Review of Operations

FINANCIAL OVERVIEW

The Group's consolidated turnover for 2005 was HK$2,620.4 million, representing an increase of 0.7% over 2004. Toy manufacturing remained the primary contributor to the Group's turnover, accounting for 70.0% of total turnover in 2005. The reliance on the toy operation is expected to decrease in 2006 and beyond with the recent purchase of The Center, a commercial property in Shanghai. The Group recorded an audited consolidated profit attributable to shareholders of HK$186.0 million for the year ended 31 December 2005 compared to HK$162.9 million for 2004, an increase of 14.2%.

The Group's toys and property operations continue to provide a good business base, while the Group is establishing new avenues for expansion of its technology and licensing and sourcing operations. The Group's earnings before interest expense and taxation ("EBIT") also benefited from the annual revaluation of its properties in Shanghai, profits from the disposal of certain properties, as well as a gain on disposal of an overseas internet B2B investment.

TOY OPERATION

The toy operation continued to contribute the bulk of the Group's revenues and recurrent profit. Turnover for the year grew slightly by 3.0% to HK$1,833.7 million, while EBIT decreased by 13.7% to HK$55.5 million.

Dongguan Crown-Ace Toys Co. Ltd.

The EBIT decline was mainly attributable to rising labour costs, exacerbated by the appreciation in Renminbi during the year. Higher labour costs have affected all manufacturers in southern China reflecting tightness in the labour market and a substantial increase in the statutory minimum wages that came into effect in the Pearl River Delta region during the year. Increasing price competition has also affected margins.

Management focuses on reducing operating costs. In January 2006, the toy operation completed the consolidation of the four factories in Guangdong province into three factories, thereby freeing up the remaining factory for the expansion of the technology operation as well as yielding substantial savings to the toy operation.

Despite the continuing rise in raw material costs, notably plastics, the operation was able to minimise the adverse impact by adjusting the pricing for new products and sharing the material costs fluctuations with customers on on-going projects. In order to control costs of raw materials and components, management continues to work on strengthening its central procurement function.

The toy operation, as an original equipment manufacturing ("OEM") supplier to some of the world's leading brand names and niche players in the toy industry, relies on its reputation for quality, service, timeliness and cost-effectiveness to maintain its competitive advantage. Management endeavours to continue providing quality services to customers. During the year, the Group achieved a major milestone in this regard by gaining the Seal of Compliance from the International Council of Toy Industries in the United States.

TECHNOLOGY OPERATION

Surface Mounting and Bonding Department

The technology operation entered a phase of increased, yet prudent investment in its brand-building and overseas expansion in 2005, while consolidating its leadership in Bluetooth® accessories. The operation experienced a slight drop in turnover by 2.5% from HK$636.9 million in 2004 to HK$621.0 million in 2005. EBIT declined to HK$14.8 million as a result of the increased investment in marketing and the set up of overseas subsidiaries.

Bluetooth® sales and the i.Tech brand benefited from the overall expansion of the mobile telecommunications market. Despite new competitors entering the market, the Group's technology, strong design capability and reputation, as well as growing i.Tech brand awareness, enabled it to compete effectively.

In preparing for a major expansion in the Europe, Middle East and Africa ("EMEA") markets, a service company was set up in the UK, with geographic coverage in over 20 cities. A distribution company was also set up in Milan, Italy, in mid-2005 to develop the Italian market. In September 2005, the Group signed a contract to be the exclusive distributor of "3" branded mobile phone accessories to designated resellers of the 3 Italia services of Hutchison Group, which commenced contributing revenues to the Group from the fourth quarter of 2005.

The award-winning Virtual Keyboard was enhanced to a Bluetooth® capable version. During the year, the Group successfully became one of the first companies to introduce Bluetooth® stereo headphones to the market. Aided by strong R&D capabilities, management continues to strive to diversify its product offerings to match with the pace of technological changes and retain its competitive edge. For instance, an initial successful launch of digital audio broadcast radio and portable media player represents a cornerstone for the Group in the development of digital multimedia products. The technology operation also continued to add to its roster of certifications from handset manufacturers and network operators.

i.Tech in Electronic Fair 2005, Hong Kong

In Asia, the Group is strengthening its working relationship with its mobile phone producer partners in Japan and Korea, including LG. The Group is extending the network of distributors to eastern and southern China by co-operating with major local corporations, handset manufacturers and network operators. In Hong Kong, the distributorship was reorganised and the awareness of the i.Tech brand was effectively raised through successful promotional campaigns.

Review of Operations

LICENSING AND SOURCING OPERATION

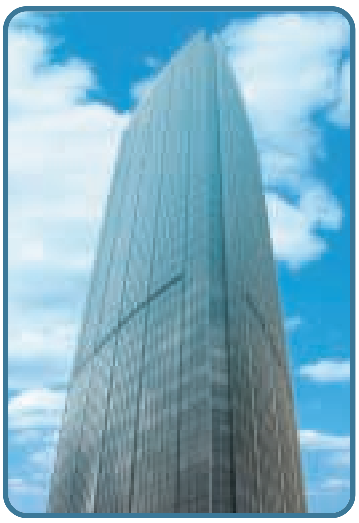
Established in 2004, the operation is focusing on consolidating its sourcing businesses and preparing for the roll-out of retail operation during the year, and as a result, a loss before interest and taxation ("LBIT") of HK$3.0 million was recorded during the year, compared with an EBIT of HK$1.6 million in 2004.

