 2005 was HK$10 million (2004: HK$26 million), approximately 62% less than that in the corresponding period in 2004.

Business Review

For the interim period of 2005/06, the Group's operations were affected by the challenges impacting the toy industry as well as difficulties encountered by manufacturers with factories in the Guangdong province. Lacking of suitable workers led to a delay in delivery in the first half of our 2005/06 financial year. Although the Group has caught up with the required delivery schedule, the Directors expect that competition for factory workers will continue in the years to come.

Apart from labor shortage in the Mainland, the Group has had to deal with mandated increase in minimum wages, high raw material costs and fierce pricing competition within the toy industry. The Group's success in ODM products in the first half of 2005/06 financial year had contributed to the maintenance of the gross margin when compared to previous year.

The Group's selling expenses increased as compared with the previous corresponding period due to the increase in licensing investments, sales and promotional activities and increase in commission paid. The increase in costs of transportation and delivery also added to this expenditure segment due to the rise in fuel prices.

Another expenditure segment impacting the Group's profit margin was the administration expenses which has recorded an increase due to the appreciation of the Renminbi (RMB), thus adding to our expenses in RMB which consisted of salaries, water and electricity, cost of operating power generators, material purchases and local fees and taxes. Operating costs sore because the Group had to offer additional fringe benefits to its employees in order to maintain a steady and skillful work force in the competition for hiring labor in the Guangdong province.

Construction of the Group's new factory in Dongguan Changping has been proceeding according to plans and schedules. The Directors expected that the Group should be able to relocate the operations of the factory in stages, commencing April 2006. Although, financing for the new factory has been in placed with the provision of a new HK$300 million Term and Revolving facility granted by a group of banks since December 2004, interest expense for the period in review has increased to HK$7 million when compared to HK$4 million in the previous corresponding period.

Future Plans and Prospects

The Directors anticipated tough economic conditions to continue for the rest of 2005/06. The Group's continued investments into further ODM, OBM and licensed products are expected to improve, if not keep margins at the current level. Standard Tooling and Products Co. Ltd. ("STP") will continue to play an important role in designing and engineering all the innovative products the Group brings to its ODM customers and the market through Kid Galaxy. The year in review alone, Kid Galaxy has introduced new toys and brands to the market including Radio Control GoGo Auto, Morphibians and DRV, just to name a few.

On the licensing front, the Group has been very active in this area. Popular licenses obtained during the period under review include the National Basketball Association ("NBA"), "The Legend of Nezha", "Yamucha's" and most recently an exclusive bendable figurine license for the 2006 FIFA World Cup Football finals in Germany. The Group has also ventured into the comic business through investing in Liberal Cultural Studies Ltd. Coinciding with the local introduction of liberal studies curriculum in schools, in the comic books our Captain Bendo and troops would journey through 5,000 years of Chinese history with its readers. The Directors believe revenues from these licenses will contribute positively toward the results for the reminder of this financial year.

The Directors are of the opinion that the new Changping factory will resolve some of the issues currently faced by the Group. Consolidation of the Group's operations into one factory should ultimately lead to economies of scale, thus making our operation more efficient, when competing for orders. Initially, the Group will have to keep all three factories in operation until such time that the Changping new factory obtains all the approvals and accreditations for itself to produce for certain customers.

The Directors feel that the labor shortage suffered by the Group in this financial year may be dealt with after relocation to new factory. Changping being a major railway terminus for workers arriving from other provinces should provide the Group with the opportunity to capture these new immigrants. The Group has ensured that the new factory has a much improved living conditions and amenities to attract and retain workers.

Plans are in place for the relocation of the operations to Changping with the minimum interruption to our customers and production needs. Renovation for the new factory has commenced and the Directors expect the benefits of the centralization of production lines and warehousing upon completion of the Changping factory will improve efficiency and reduce operation costs.

The Board believes that turnover for the rest of the year will improve with the view not only delivery schedule has caught on, but also that the labor shortage, in the short term, is not an issue for the factory. Customer orders are now being negotiated with consideration of the increase in wages and material costs. Therefore the Directors are reasonably optimistic that margin will stabilize in the second half of this reporting period.

LIQUIDITY AND CAPITAL RESOURCES

At 30 September 2005, net current assets of the Group was approximately HK$258 million (31 March 2005 (restated): HK$269 million). The long-term borrowings to shareholders' funds was 52% (31 March 2005: 59%). The current assets comprised inventories of approximately HK$254 million and trade receivables of HK$182 million, and bank balances and cash of approximately HK$65 million. The balances of the inventories and trade receivables as at that date are in line with the seasonal factor of the Group's business operations. As at the same date, the Group had total assets of HK$909 million which were financed by current liabilities of approximately HK$267 million, long-term liabilities of approximately HK$227 million and shareholders' funds of HK$415 million. The Group has no significant exposure to foreign exchange fluctuation.

