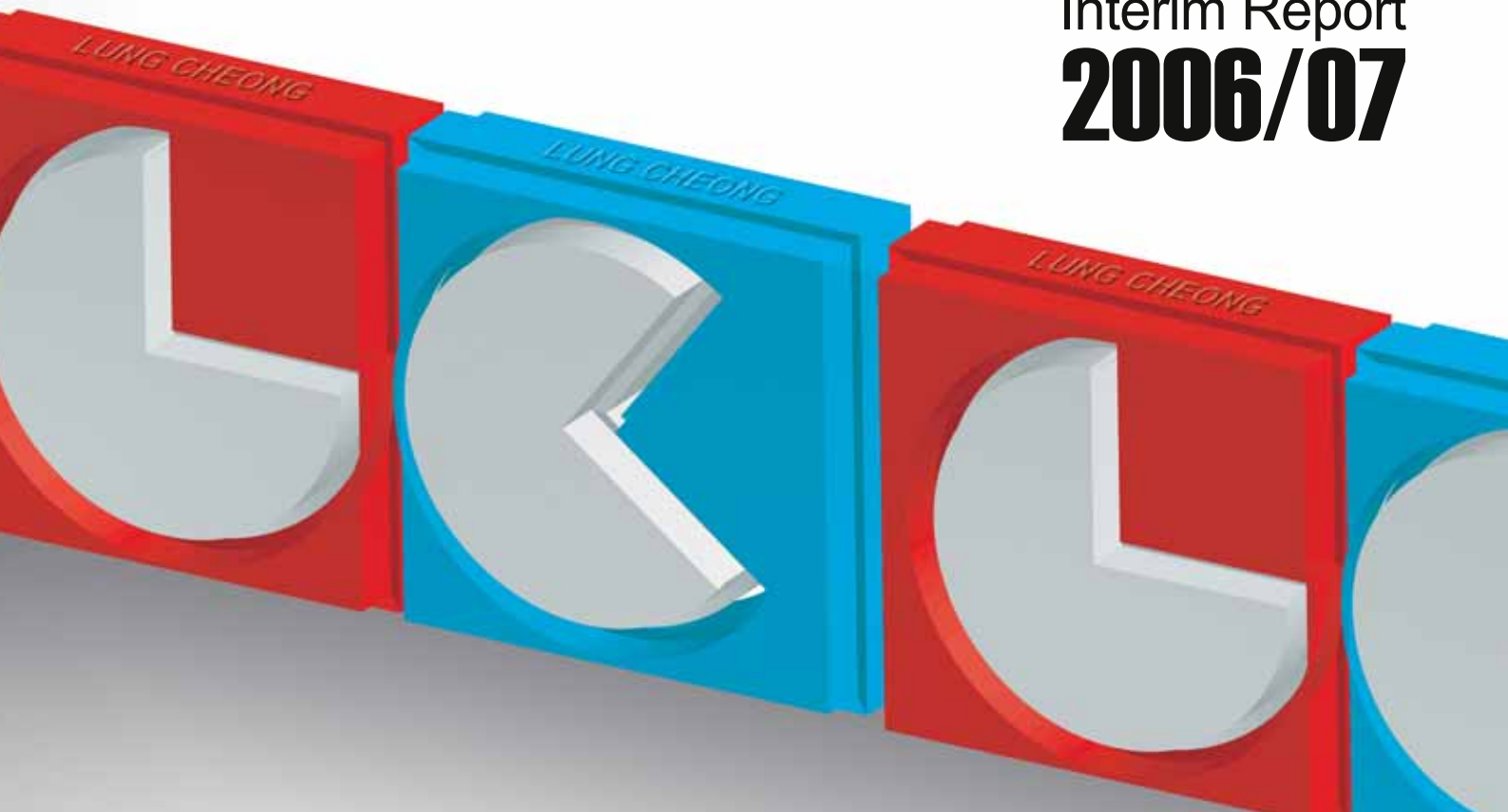


LUNG CHEONG INTERNATIONAL HOLDINGS LIMITED

(Incorporated in the Cayman Islands with limited liability)

Stock Code : 348

Interim Report **2006/07**



CORPORATE INFORMATION

Executive Directors

Mr. Leung Lun (*Chairman*)
Mr. Leung Chung Ming (*Managing Director*)
Mr. Zhong Bing Quan
Ms. Cheng Yun Tai
Mr. Wong, Tze On Andy

