Chairman's Statement

Mr Leung Lun,
Chairman

On behalf of the Board and as Chairman of the Group, I am pleased to present the results of Lung Cheong International Holdings Limited ("the Company") and its subsidiaries (collectively referred to as "the Group") for the year ended 31 March 2006.

For the year ended 31 March 2006, the Group reported a turnover of HK$751 million, compared to HK$775 million for the corresponding period in the previous year, sales were lowered by approximately 3%. Profits attributable to shareholders amounted to HK$17 million against last year's figure of HK$20 million. Basic earnings per share for the year were HK3.45 cents (2005: HK4.17 cents).

Business Review

The financial year ended 31 March 2006 has been a challenging one for the Group. The increase in borrowings and a hike in interest rates have more than doubled our interest expense compared with last financial year. The increase in borrowings was not only for meeting the increased working capital requirement, but also for the construction of the new factory in Changping town ("Changping"), Dongguan City ("Dongguan"), Guangdong Province ("Guangdong"), People's Republic of China ("PRC").

Limited peak season capacity, market competition and meeting customers' pricing strategies continued to affect our turnover. The Group's Original Equipment Manufacturing ("OEM") and Original Design Manufacturing ("ODM") business would have contributed if not for the reduced orders from a major United States ("US") electronic retail chain and a major toy customer.

The increase in plastic resin prices, the fluctuation in oil prices, unstable energy supply and upward adjustment of the Yuan against the US currency and continual compliance with customers' increase in demand for keeping up with labour and environmental requirements led to tighten margins which had been factors influencing our costs management.

Chairman's Statement

ODM business helped to stabilize the Group's gross margin but due to the tough pricing competition in the market, it had been difficult to achieve higher margins for ODM products compared to previous years.

Announcement of "2006 FIFA World Cup™" License
Hong Kong, 27 October 2005

The weakness of the Group's current production facilities were exposed in this financial period, restricting peak season production needs and meeting the stringent requirement of constant compliance request by customers. With a couple of aging manufacturing and accommodation facilities, we had to offer favourable remuneration packages, in order to compete for, and retain workers.

Buyers continued to demand for supplier to comply with stringent labor and environmental laws and regulations which put a strain on the Group's administration cost. These compliance requirements will continue to change in accordance with local by-laws, and the Group had to invest and upgrade existing facilities in order to supply goods to these customers.

The Group branched into non-toy products such as educational and competition based robotic products as well as expanding the non-toy wireless Bluetooth product range. The high end metal based robotics shipped in the current and late last financial year continued to sell and consolidating its position in the North American market. Management believed that there are untapped opportunities in this category and have developed a whole new median priced plastic based robotics to fill in the gap within the education field.

Kid Galaxy Inc. ("KGI"), the Group's North American OBM division, had its best performing year since the acquisition. KGI managed to penetrate the mass market channel and sold directly into a few major US supermarket chains. Kid Galaxy Corp. ("KGC") also contributed with one of its popular licensed products, the FIFA World Cup Bendos, which began to ship late in 2005/06 and coming first quarter of 2006/07.

Overall revenue declined slightly, net margins were adversely affected and the profit attributable to shareholders was reduced by 17% for the year ended 31 March 2006.

Hong Kong Toy Fair, 10-13 January 2006

Chairman's Statement

Lung Cheong Intelligent Centre Opening Ceremony
Dongguan, 28 December 2005

With a reduced profit recorded for 2005/06, the Directors are regrettably not able to recommend any dividend (2004/05:HK1.00 cent) for the year. We believe, that we would soon be in position to resume payment of dividends in the coming year in order to reward shareholders for their support during this consolidation and restructuring period.

Prospects

Looking forward to the financial year 2006/07, the Group will continue to be tested. Interest rates are expected to peak in the coming year, while oil prices are anticipated to stay relatively high throughout the period. These uncertainties and continuous instability in the Middle East may somehow affect consumers' confidence and spending.

On the home front, the United States and European Unions ("EU") will continue to apply pressure on China to revalue its currency. If the Renminbi appreciates, the Group will have to bear higher costs relating to our production facilities located in Dongguan. The Guangdong Provincial authorities have recently announced a 20% raise in minimum monthly wages for workers to 690 Yuan commencing in September 2006 compared to the current 574 Yuan monthly.

Shortly, we will relocate and consolidate the Group's major production facility in Changping before the 2006/07 financial year ends. The new factory has approximately 90,000 square meters consisting of mixed office, showroom, dormitory, workshop, production and leisure facilities. The modernized plant will pull the Group's manufacturing, design and engineering capabilities within one locality. The Directors strongly believe resources can be utilized more efficiently, which ought to result in immediate cost savings for the Group. However, management anticipates incurring extraordinary restructuring charges relating to this consolidation process.

U.S. Toy Fair, 12-15 February 2006

The Directors feel that the manpower issues faced by the Group should be dealt with after relocation. Changping train terminus, being a major interchange station for arrivals from the inland provinces to Guangdong should provide the Group with plenty of opportunities to source for workers. The Dongguan local authorities have consistently promote the city which helped attract workers seeking employment to the area.

Post relocation, the two existing factories in Dongguan, Zhou Wu leased facilities will continue to support the Group's future seasonal production needs, while the wholly owned Qian Tou property will either be rezoned and disposed, or redeveloped depending on the property market condition. In view of the high interest rate environment, the Directors are constantly seeking alternatives to reduce borrowings and gearing level of the Group, one being disposal of non-core assets.

Chairman's
Statement

The Group will continue to actively develop the ODM business and strengthen existing R&D capabilities to increase our innovative product range. In view of the encouraging result in higher end wireless consumer electronic products and its huge market potential, the Group will place greater emphasis in developing this market segment.

Topping Out Ceremony for Changping new factory 18 November 2005

Changping new factory

The Group's product design and engineering arm, STP continues to introduce innovative toys and support our OEM customers in new products development. We expect this to form the core of the Group's 2006/07 business. Our excellent reputation as manufacturer of high quality wireless products had earned us numerous referrals, particularly to clients in the high-end sophisticated gadgetry segment. We believe this segment will soon generate revenue and margins to the Group.

The Group's own brand segments KGC and KGI should contribute positively in this coming financial year after laying the foundation in the previous years, equipped with popular sport licenses in conjunction with continuous marketing and promotion efforts, KG's branded products are expected to make further inroads and expand sales to the US department stores, supermarket chains and EU gift and toy retailers.

With the goals of returning Group to higher profit and recommence payment of dividends, management strategy is to improve overall profit margin through various measures, including attacking higher margin business, followed by "right-sizing" the manufacturing operations, necessitated after combining the China production facilities, taking into consideration our Indonesian factory.

I would like to thank my fellow Board members and senior management, and all Lung Cheong's employees for their commitment to the Group. My appreciation goes out to our bankers and financial partners for their invaluable support.

Leung Lun
Chairman

28 July 2006