Management Discussion and Analysis

RESULTS

The Board of Directors has much pleasure to announce that the profit attributable to shareholders in the financial year of 2005 is approximately HK$80.35 million, representing an increase of 107.33% over the last year's restated figure of HK$38.75 million. The Group's turnover for the financial year ended 31st December, 2005 amounted to approximately HK$539.81 million, representing an increase of 7.72% over that reported in the last financial year.

The profit from operations before tax for the year 2005 amounted to HK$102.42 million, which included valuation gain of investment property amounted to HK$58.28 million, as compared to last year's restated figures of HK$86.97 million and HK$52.76 million respectively. In addition, the share of profits of associates for the year 2005 amounted to HK$10.89 million, as compared to the last year's loss of HK$11.43 million.

During the year under review, though operating conditions remained harsh, the Group succeeded in achieving a remarkable performance through enhancing its competitiveness in terms of productivity, quality, reliability and delivery. The Group is best known for producing high-quality toys. Our success in shifting towards high value added products had contributed to the outstanding performance. Moreover, the booming in the global property markets further improved the Group's financial position in its property investment business.

BUSINESS REVIEW

Toys

The turnover for the OEM/ODM toys business for the year ended 31st December, 2005 amounted to HK$161.59 million, representing a mild increase of 2.89% as compared to the corresponding period of last year.

During the year under review, competition remained keen and operating conditions remained tough, especially with the continuous increase and volatility of raw material prices that adversely affected the profitability. However, the Group has managed to strengthen production and financial management, and expanded high value added business to improve the profit margin. Eventually, the bottom line of the Group's OEM/ODM toys business continued to improve.

The Group will follow its on-going strategy of developing and enhancing high value added products. The worldwide mega-trend is to integrate electronics and new technology with toys, thus the Group will invest more in research and development to develop innovative toys that captures the high margin market segment. On the other hand, great efforts will be placed in the area of maintaining close contact with large buyers and to keep abreast of market trends, expanding business networks, and exploring market opportunities.

Management Discussion and Analysis *(Continued)*

Model Trains

During the year under review, the model trains section continued to achieve good performance. Turnover in model trains amounted to HK$353.73 million, representing an increase of 10.68% as compared to last year.

The Group was making continuous efforts on enhancing quality, developing innovative products, expanding accessories and promoting product image and brand names, which further strengthened the Group's leading position in the model train industry. Our own brand name product lines, Bachmann Branchline, Graham Farish and Lilliput, continued to be well received in the field of model train collectors both in Europe and America. At the same time, operational efficiency and cost control has been seriously reviewed. As a result, the profit margin was remarkably increased.

Looking ahead, the Group's major focus will still be putting on research and development. One of our missions is to develop high quality products with creative ideas. Following the successful launch of Digital Command Control ("DCC") model train series in recent years, the product development team has managed to bring in the latest technology to further enhance our new DCC lines. The Group will continue to enrich our product lines and expand the variety of accessories to strengthen its business growth.

Recently the Group has tried to penetrate into the Japan market. Initial response is promising. With global growing demand for collectibles, the Group is anticipating that year 2006 will be another promising year for the Group's model train business development.

Property Investment

During the year under review, the rental income of the Group has slightly increased by 1.54% as compared to last year. Moreover, the Group recorded a revaluation gain on its investment properties amounted to HK$58.28 million.

Prosperity of the rental market in the East Kowloon district has contributed much to this improvement. As a result, the occupancy rate of the Group's major investment property, Kader Building, has increased to 93% as at the year end, as compared with 85% last year.

The rental market for commercial/industrial buildings in the East Kowloon district remains strong. With both the occupancy rate and the rental rate continuing to increase, the Board is optimistic that rental income of the Kader Building will be further improved upon the renewal of leases in the coming year.

During the year under review, global property markets were encouraging. Taking the opportunity, the Group had succeeded in disposing its rental properties in Canada, which was further strengthening the liquidity position of the Group.

Besides, the Group also realised a gain of approximately HK$2.05 million on disposing an investment property in Shenzhen, PRC before the expiry of the land use right.

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, a real estate and hospitality group was admitted to the ownership and a new hotel operator was appointed to manage the Resort in April 2004.

During 2004, the ownership conducted a feasibility study on the opportunity for the condominium sale of the existing hotel guest rooms and decided to convert the Resort to a condominium hotel pursuant to which the guest rooms are structured as separate condominium units, which were marketed and sold to individual owners. The condominium owners will then contribute their unit to a rental program managed by the hotel operator.

The initial condominium sale was successfully launched in March 2005 and over 60% of the units were sold on the first day of the launch. As at 31st December, 2005, over 80% of the units were sold.

FINANCIAL REVIEW

Liquidity and Financial Resources

As at 31st December, 2005, the Group's current ratio was 1.01 (2004 restated: 0.99). The Group's total bank borrowings were reduced from approximately HK$214.17 million as reported last year to approximately HK$190.97 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 31.25% (2004 restated: 42.37%). There is no significant seasonality of borrowing requirements except during peak production period in the second half of the year when the Group's trade loans will be comparatively higher.