Independent Non-executive Directors

Mr. Wong Lam, O.B.E., J.P.
Mr. Ye Tian Liu
Mr. Lai Yun Hung

Non-executive Director

Mr. Ko, Peter Ping Wah

Company Secretary

Mr. Mak, Yee Chuen Vincent

Auditors

PricewaterhouseCoopers

Audit Committee

Mr. Ye Tian Liu (*Chairman*)
Mr. Wong Lam, O.B.E., J.P.
Mr. Ko, Peter Ping Wah
Mr. Lai Yun Hung

Remuneration Committee

Mr. Wong Lam, O.B.E., J.P. (*Chairman*)
Mr. Leung Lun
Mr. Leung Chung Ming
Mr. Ye Tian Liu
Mr. Lai Yun Hung
Mr. Ko, Peter Ping Wah

Nomination Committee

Mr. Leung Lun (*Chairman*)
Mr. Leung Chung Ming
Mr. Wong Lam, O.B.E., J.P.
Mr. Ye Tian Liu
Mr. Lai Yun Hung
Mr. Ko, Peter Ping Wah

Registered Office

Ugland House
South Church Street
P. O. Box 309
George Town
Grand Cayman
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Head Office and Principal Place of Business

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1 Lok Yip Road
Fanling
Hong Kong
Tel: (852) 2677 6699
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Legal Advisers on Hong Kong Law

Jennifer Cheung & Co.

Principal Share Registrar and Transfer Office

Bank of Bermuda (Cayman) Limited
P. O. Box 513 G.T.
3rd Floor, British American Tower
Dr. Roy's Drive
George Town
Grand Cayman
Cayman Islands
British West Indies

Branch Share Registrar and Transfer Office in Hong Kong

Abacus Share Registrars Limited
26th Floor, Tesbury Centre,
28 Queen's Road East
Hong Kong

Listing Information

The Stock Exchange of Hong Kong Limited
Stock Code: 348

Website

www.e-lci.com

The board of directors (the "Directors") of Lung Cheong International Holdings Limited (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (the "Group") for the six months ended 30 September 2006 together with comparative figures for the corresponding period in 2005. These interim consolidated accounts have not been audited but have been reviewed by the Company's Audit Committee.

CONDENSED CONSOLIDATED INCOME STATEMENT

For the six months ended 30 September 2006

	Note	Unaudited Six months ended 30 September	
		2006 HK\$'000	2005 HK\$'000
Turnover	2	371,613	369,013
Cost of sales		(268,024)	(268,955)
Gross profit		103,589	100,058
Other revenues	2	2,065	1,619
Selling and distribution expenses		(17,420)	(20,004)
Administrative expenses		(66,100)	(63,487)
Operating profit	3	22,134	18,186
Finance costs	4	(13,367)	(7,069)
Profit before taxation		8,767	11,117
Taxation	5	(370)	(1,113)
Profit for the period		<u>8,397</u>	<u>10,004</u>
Attributable to:			
Equity holders of the Company		8,454	10,004
Minority interest		(57)	—
		<u>8,397</u>	<u>10,004</u>
Dividends	6	—	—
Earnings per share for the profit attributable to the equity holders of the Company during the period			
— Basic	7	<u>1.75 cents</u>	<u>2.07 cents</u>
— Diluted	7	<u>N/A</u>	<u>N/A</u>

CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 September 2006

		Unaudited 30 September 2006 HK\$'000	Audited 31 March 2006 HK\$'000
	Note		
Non-current assets			
Intangible assets		21,714	21,714
Leasehold land and land use rights		46,898	47,458
Property, plant and equipment	8	368,665	387,409
Available-for-sale financial assets		28,599	28,103
Deferred income tax assets		5,601	4,872
		<u>471,477</u>	<u>489,556</u>
Current assets			
Inventories		227,156	188,295
Trade and other receivables	9	283,833	254,422
Derivative financial instruments		1,044	450
Current tax recoverable		3,082	2,512
Cash and cash equivalents		56,467	89,752
		<u>571,582</u>	<u>535,431</u>
Current liabilities			
Trade payables	10	103,999	46,592
Other payables and accrued charges		20,211	45,492
Derivative financial instruments		513	105
Trust receipt bank loans		74,776	57,306
Loans from banks and financial institutions		373,987	414,986
Current income tax liabilities		7,302	7,438
		<u>580,788</u>	<u>571,919</u>
Net current liabilities		<u>(9,206)</u>	<u>(36,488)</u>
Total assets less current liabilities		<u>462,271</u>	<u>453,068</u>
Financed by:			
Share capital	11	48,373	48,373
Other reserves		118,501	117,756
Retained profits		280,773	272,320
Equity attributable to equity holders of the Company		<u>447,647</u>	<u>438,449</u>
Minority interest		—	57
Total equity		<u>447,647</u>	<u>438,506</u>
Non-current liabilities	12	<u>14,624</u>	<u>14,562</u>
		<u>462,271</u>	<u>453,068</u>

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 September 2006

	Unaudited	
	Six months ended	
	30 September	
	2006	2005
	HK\$'000	HK\$'000
Net cash inflow/(outflow) from operating activities	25,721	(50,239)
Net cash outflow from investment activities	(5,384)	(15,728)
Net cash outflow from financing activities	(54,366)	(38,345)
	<hr/>	<hr/>
Decrease in cash and cash equivalents	(34,029)	(104,312)
Cash and cash equivalents at 1 April	89,752	168,669
Effect on foreign exchange rate changes	744	291
	<hr/>	<hr/>
Cash and cash equivalents at 30 September	<u>56,467</u>	<u>64,648</u>
	<hr/>	<hr/>
Bank balances and cash	<u>56,467</u>	<u>64,648</u>

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 September 2006

	Unaudited									
	Share capital HK\$'000	Share premium HK\$'000	Exchange fluctuation reserve HK\$'000	Capital reserve HK\$'000	Investment revaluation reserve HK\$'000	Buildings revaluation reserve HK\$'000	Retained profits HK\$'000	Attributable	Minority interests HK\$'000	Total equity HK\$'000
								to equity		
								holders		
Company										
At 1 April 2006	48,373	110,548	(42,456)	28,524	—	21,140	272,320	438,449	57	438,506
Exchange difference arising from translation of accounts of overseas subsidiaries	—	—	744	—	—	—	—	744	—	744
Profit for the period	—	—	—	—	—	—	8,454	8,454	(57)	8,397
At 30 September 2006	<u>48,373</u>	<u>110,548</u>	<u>(41,712)</u>	<u>28,524</u>	<u>—</u>	<u>21,140</u>	<u>280,774</u>	<u>447,647</u>	<u>—</u>	<u>447,647</u>

	Unaudited									
	Share capital HK\$'000	Share premium HK\$'000	Exchange fluctuation reserve HK\$'000	Capital reserve HK\$'000	Investment revaluation reserve HK\$'000	Buildings revaluation reserve HK\$'000	Retained profits HK\$'000	Attributable	Minority interests HK\$'000	Total equity HK\$'000
								to equity		
								holders		
Company										
At 1 April 2005	48,373	112,967	(48,570)	27,828	—	22,485	244,343	407,426	—	407,426
Exchange difference arising from translation of accounts of overseas subsidiaries	—	—	(830)	—	—	—	—	(830)	—	(830)
Gain on investment revaluation	—	—	—	—	523	—	—	523	—	523
Capital contribution from minority shareholders	—	—	—	—	—	—	—	—	1,202	1,202
Profit for the period	—	—	—	—	—	—	10,004	10,004	—	10,004
Dividends	—	(2,419)	—	—	—	—	—	(2,419)	—	(2,419)
At 30 September 2005	<u>48,373</u>	<u>110,548</u>	<u>(49,400)</u>	<u>27,828</u>	<u>523</u>	<u>22,485</u>	<u>254,347</u>	<u>414,704</u>	<u>1,202</u>	<u>415,906</u>

NOTES TO THE CONDENSED INTERIM ACCOUNTS

1. Basis of Presentation and Principal Accounting Policies

The condensed consolidated interim financial statements have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants and with the applicable disclosure requirement of Appendix 16 of the Rules Governing the Listing of Securities ("Listing Rules") on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

The accounting policies and basis of preparation adopted in the preparation of these condensed consolidated interim financial statements are consistent with those used in the annual financial statements for the year ended 31 March 2006, with addition for the following amendments to standards and interpretations which are relevant to the Group's operation and are mandatory for financial year ending 31 March 2007:

HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates — Net Investment in a Foreign Operation
HKAS 39 (Amendment)	The Fair Value Option
HKFRS — Int 4	Determining whether an Arrangement contains a Lease

These amendments to standards and interpretations had no material effect on the Group's accounting policies.