EMPLOYEE SCHEMES

At 30 September 2005, the Group had approximately 7,820 employees. Approximately 74, 7529, 206 and 11 employees were based in Hong Kong, Dongguan factories, Indonesia factory and the U.S. office respectively. The number of workers employed by the Group varies from time to time depending on production needs and are remunerated based on industry practice.

The Group operates different remuneration schemes for different employees. Apart from pension funds and year-end bonuses, in-house training programmes are offered.

SHARE BASED PAYMENT

The Group has not entered into any share based payment transactions leading to any change in the presentation of the account and any disclosure required.

On 8 September 1997, a share option scheme (the "Old Scheme") was approved by the equity holders of the Company. Under this Old Scheme, there were outstanding 10,800,000 share options granted in 2000, still valid on 1 April, 2005. The Options were exercisable from 1 October 2000 till 30 September 2005 at the exercise price of HK$0.675 for an ordinary share of HK$0.10 each in the Company subject to the terms and conditions stipulated therein.

Details of the movements of share options under Old Scheme under the period of review are as follows:

	Options held at 1 April 2005	Options granted during period	Options exercised during period	Options lapsed during period	Options held at 30 September 2005	Exercise price HK$	Grant date	Exercisable from	Exercisable until
Mr. LEUNG Lun	2,000,000	—	—	2,000,000	—	0.675	14 March 2000	1 October 2000	30 September 2005
Mr. LEUNG Chung Ming	2,000,000	—	—	2,000,000	—	0.675	14 March 2000	1 October 2000	30 September 2005
Mr. ZHONG Bing Quan	2,000,000	—	—	2,000,000	—	0.675	14 March 2000	1 October 2000	30 September 2005
Ms. CHENG Yun Tai	2,000,000	—	—	2,000,000	—	0.675	14 March 2000	1 October 2000	30 September 2005
Mr. WONG Tze On, Andy	2,000,000	—	—	2,000,000	—	0.675	14 March 2000	1 October 2000	30 September 2005
Continuous contract employees	800,000	—	—	800,000	—	0.675	14 March 2000	1 October 2000	30 September 2005
Total	**10,800,000**	**—**	**—**	**10,800,000**	**—**				

On the other hand, on 3 September 2002, the equity holders of the Company approved the termination of the Old Scheme and the adoption of a new scheme ("2002 Scheme") as a result of the amendments of Chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"). Upon termination of the Old Scheme, no further options could be granted under the Old Scheme, but in all other respects, the provisions of the Old Scheme remained in force and all share options granted prior to such termination continued to be valid and exercisable in accordance therewith.

Details of the 2002 Scheme are detailed in the 2004/05 Annual Report. No options have ever been granted under the 2002 Scheme since it was established in 2002.

Upon the lapse of the options under Old Scheme on 30 September 2005, there is no outstanding options granted for the Company.

No recognition of the options granted but unexercised has been made in the accounts. Rule 17.08 of the Listing Rules stipulates that the listed issuer is encouraged to disclose in its interim report the value of share options granted to the participants. The Directors consider it inappropriate to value the share options as a number of factors critical for the valuation cannot be determined accurately. Any valuation of the share options based on various speculative assumptions would be meaningless and could be misleading to the equity holders.

DIRECTORS' INTERESTS IN EQUITY SECURITIES

At 30 September 2005, the interests and short positions of each Director in the shares or underlying shares of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of Laws of Hong Kong) ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules were as follows:

Name	**Name of company**	**Capacity**	**Number and class of securities** (Note 1)
Leung Lun	The Company	Interest of controlled corporation (Note 2)	279,442,000 ordinary shares (L)
	Lung Cheong Investment Limited	Interest of controlled corporation (Note 2)	1,000 ordinary shares (L)
	Rare Diamond Limited	Beneficial interest	70 ordinary shares (L)
Leung Chung Ming	The Company	Interest of controlled corporation (Note 2)	279,442,000 ordinary shares (L)
	Lung Cheong Investment Limited	Interest of controlled corporation (Note 2)	1,000 ordinary shares (L)
	Rare Diamond Limited	Beneficial interest	30 ordinary shares (L)

Notes:

1. The letter "L" represents the Director's interests in the shares and underlying shares of the Company.

2. These shares were held by Lung Cheong Investment Limited, a company wholly owned by Rare Diamond Limited. Rare Diamond Limited is beneficially owned as to 70% by Mr. Leung Lun and 30% by Mr. Leung Chung Ming respectively.