Capital Structure

During the year ended 31st December, 2005, there were no changes in the Company's share capital. The Group's capital instruments were mainly composed of bank loans and directors' support, which were denominated in HK Dollars, Sterling Pounds and US Dollars at prevailing market rates.

Charges on Group Assets

As at 31st December, 2005, certain investment properties, leasehold land and buildings and other assets of the Group valued at approximately HK$732.76 million (2004: HK$659.59 million) were pledged to banks to secure banking facilities granted to the Group.

Material Acquisitions and Disposals

Other than the disposal of certain investment properties mentioned above, there are no material acquisitions and disposals during the year ended 31st December, 2005. At the moment, there are no major plans for acquiring substantial investments or capital assets.

Management Discussion and Analysis *(Continued)*

Exchange Rate Exposure

Major assets, liabilities and transactions of the Group are denominated either in Sterling Pounds, U.S. Dollars, Canadian Dollars, Renminbi Yuan 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 Pounds while the majority of its raw materials and equipment purchases were required to be settled in HK Dollars. As such, the Group was facing a certain degree of exchange risk, mainly in Sterling Pounds. Efforts were taken to hedge against various transactions in foreign currency, so as to minimize possible exchange risk. During the year 2005, the Group recorded an aggregate exchange loss of approximately HK$3.23 million (2004: HK$4.19 million).

Contingent Liabilities

As at 31st December, 2005, the Group did not have any significant contingent liabilities except:–

1. As reported in the Group's 2003 and 2004 Annual Report, an action was commenced in 2003 by a supplier of resin materials (the "Supplier") against a Group company in the Hong Kong High Court for payment of a trading debt amounting to HK$643,980. HK$20,852.50 of this debt has already been paid by the Group company pursuant to a court order. About 75% of the remaining debt is not disputed by the Group company. However, this has not been paid because the court ordered that this action should be tried together with a separate action commenced by the Group company against the same supplier in 2003 for damages amounting to US$590,000 on the basis, inter alia, that bulk resin supplied by the Supplier did not reasonably correspond with the sample first provided and tested by the Group company. The effect of both actions being tried together is that the court will take into account, and set-off, any damages awarded in either action to produce a net result. The trial date was fixed for the third quarter of 2006. The directors believe the Group will not suffer any material loss as a result of these actions. Meanwhile, the Group has made adequate provisions on the anticipated legal costs to be incurred.

2. As reported in the Group's 2004 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 at that time and it was disposed of in 1996. The plaintiffs allege claimed against Sinomex and the Company of approximately US$5,000,000 for unpaid obligations of Sinomex under such Lease Agreement plus interest (in the amount of 2% per month, or 24% annually), court costs and attorney fees.

   In 2004, the Company 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 did 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.

In January 2005, the Arizona court denied the initial motion submitted by the Company. The Company planned 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 proved to be successful.

Having considered the Litigation with the Company's legal counsel, the management and the Board believed that the Company's opposition to the plaintiffs' complaint, and its defenses, including defenses to the amount of damages awardable, were meritorious. As such, the Company intends to continue to vigorously defend the Litigation. On that basis, the Company has not made provision in relation to the claims under the Litigation, while anticipated legal cost has been sufficiently provided for in the year under review.

EMPLOYEES AND REMUNERATION POLICIES

As at 31st December, 2005, the Group employed approximately 6,960 (2004: 5,150) full time management, administrative and production staff in Hong Kong SAR, mainland China, the United States and Europe. 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 reviewed with management the key accounting policies, and discussed auditing, internal controls and financial reporting matters, including a review of the annual results for the year ended 31st December, 2005.

PROSPECTS

Year 2005 was a year of challenge. The Group strived for its goals under harsh operating conditions, and finally achieved promising performance.

During the year, the prices of raw materials such as paper and plastic remained high, interest rates were rising and keen competition remained within the industry. In the PRC, especially the Guangdong Province where the Group's production plant is located, labour and electricity supply remained tight, not to mention the increasingly sophisticated customs and tax rules. All these created production pressure and lifted production costs. However, the Group faced those challenges, exercised stringent cost control and performed well even under such harsh conditions.

Looking ahead, under sound global economic climate, both consumer confidence and business sentiment is good. Locally, the Financial Secretary has delivered to us a fiscal surplus and the unemployment rate is falling. The improvement in basic economic conditions has favorably eased the operating environment for our manufacturing and export-orientated business. All these factors have attributed to an optimistic market outlook in 2006.

Management Discussion and Analysis *(Continued)*

In the coming year, the Group will emphasize on research and development because the world-trend is to focus on innovative products. Therefore, more resources will be allocated to the development of new products. Continuous efforts will be placed on production planning and financial management so as to attain operational efficiency and cost control. The Group will seize every opportunity to penetrate into new and potential markets, like the Japan market. Barring any unforeseen circumstances, the Board remains cautiously optimistic toward the business prospects of the Group.

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

Hong Kong, 19th April, 2006