Warner Bros. Flagship Store, Shanghai

The brand licensing arrangement with Warner Bros., mainly covering licensing, product sourcing and retail sub-licensing in Hong Kong, Mainland China and Macau, continued to develop well. Significant effort was made in preparing for the opening in January 2006 of the flagship store in Shanghai, which will form the template for developing its brand licensing, retail sub-licensing and product distribution businesses across the Mainland.

PROPERTY OPERATION

Turnover for the year at the Group's property operation was HK$69.0 million, while EBIT was HK$117.8 million, which are 47.2% and 82.3% higher than in 2004 respectively. During 2005, the Group disposed of certain smaller properties in Shenzhen, Macau and Shanghai, realising a total gain of HK$27.9 million. In addition, a surplus of HK$32.2 million arose from the revaluation of remaining properties was recorded. Excluding these two items, EBIT of the property division rose 23.0% over the recurrent income of 2004 to HK$57.7 million, reflecting the higher rental income received during the year.



The Center, Shanghai

The commercial property market in Shanghai continued to grow in 2005. As a result, the Group's two existing properties, Harbour Ring Plaza and Harbour Ring Huang Pu Centre, achieved satisfactory occupancy rates of over 96%, which together with rising rental levels, increased EBIT.

Encouraged by the prospects in the Shanghai properties market and in order to further diversify the Group's operations toward more stable, less cyclical operations, the Group acquired The Center, a new Grade A commercial property in Shanghai for a total consideration of HK$2,191.9 million. Constructed in 2004, The Center is an office tower with a gross floor area of 98,337 square metres with underground carparking facilities and a clubhouse adjacent to it. It was fully let on acquisition with satisfactory rental rates and started contributing additional rental income to the Group during the final quarter of 2005.

CAPITAL RESOURCES AND LIQUIDITY

The Group's total borrowings at 31 December 2005 were HK$1,165.7 million (2004: HK$46.4 million). In November 2005, the Group raised US$128.2 million through the issuance of 2% convertible notes to a subsidiary of Hutchison Whampoa Limited. The proceeds were used to fund the acquisition of The Center. These notes are due in November 2010 and, if converted, would raise Hutchison Group's interest in the Group from approximately 62% to approximately 67%.

At the end of 2005, cash and cash equivalents together with other liquid listed investments totalled HK$1,153.4 million, compared to HK$2,043.3 million at the end of 2004.

TREASURY POLICIES

As at 31 December 2005, the Group had no material exposure under foreign exchange contracts, interest or currency swaps or other financial derivatives.

CHARGES AND CONTINGENT LIABILITIES

At 31 December 2005, the available-for-sale financial assets of HK$360.7 million were pledged to a bank to secure banking facilities of HK$300.0 million, of which HK$241.8 million has been drawn down. In addition certain of the shares of and loans to the Group's subsidiaries which have interests in The Center were pledged to the Hutchison Group as security for the convertible notes recently issued as mentioned above.

The Group had provided guarantees for mortgage loan facilities granted to purchasers of the Group's properties in China amounting HK$19.1 million as at 31 December 2005 (2004: Nil).

HUMAN RESOURCES

Excluding associated companies, the Group employed 23,856 people at the end of 2005. Total employee costs for the year, including directors' emoluments, amounted to HK$491.7 million.

The salary and benefit levels of Group employees are competitive and individual performance is rewarded through the Group's salary and bonus system. Remuneration packages are reviewed annually during the year.

The Group places considerable emphasis on training and ensures employees have the skills training they need to be able to contribute towards achieving common goals.

Arrow II

Review of Operations

OUTLOOK

The Group is confident that the investments it has made in expanding and diversifying its operations in 2005 will bring rewards in 2006.

The Group's strong position in the toys market will be reinforced by the trend toward consolidation and its ability to meet customer expectations for quality, services, timeliness, cost-effectiveness and operational compliance. The Group continues to enhance its design capability, to offer a "one-stop-shop" solution to its OEM customers and achieve higher margins through adding more value in the production process.

The technology operation will benefit from the enlarged distribution network now in place, the continuing expansion of mobile telecommunications market and the rise in the adoption of Bluetooth® technology by consumers. The Group is exploring co-operation similar to that with 3 Italia with other Hutchison Group's companies. In addition to existing markets, the Group will also focus on China, Japan and Korea in 2006 to begin promotion of Bluetooth® products. The Group will invest further in the i.Tech brand and in the development of more advanced wireless technology and digital multimedia products, with a view to staying at the forefront of technology. This will in turn allow the Group to improve margins.

The licensing and sourcing operation will see results flowing from the opening of its flagship store in Shanghai in January 2006. This will allow the Group to build quickly towards a network of retail sub-licensees across China, aggregating significant volumes. Licensing and sourcing arrangements with other parties are being explored.

The strong economic growth in the China is expected to result in continuing high occupancy rates and rental levels for the Group's three investment properties in Shanghai, providing strong and steady earnings and cashflow.

Chan Wen Mee, May (Michelle)
Managing Director

Hong Kong, 8 March 2006