

Corporate Governance Report

CORPORATE GOVERNANCE PRACTICES

The board considers that good corporate governance of the Company is central to safeguarding the interests of the shareholders and enhancing the performance of the Group. The board is committed to maintaining and ensuring high standards of corporate governance. The Company has applied the principles and complied with all the applicable code provisions of the Code on Corporate Governance Practices (“Code”) as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“Listing Rules”) for the year ended 31 December 2005, except for the deviation from provision A.2.1 of the Code in respect of segregation of the roles of chairman and chief executive officer. The board will continuously review and improve the corporate governance practices and standards of the Company to ensure that business activities and decision making processes are regulated in a proper and prudent manner.

DIRECTORS’ SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (“Model Code”) as set out in Appendix 10 of the Listing Rules for securities transactions by directors of the Company in 2004. All the members of the board have confirmed, following specific enquiry by the Company, that they have complied with the required standard as set out in the Model Code throughout the year ended 31 December 2005. The Model Code also applies to other specified senior management of the Group.

BOARD OF DIRECTORS

Composition and role

The board of directors of the Company comprises:

Executive Directors:	Thomas CHAN Chun Hoo, <i>Chairman</i> Sidney TO Shu Sing Alain CHENG Bing Kin
Independent Non-executive Directors:	Allen LEE Peng Fei Anthony LO Kai Yiu David YU Hon To Alexander CHOW Yu Chun
Non-executive Directors:	TSIM Tak Lung, <i>Deputy Chairman</i> Charles IP Shu Wing

The board comprises of three executive directors (one of whom is the Chairman) and six non-executive directors. Of the six non-executive directors, four of them are independent non-executive directors which represent more than one-third of the board. In addition, three of the independent non-executive directors possess appropriate professional accounting qualifications and financial management expertise.

The principal focus of the board is on the overall strategic development of the Group. The board also monitors the financial performance and the internal controls of the Group's business operations.

With a wide range of expertise and a balance of skills, the non-executive directors bring independent judgment on issues of strategic direction, development, performance and risk management through their contribution at board meetings and committee work.

The independent non-executive directors also serve the important function of ensuring and monitoring the basis for an effective corporate governance framework. The board considers that each independent non-executive director is independent in character and judgment and that they all meet the specific independence criteria as required by the Listing Rules. The Company has received from each independent non-executive director an annual confirmation or confirmation of his independence pursuant to Rule 3.13 of Chapter 3 of the Listing Rules and the Company still considers such directors to be independent. The independent non-executive directors are explicitly identified in all corporate communications.

All directors are regularly updated on governance and regulatory matters. There is an established procedure for directors to obtain independent professional advice at the expense of the Company in the furtherance of their duties. The Company has also arranged appropriate director and officer liability insurance cover in respect of legal actions against its directors.

The board meets regularly throughout the year to review the overall strategy and to monitor the operation as well as the financial performance of the Group. The Chairman is primarily responsible for drawing up and approving the agenda for each board meeting in consultation with all directors. Notice of at least 14 days have been given to all directors for all regular board meetings and the directors can include matters for discussion in the agenda if necessary. Agenda and accompanying board papers in respect of regular board meetings are sent out in full to all directors within reasonable time before the meeting. Draft minutes of all board meetings are circulated to directors for comment within a reasonable time prior to confirmation.

Minutes of board meetings and meetings of board committees are kept by duly appointed secretaries of the respective meetings and all directors have access to board papers and related materials, and are provided with adequate information on a timely manner, which enable the board to make an informed decision on matters placed before it.

There is no relationship between members of the board except for the in-law relationship between Mr. Tsim Tak Lung and Mr. Sidney To Shu Sing.

Corporate Governance Report

BOARD OF DIRECTORS (Continued)

Composition and role (Continued)

During the year, twelve full board meetings (of which four were regular quarterly meetings) were held and the individual attendance of each director is set out below:

Name of director	Number of board meetings attended	Attendance rate
Thomas CHAN Chun Hoo	12/12	100%
Sidney TO Shu Sing	12/12	100%
Allen LEE Peng Fei	11/12	92%
Anthony LO Kai Yiu	12/12	100%
David YU Hon To	11/12	92%
TSIM Tak Lung	6/12	50%
Charles IP Shu Wing	9/12	75%

Chairman and Chief Executive Officer

The Chairman and chief executive officer of the Company is Mr. Thomas Chan Chun Hoo. This deviates from provision A.2.1 of the Code which stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual.

Mr. Thomas Chan Chun Hoo is primarily responsible for leadership of the board, ensuring the effectiveness on all aspects of its role and setting its agenda, whereas clearly established executive responsibilities for running of the business operations of the Group lie with different designated senior executives. The board considers that this structure will not impair the balance of power and authority between the board and the management of the business of the Group given that there is a strong and independent non-executive element on the board and a clear division of responsibility for the running of the business of the Group. The board believes that the structure outlined above is beneficial to the Company and its business.

