Management Discussion and Analysis

RESULTS

For the year ended 31st December, 2005, the Group attained a modest surge of 32.7% in turnover amounted to HK$911,044,000 (2004: HK$686,684,000) which was driven by the turnover contribution from the Shelcore Companies' Original Design Manufacturing ("ODM") operations as well as the steady growth of the Group's Original Equipment Manufacturing ("OEM") operations. The profit attributable to equity holders of the Company was dropped by 7.2% to HK$140,929,000 (2004: HK$151,810,000) by which the basic earnings per share was HK24 cents (2004: HK27 cents).

Comparing to the year 2004, the drop in profit was primarily attributable to the hike in commodity prices as well as increase in labour cost and other operating expenses in Mainland China since 2004. Although the Group enjoyed a growth in turnover due to inclusion of Shelcore Companies' sales turnover, competition between toy retailers, customers of the Shelcore Companies resulting sustained pricing pressure which had an adverse impact on the Group's result. However, benefits of synergies from the amalgamation and considerable economies of scale after implementation of a series of cost saving, prudent production policies and inventory management measures, the Group was able to mitigate to a certain extent the negative impact and negotiate for more competitive raw material prices.

DIVIDENDS

During the year, the Company paid an interim dividend of HK8 cents (2004: HK8 cents) and declared a special dividend of HK3 cents (2004: HK3 cents) per share to the shareholders. The Directors recommended the payment of a final dividend of HK9 cents (2004: HK9 cents) per share in respect of the year ended 31st December, 2005 (Based on 574,796,000 shares at this announcement date in an amount of approximately HK$51,732,000). 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 (2004: 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 3rd May, 2006.

BUSINESS REVIEW

In January 2005, the Group had successfully completed the acquisition of the Shelcore Companies, well-established US-based toy companies with ODM operations specialising in the design, manufacture and sales of plastic toys for infant and pre-school children.

With the Group's implementation of a series of cost saving and inventory measures, to certain extent, the adverse effect of the threats of the Group of being a toy manufacturer could be minimised. Accordingly, the OEM business maintained stable growth with the same level of year 2004 whilst the ODM on the other hand encountered a changing environment.

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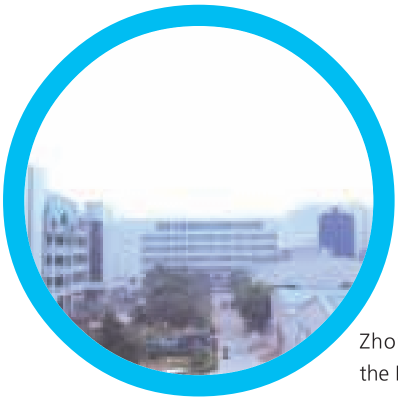

Zhongshan, the PRC

Zhongshan, the PRC

TOYS MANUFACTURING OPERATION

Original Equipment Manufacturing

PRC

The Group's strong manufacturing foothold in Zhongshan, the People's Republic of China ("PRC") is well-equipped with fully-integrated and centralised facilities for molding, welding, spray painting, printing and assembly which enabled the Group's OEM business sustained to strive and achieve stable growth to enhance the manufacturing process and the customer appeal and satisfaction as well.

First and foremost, the capacity of the Zhongshan plant had been augmented subsequent to the installation of a number of plastic injection machines amounted to approximately HK$20 million to boost its production of plastic toys. During the year under review, the newly-constructed warehouse with a total gross floor area of approximately 5,000 square metres at Zhongshan Plant commenced operation in order to accommodate more raw materials and finished goods inventory to meet the increasing orders from customers.

Management Discussion and Analysis

Danang City, Vietnam – First Plant

Danang City, Vietnam – Second Plant

Vietnam

To enhance production efficiency, the renovation of the Group's first Vietnam plant for improving the factory floor layout and ensuring more systematic physical production flow is underway and is scheduled to complete by mid-2006. Upon completion of the renovation of plant, the overall production efficiency of the Group, who is one of the first movers in the Asian regional toy industry, would be further enhanced.

The improved business environment in Vietnam including the development of structural road networks and enhanced shipping and logistic facilities provided, and stable supply of public facilities, enables the Group having further development in Vietnam.

The Group is conscious of adhering to its strict production code of conduct and takes social responsibility on providing comfortable working place and leisure centre to ensure our staff working in a humanity environment. Frequent human resources function and activities were taken place to enhance the loyalty of our workers. In addition, the Group strives to ensure that the working conditions in its plant such as safety standards, staff employment terms and environment conditions, meet international standards.

Management Discussion and Analysis

U.S.A. – Office


U.S.A. – Showroom

Original Design Manufacturing

The acquisition of Shelcore Companies in January 2005 not only expanded the Group's toy product portfolio by including infant and pre-school children toys, but also provided a new diversified source of revenue, and allowed the Group to gain exposure to the global toy industry with a pool of potential customers by leverage on Shelcore Companies' extensive worldwide distribution network.

The benefits from the amalgamation of operation and corporate structural reorganisation after the acquisition of the Shelcore Companies have been reflected as the profitability of the Shelcore Companies was enhanced and the result of the Shelcore Companies was improved during the year under review. The Group continued to maximise the full potential of the distribution channels spanning over 60 countries by introducing new toys for infant and pre-school children market. In addition, due to the positive response from the newly-developed markets such as United Kingdom, France, Germany and Spain, additional sales force had been employed to further strengthen the Group's marketing efforts in opening up other new markets in Europe. Other than the United States and European markets, a retail business market in the PRC would be worthwhile to build up.