The following new standards, amendments to standards and interpretations are relevant to the operation but are not effective for 2006 and have not been early adopted:

HKFRS 1 (Amendment)	Capital Disclosures ¹
HKFRS 7	Financial Instruments: Disclosures ¹
HK (IFRIC) — Int 8	Scope of HKFRS 2 ²

¹ Effective for the annual periods beginning on or after 1 January 2007.

² Effective for the annual periods beginning on or after 1 May 2006.

The Group is still not yet in the position to reasonably estimate the impact that may arise on the Group's results and financial position from the application of these standards, amendments or interpretations.

2. Turnover, Revenue and Segmental Information

The Group is principally engaged in the development, engineering, manufacture and sale of toys and moulds.

Revenues recognised during the periods are as follows:

	Unaudited Six months ended 30 September	
	2006 HK\$'000	2005 HK\$'000
Turnover		
Sale of goods	354,558	358,035
Mould income	17,055	10,978
	<u>371,613</u>	<u>369,013</u>
Other revenues		
Interest income	293	312
Other	1,772	1,307
	<u>2,065</u>	<u>1,619</u>
Total revenues	<u>373,678</u>	<u>370,632</u>

Primary reporting format — business segments

The Group's turnover and results are substantially derived from the manufacturing of toys. Accordingly, no analysis by business segment is presented.

Secondary reporting format — geographical segments

	Unaudited Six months ended 30 September	
	2006 HK\$'000	2005 HK\$'000
Turnover		
United States	167,397	176,437
Europe	68,052	71,852
Japan	46,638	43,645
Mainland China	38,723	34,185
Other	50,803	42,894
	<u>371,613</u>	<u>369,013</u>

No analysis of contribution to operating profit by geographical segment has been prepared as no contribution to operating profit from any of the above segments is substantially out of line with the normal ratio of profit to turnover.

The turnover derived from Europe represents sales of toys to multiple customers with goods shipped directly to Europe under the instruction of these customers.

3. Operating Profit

Operating profit is stated after charging the following:

	Unaudited Six months ended 30 September	
	2006 HK\$'000	2005 HK\$'000
Charging:		
Depreciation of owned fixed assets	24,021	21,261
Amortisation of leasehold land and land use rights	560	234
	<u>24,581</u>	<u>21,495</u>

4. Finance Costs

	Unaudited Six months ended 30 September	
	2006 HK\$'000	2005 HK\$'000
Interest on loans from banks and financial institutions	13,075	6,577
Interest on other loans	—	200
Arrangement fees on bank loans	292	292
	<u>13,367</u>	<u>7,069</u>

5. Taxation

	Unaudited Six months ended 30 September	
	2006 HK\$'000	2005 HK\$'000
Current taxation		
Hong Kong profits tax	226	1,100
Mainland China enterprise income tax	826	1,426
	<u>1,052</u>	<u>2,526</u>
Deferred taxation	(682)	(1,413)
	<u>370</u>	<u>1,113</u>

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profit for the period. Taxation on profits of Mainland China subsidiaries has been calculated on the estimated assessable profit for the period at the rates of taxation as applicable to the local subsidiaries. No provision for taxation of the subsidiaries in Indonesia and the United States has been made as they have tax losses as at 30 September 2006 and 30 September 2005.

6. Dividends

	Unaudited Six months ended 30 September	
	2006 HK\$'000	2005 HK\$'000
Ordinary shares		
Interim dividend — HK Nil cents (2005: HK Nil cents)	—	—

The Board of Directors does not recommend the payment of interim dividend for the six month ended 30 September 2006 (2005: HK Nil cents).

7. Earnings Per Share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by weighted average number of ordinary shares in issue during the period.