Re-election of Directors

Each of the non-executive directors of the Company has entered into a service contract with the Company for a term of three years. However, such term is subject to his re-appointment by the Company at general meeting upon retirement by rotation pursuant to the Bye-laws of the Company. In accordance with the relevant provisions in the Bye-laws of the Company, the appointment of directors is considered by the board and they must stand for election by shareholders at the first annual general meeting following their appointment and must, except for the Chairman, stand for re-election by shareholders at least every three years. In the spirit of good corporate governance practices, the Chairman had voluntarily retired from his office and offered himself for re-election at the annual general meeting held on 28 April 2005 notwithstanding that he is not required to do so by the Bye-laws.

Audit Committee

The Audit Committee was established in 1999 and its current members include:

Anthony LO Kai Yiu – *Committee Chairman*

Allen LEE Peng Fei

TSIM Tak Lung

David YU Hon To

The majority of the Audit Committee members are independent non-executive directors. The board considers that each Audit Committee member has broad commercial experience and there is a suitable mix of expertise in business, accounting and financial management on the Audit Committee. The composition and members of the Audit Committee complies with the requirements under Rule 3.21 of the Listing Rules. The written terms of reference which describe the authority and duties of the Audit Committee were adopted in 1999 and subsequently amended in 2005 to conform to the provisions of the Code, a copy of which is posted on the Company's website.

The Audit Committee meets regularly to review the reporting of financial and other information to shareholders, the system of internal controls, risk management and the effectiveness and objectivity of the audit process. The Audit Committee also provides an important link between the board and the Company's auditors in matters coming within the scope of its terms of reference and keeps under review the independence and objectivity of the auditors.

The Audit Committee has reviewed with the management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters including a review of the accounts for the year ended 31 December 2005.

Corporate Governance Report

BOARD OF DIRECTORS (Continued)

Audit Committee (Continued)

During the year, eight Audit Committee meetings were held and the individual attendance of each member is set out below:

Name of director	Number of meetings attended	Attendance rate
Anthony LO Kai Yiu	8/8	100%
Allen LEE Peng Fei	8/8	100%
TSIM Tak Lung	3/8	38%
David YU Hon To	8/8	100%

Compensation Committee

The Compensation Committee was established in early 2004 and the current members include:

TSIM Tak Lung – *Committee Chairman*

Allen LEE Peng Fei

Anthony LO Kai Yiu

The majority of the Compensation Committee members are independent non-executive directors. The Compensation Committee advises the board on the Group's overall policy and structure for the remuneration of directors and senior management. The Compensation Committee ensures that no director or any of his associate is involved in deciding his own remuneration. The terms of reference of the Compensation Committee were adopted in 2004 and subsequently amended in 2005 to conform to the provisions of the Code, a copy of which is posted on the Company's website.

In determining the emolument payable to directors, the Compensation Committee takes into consideration factors such as salaries paid by comparable companies, time commitment and responsibilities of the directors, employment conditions elsewhere in the Group and the desirability of performance-based remuneration.

The Compensation Committee meets regularly to determine the policy for the remuneration of directors and assess performance of executive directors and certain senior management. During the year, two Compensation Committee meetings were held, the individual attendance of each member is set out below:

Name of director	Number of meetings attended	Attendance rate
TSIM Tak Lung	1/2	50%
Allen LEE Peng Fei	1/2	50%
Anthony LO Kai Yiu	2/2	100%

Group Compensation Policy

Objectives

The objectives of the compensation policy are:

- to provide an equitable and competitive compensation package so as to attract and retain the best available human resources to serve corporate needs
- to provide base compensation to the employees that is competitive to the industry and general market condition
- to award employees in recognition of good individual and corporate performance
- to encourage future employee contributions to achieve overall corporate goals

Components

The compensation package for each employee is structured to attract and retain the best talent available, and will contain a combination or modification of some or all of the following three main components:

I. Base salary

Base salary and wage rate ranges are established for each position by evaluating the responsibilities and the duties required to be performed. The actual salary or wage rate for the person filling the position is determined based on the experience and ability of the individual selected for the position.

The base salary and wage rate ranges are reviewed periodically by reference to the general market and by comparison to comparable positions at competitors in the relevant industry. The actual salaries and wage rates of employees are reviewed annually and may be adjusted from time to time based on the cost of living and financial performance of the company.

Salaries and wages are base compensation and not intended to reward performance, either individually or corporately. Performance is rewarded through the other components of the compensation plan.

II. Incentive bonus

Incentive bonus is linked to individual and corporate performance. Every year, profitability and other corporate performance targets are set and incentive bonuses will only be paid for that year if the targets are achieved.

The incentive bonus for each employee is determined with reference to his position and his individual performance during the year.

Corporate Governance Report

BOARD OF DIRECTORS (Continued)

Compensation Committee (Continued)

Group Compensation Policy (Continued)

Components (Continued)

III. Stock option

Options to purchase shares in the Company are granted to employees from time to time at the discretion of the board, in order to retain valuable human resources and to motivate future performance of the employees.

Stock options granted to individual employees are determined with reference to their positions, their performance and ability to contribute to the overall corporate success.