Management Discussion and Analysis

PRINTING OPERATION

To maximise the use of printing machines, the Group had utilised the excess capacity to develop the network of external customers and bring in a new source of revenue to the Group. In the year 2005, the external customers' orders have been increased.

The Group has widened the variety of printed products and therefore in addition to the Group's internal consumption and supplementing the packaging function in the overall production process, the enlarged range of finalised products could better meet external customer demands and satisfaction as well.

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 in the forthcoming years.

MARKETING AND PROMOTIONAL OPERATION

The business promotional operation of the Group has not yet achieved the expected market shares in the promotional industry in the PRC during the year under review. The management would continue to observe the potential market segment of its business promotional operation.

FINANCIAL REVIEW

Liquidity and Financial Resources

As at 31st December, 2005, the Group had bank balances and cash of HK$42,258,000 (2004: HK$89,688,000) and pledged bank deposit of HK$51,990,000 (2004: HK$5,011,000) secured for banking facilities granted. During the year under review, the Group was granted banking facilities in a total of HK$81,000,000 (2004: HK$5,000,000) secured by fixed deposits and corporate guarantee given by the Company.

The Group's gearing ratio, representing the total debt divided by equity attributable to equity holders of the Company, was not applicable as the Group did not have any bank loans or borrowings as at 31st December, 2005 and 2004.

During the year, the Group financed its operations with internally generated cash flows. Net cash generated from operating activities amounted to approximately HK$225 million (2004: HK$151 million). The Group has consistently maintained a healthy financial position during the year.

Capital Expenditure

During the year, the Group acquired property, plant and equipment at a cost of HK$46,766,000 (2004: HK$14,790,000) directly and HK$48,234,000 (2004: HK$447,000) through the acquisition of subsidiaries to expand and upgrade the production capacity. These capital expenditures were primarily funded by internal resources.

Management Discussion and Analysis

Assets and Liabilities

At 31st December, 2005, the Group had total assets of HK$512,691,000 (2004: HK$454,007,000), total liabilities of HK$179,234,000 (2004: HK$170,900,000) and shareholders' equity of HK$333,457,000 (2004: HK$282,975,000). The net assets of the Group increased 17.8% (2004: 19.3%) to HK$333,457,000 as at 31st December, 2005 (2004: HK$283,107,000). Certain of the Group's fixed assets were revalued at year-end date, the revaluation resulted in an increase in value, which has been reflected in the financial statements.

Exchange Rate Risk

Several subsidiaries of the Company have foreign currency sales, which expose the Group to foreign currency risk. Certain bank balances, pledged bank deposit and trade receivables of the Group are denominated in foreign currencies. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arises.

NUMBER OF EMPLOYEES AND REMUNERATION POLICIES

As at 31st December, 2005, the Group had a total of approximately 17,000 (2004: 15,000) employees in Hong Kong, Macau, PRC, Vietnam, U.S.A. and Canada. The Group provides its employees with competitive remuneration packages commensurate to the level of pay established by the market trend in comparable businesses. A share option scheme was adopted for selected participants (including full-time employees) as incentives or rewards for their contributions to the business and operation of the Group. A mandatory provident fund scheme and respective local retirement benefit schemes are also in place.

Management Discussion and Analysis

PROSPECTS

Looking forward, the Group will continue to implement effective cost-saving measures and study ways to streamline its ODM business so as to further improve the overall efficiency, and thereby enhancing the competitiveness of its toy businesses. As the global crude oil prices have shown signs of stabilising, the profit margins will be expected to remain stable and not be squeezed further. Moreover, benefits from the amalgamation of the two OEM and ODM businesses as well as corporate reorganisation of Shelcore Companies are gradually materialised. In addition, the Shelcore Companies' ODM business is targeted to become profitable after completion of corporate restructuring and launch of new product lines by enhancing the research and development campaign of the Company.

Shelcore Companies' international outlook shows potential growth through new accounts and new market segments in Europe. The recruitment of expert toy sales and marketing team in Europe enhances its product and market development and brand re-enforcement which may better off result in future. With plans to enhance its research and development efforts, in particular reinforcing the product development team in a cost effective location, the Group will increase the varieties of its ODM toy products for the sales in its retail chain stores. All these moves will definitely enhance the Group's competitiveness. In addition, with financial and operational support from the Group, there is full confidence of revitalising the Shelcore Toys brandname worldwide – including opening brand new retail stores in major cities in the PRC. Effective market studies and product search and development are crucial to the success of the launch of new toys to meet demand of those new markets. The marketing efforts supported with public relations, marketing and promotional campaigns as well as continuous media presence offering another way for the Group to increase its market share, in particular, in North America.

The management will closely monitor the impact of the implemented government-mandated minimum wage, the shortage and unstable supply of public facilities, the impact on future tax treatment of processing arrangement and the recent growth of currency rate of RMB in the PRC and aim at devising a measure for the Group to minimise the adverse effect of those factors on the Group's profitability continuously.

Though the operating conditions is challenging, the Group is dedicated to strive for the best performance by implementing its strategy to produce high quality products with competitive prices. Besides, the Group will continue to strengthen its core business, streamline its existing operations and tighten cost control measures and inventory measures. The Group is confident all these efforts can sustain and enhance its business growth.