	Unaudited Six months ended 30 September	
	2006 HK\$'000	2005 HK\$'000
Profit attributable to equity holders of the Company	8,454	10,004
Weighted average number of ordinary shares in issue	483,733,333	483,733,333
Basic earnings per share (HK cents)	1.75	2.07

No diluted earnings per share is shown as the Company has no potential dilutive ordinary shares at 30 September 2006. For the six months ended 30 September 2005, diluted loss per share is not shown as the potential ordinary shares are anti-dilutive.

8. Property, Plant and Equipment

	<i>HK\$'000</i>
At 1 April 2006	387,409
Additions	5,384
Depreciation	(24,021)
Exchange adjustment	(107)
	<u> </u>
At 30 September 2006	<u><u>368,665</u></u>

9. Trade and Other Receivables

The carrying amounts of trade and other receivables are as follows:

	Unaudited 30 September 2006 <i>HK\$'000</i>	Audited 31 March 2006 <i>HK\$'000</i>
Trade receivables	212,326	187,043
Other receivables, deposits and prepayments	<u>71,507</u>	<u>67,379</u>
	<u><u>283,833</u></u>	<u><u>254,422</u></u>

The ageing analysis of the trade receivables was as follows:

	Unaudited 30 September 2006 <i>HK\$'000</i>	Audited 31 March 2006 <i>HK\$'000</i>
0 — 30 days	107,083	88,480
31 — 60 days	32,746	17,813
61 — 90 days	16,309	21,660
91 — 180 days	44,272	53,257
181 — 365 days	11,868	3,856
Over 365 days	<u>48</u>	<u>1,977</u>
	<u><u>212,326</u></u>	<u><u>187,043</u></u>

The Group's sales are on letter of credit or open account terms. Credit terms are reviewed on a regular basis. The normal trade term is between 30 to 90 days but business partners with strong financial background may be offered longer credit terms.

10. Trade Payables

The ageing analysis of the trade payables was as follows:

	Unaudited 30 September 2006 HK\$'000	Audited 31 March 2006 HK\$'000
0 — 30 days	19,033	18,189
31 — 60 days	32,174	10,563
61 — 90 days	26,793	6,585
91 — 180 days	20,840	10,285
181 — 365 days	4,902	853
Over 365 days	257	117
	<u>103,999</u>	<u>46,592</u>

11. Share Capital

	Authorised			
	Convertible cumulative redeemable preference shares of US\$100,000 each		Ordinary shares of HK\$0.10 each	
	<i>No. of shares</i>	<i>US\$'000</i>	<i>No. of shares</i> <i>(thousands)</i>	<i>HK\$'000</i>
At 31 March 2006 and 30 September 2006	<u>40</u>	<u>4,000</u>	<u>1,000,000</u>	<u>100,000</u>

	Issued and fully paid			
	Convertible cumulative redeemable preference shares of US\$100,000 each		Ordinary shares of HK\$0.10 each	
	<i>No. of shares</i>	<i>HK\$'000</i> <i>(equivalent)</i>	<i>No. of shares</i> <i>(thousands)</i>	<i>HK\$'000</i>
At 31 March 2006 and 30 September 2006	<u>—</u>	<u>—</u>	<u>483,733</u>	<u>48,373</u>

12. Non-current Liabilities

	Unaudited 30 September 2006 HK\$'000	Audited 31 March 2006 HK\$'000
Deferred income tax liabilities	13,366	13,366
Provision for long service payment	1,258	1,196
	<u>14,624</u>	<u>14,562</u>

13. Contingent Liabilities

At 30 September 2006, the Group did not have material contingent liabilities.

14. Commitments

(a) Capital commitment for fixed assets

	Unaudited 30 September 2006 HK\$'000	Audited 31 March 2006 HK\$'000
Contracted but not provided for	—	109

(b) Commitments under operating leases

At 30 September 2006, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	Unaudited 30 September 2006 HK\$'000	Audited 31 March 2006 HK\$'000
Not later than one year	3,458	3,812
Later than one year but not later than five years	12,673	12,673
Over five years	3,703	5,291
	<u>19,834</u>	<u>21,776</u>

(c) Commitments under forward foreign currency contracts

As at 30 September 2006, the Group had maximum outstanding forward foreign currency contracts to purchase approximately USD 67,200,000 (2006 March: approximately USD 109,500,000) for approximately HK\$524,160,000 (2006 March: approximately HK\$ 854,100,000).