Apart from the Share Option Scheme, at no time during the period was the Company, its holding companies or its subsidiaries a party to any arrangements to enable the Directors, Chief Executives and their Associates to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Pursuant to the Term and Revolving facilities agreement entered into by the Company and a group of financial institutions on 7 December 2004 amounting to HK$300 million, Mr Leung Lun and Mr Leung Chung Ming are required to jointly hold at least 45% of the issued share capital of the Company.

SUBSTANTIAL SHAREHOLDERS

At 30 September 2005, the following persons, other than a director or chief executive of the Company, had an interest in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO:

Name of shareholder	**Number of ordinary shares** (Note 1)	**Capacity**	**Approximate percentage of interest**
Lung Cheong Investment Limited	279,442,000 (L)	Beneficial owner	57.76%
Rare Diamond Limited	279,442,000 (L) (Note 2)	Interest of controlled corporation	57.76%

Notes:

1. The letter "L" represents the entity's interests in the shares.

2. These Shares were registered in the name of Lung Cheong Investment Limited, the entire issued share capital of which was owned by Rare Diamond Limited.

DISCLOSURE OF TRADE RECEIVABLES PURSUANT TO CHAPTER 13 OF THE LISTING RULES

On 17 November 2005, pursuant to rules 13.13 and 13.15 of the Listing Rules, an announcement was made to disclose the details of the trade receivables as at 31 October 2005 which exceeded 8% of the total market capitalisation of the Company at that date.

CONNECTED TRANSACTIONS

At 30 September 2005, a wholly-owned subsidiary of the Company, Lung Cheong Toys Limited ("LC Toys"), had long-term loans and deferred trading balances amounted in aggregate to HK$60,648,000, plus accrued interest, due by PT. Lung Cheong Brothers Industrial ("PTLC"), a 60% owned subsidiary of LC Toys. The balance of the 40% interest in PTLC is owned by independent third parties who are not connected with the Directors, Chief Executives or substantial shareholders of the Company and its subsidiaries, other than PTLC, or any of their respective associates. The long-term loans were advanced to finance the set up of the production facilities of PTLC. The amounts are unsecured, bearing interest at 3-month HIBOR per annum and have no fixed repayment terms. LC Toys does not intend to demand repayment of the advances in the foreseeable future.

The Directors, including the Non-Executive Directors, are of the opinion that the above transaction was entered into on normal commercial terms which are fair and reasonable.

PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not redeemed any of its shares during the period. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the period.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding securities transactions by directors on terms no less exacting than the required standard set out in Appendix 10 of the Listing Rules (the "Model Code"). Having made specific enquiry of the Company's directors, all directors confirmed that they have complied with the required standard set out in the Model Code and the code of conduct regarding securities transactions by directors adopted by the Company throughout the accounting period covered by the interim report.

AUDIT COMMITTEE

The Company has an audit committee established in compliance with Rule 3.21 of the Listing Rules for the purpose of reviewing and providing supervision over the Group's financial reporting process including a review of the unaudited condensed accounts for the six months ended 30 September 2005 and internal controls. The audit committee comprises all the three independent non-executive directors of the Company.

REMUNERATION COMMITTEE

On 2 November 2005, a remuneration committee was established by the Company. The committee comprises members, the majority of which is three independent non-executive directors of the Company. The committee has adopted the terms of the reference in line with those set out in Appendix 14 of the Listing Rules.

COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

In the opinion of the directors, the Company has complied with the code provisions as set out in Appendix 14 of the Listing Rules, throughout the accounting period covered by the interim report.

Non-executive Directors are not appointed for a specific term as recommended under paragraph 7 of Appendix 14 of the Listing Rules. They are subject to retirement by rotation and re-election at the Annual General Meeting in accordance with the Articles of Association of the Company. In the opinion of the Directors this meets the same objective as the Code of Best Practice.

Under the code provision B.1.1, a listed issuer should establish a remuneration committee with specific written terms of reference which deal clearly with its authority and duties. The Company has only set up the remuneration committee on 2 November 2005.

Except for the above, none of the Directors of the Company is aware of any information which would indicate that the Group is not, or was not, in compliance with the Code of Best Practice as set out in Appendix 14 of in the Listing Rules of The Stock Exchange of Hong Kong Limited at any time during the six months ended 30 September 2005.

On behalf of the Board of
Lung Cheong International Holdings Limited

Leung Lun
Chairman

13 December 2005