The granting of stock options is subject to shareholders mandates as required and all applicable laws and regulations of relevant jurisdictions.

IV. Other benefits

In addition to the three main components, the Group offers other customary and/or mandatory benefits to employees, such as retirement fund scheme, insurance and paid holiday, with reference to prevailing practices in relevant jurisdictions.

Chief Executive Officer and Top Paid Employees

The following table summarizes compensation information for the Chief Executive Officer and the four most highly compensated executive officers of the Group for the year ended 31 December 2005:

Name of officer	Salary HK\$'000	Performance bonus HK\$'000	Other benefits HK\$'000 (Note)	Employer's contribution to provident fund HK\$'000	Share-based compensation HK\$'000	Total HK\$'000
Thomas CHAN Chun Hoo	120	–	62	7	–	189
Lou NOVAK	3,276	2,122	252	98	4,704	10,452
Ronnie SOONG	2,271	1,207	20	12	356	3,866
Don SUTHERLAND	1,428	–	1,624	71	–	3,123
John SINCLAIR	2,278	–	160	98	423	2,959

Note: Other benefits include car allowance, insurance premium and club membership.

AUDITORS' REMUNERATION

For the year ended 31 December 2005, the auditors of the Company only provided audit services to the Company.

INTERNAL CONTROLS

The board has overall responsibility for the system of internal controls of the Company and for reviewing its effectiveness. The board is committed to implementing an effective and sound internal controls system to safeguard the interest of shareholders and the Group's assets. The board has delegated to executive management the implementation of the system of internal controls and reviewing of all relevant financial, operational, compliance controls and risk management function within an established framework.

Independent consultants were hired during 2005 to perform documentation and review on the internal controls system of the Group. Relevant recommendations made by such consultants would be implemented by the Group in stages to further enhance its internal control policies, procedures and practices.

DIRECTORS' RESPONSIBILITY STATEMENT

The directors are responsible for the preparation of accounts for each financial period which give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the accounts for the year ended 31 December 2005, the directors have selected suitable accounting policies and applied them consistently; adopted appropriate Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards; made adjustments and estimates that are prudent and reasonable; and have prepared the accounts on the going concern basis. The directors are also responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company.

INVESTOR RELATIONSHIP AND COMMUNICATION

The Company endeavours to maintain a high level of transparency in communicating with shareholders and the investment community at large. Briefings and meetings with institutional investors and analysts are conducted regularly. The Company is committed to continue to maintain an open and effective investor communication policy and to update investors on relevant information on its business in a timely manner, subject to relevant regulatory requirements. In order to ensure effective, clear and accurate communications with the investors and analysts, all corporate communications are arranged and handled by the executive directors and designated senior executives according to established practices and procedures of the Company.

The Company has announced its annual results and interim results in a timely manner during the year under review, which is well before the time limits set out in the Listing Rules. Separate resolutions are proposed at the general meetings on each substantially separate issue, including the election of individual directors. In addition, procedures for demanding a poll are included in the circular to shareholders dispatched together with the annual report.

Corporate Governance Report

INVESTOR RELATIONSHIP AND COMMUNICATION (Continued)

The Company has also maintained a website at <http://www.playmates.net> which enables shareholders, investors and the general public to have access to the information of the Company on a timely basis. Financial information and all shareholder corporate communications of the Company are made available on the Company's website and updated regularly.

BUSINESS ETHICS

The Company is committed to high standard of business ethics and integrity.

A long established code of conduct is enforced on all employees of the Group. No personal gifts or other forms of advantages from any person or organization doing business with the Group can be accepted by any employee. Business partners and suppliers are reminded from time to time that our policy forbids any employee or agent of the Group from accepting any gift from them.

The Group has developed a Code of Business Conduct for its manufacturing vendors and suppliers. All the vendors and suppliers of the Group are required to maintain a safe and healthy workplace, fair and ethical employment practice and ensure that proper environmental protection measures are in place. The Group also closely monitors that all the relevant codes of conduct stipulated by our major licensors and customers are strictly followed by our manufacturing vendors and suppliers.

The Company has a worldwide reputation in the toy industry for product quality and safety. Children's health, safety and well being are our primary concern and the Company is committed to observe all relevant safety and product quality rules at all costs.

SOCIAL RESPONSIBILITY

The Group has joined other leading companies in the toy industry to develop a common standard of business conduct for the toy manufacturing community to promote safe and healthy workplace, fair and ethical employment practice, and proper environmental protection measures.

The Group makes regular contributions in terms of financial and other supports to various charitable organizations. Employees are encouraged to have direct and active involvement in fundraising activities for the needs of the society.

FAMILY MEMBERS AND CLOSE PERSONAL RELATIONSHIPS

The board recognises that talents, relevant experience and skills are the most important considerations in executive officers and staff selection. It is the Group's policy that job positions are filled by suitably qualified candidates selected through internal promotions or from the open market on the merits of qualification, experience, skills and achievements. No employee is hired on account of family or close personal connection to any board member.