15. Banking and other facilities

As at 30 September 2006, the Group had a total banking and other facilities of approximately HK\$844,000,000 (2005: approximately HK\$797,000,000), of which the following had been utilized:

- (a) an outstanding bank loan of US\$3,460,000 (approximately HK\$26,988,000) (2005: US\$3,753,000 (approximately HK\$29,277,000)) for financing the lump sum payments for premiums of the three life insurance contracts. The bank loan is secured by the three life insurance contracts with a combined death benefit of approximately US\$25 million (approximately HK\$195 million) and a corporate guarantee executed by the Company;
- (b) a syndication loan of HK\$276,000,000 (2005: HK\$240,000,000); and
- (c) general banking facilities of approximately HK\$145,775,000 (2005: approximately HK\$132,106,000).

These general banking facilities are all secured by a corporate guarantee of the Company.

INTERIM DIVIDEND

The Board of Directors does not recommend the payment of interim dividend for the six months ended 30 September 2006 (2005: Nil)

RESULTS, BUSINESS REVIEW AND PROSPECTS

Results

The Group's turnover for the six months ended 30 September 2006 was HK\$372 million, representing an increase of 0.7 % as compared to HK\$369 million recorded in the corresponding period in 2005. The gross profit margin for the six months ended 30 September 2006 was 27.9%, very much in line the corresponding period in 2005. However, profit attributable to equity holders of the Group for the six months ended 30 September 2006 was HK\$8 million (2005: HK\$10 million), approximately 15.5% less than that in the corresponding period in 2005.

Business Review

For the interim period of 2006/07, the Group continued to face the challenges impacting the toy industry as well as difficulties encountered by manufacturers with factories in the Guangdong province. Orders from the Group's major customers have been consistent, in addition to the continued success of the Group's certain ODM and OEM products, radio and electronic control toys with major movie licenses in particular.

Limited production capacity and narrow supply of skilled workers restricted delivery in the first half of our 2006/07 financial year. Although the Group always stays on top of the required delivery schedule, the Directors expect that competition for factory workers will continue in the years to come. Apart from labor shortages, the Group has had to deal with mandated increase in minimum wages, fluctuating raw material costs and fierce pricing competition within the toy industry. The Group's success in ODM products in the first half of 2006/07 financial year had contributed to the maintenance of the gross margin when compared to previous year.

The Group's selling expenses decreased as compared with the previous corresponding period due to the lower licensing expenditures, sales and promotional activities and commission paid. The costs of transportation and delivery are included in this expenditure segment.

Another expenditure segment impacting the Group's profit margin was the administration expenses which recorded an increase due to the appreciation of the Renminbi ("RMB"), thus adding to our expenses in RMB which consisted of salaries, water and electricity, cost of operating power generators, material purchases and local fees and taxes. Operating costs sore because the Group had to offer additional fringe benefits to its employees in order to maintain a steady and skillful work force in the competition for hiring labor in the Guangdong province.

On the licensing front, during the period under review, the exclusive bendable figurine license for the 2006 FIFA World Cup Football finals in Germany had performed below expectations. Orders for the North American sport licensed bendable figurines such as the NBA, MLB, NHL and MLS too had not been slow. Kid Galaxy is now reviewing all sport licenses relating to Bendable figurines as the bulk of the revenue are now from sale of radio control toys rather than the non-electronic items marketed by KG.

Construction of the Group's new factory in Dongguan Changping is now completed and renovation has been proceeding according to plans and schedules. The Group has commenced to relocate the operations of the factory in December 2006 and expect to complete relocation before the end of the financial year 2006/07. Construction of the new factory were mostly financed by a HK\$300 million Term and Revolving facility granted by a group of banks since 2004. However, interest expense for the period in review has increased to HK\$14 million compared to HK\$7 million in the previous corresponding period.

Plans and Prospects

The Directors anticipated competitive conditions to continue for the rest of 2006/07. The Group's continued investments into further ODM and OBM are expected to improve, at the least keep margins at the current level. Standard Tooling and Products Co. Ltd. ("STP") will continue to play an important role in designing and engineering innovative products the Group brings to its ODM customers and the market through Kid Galaxy. The year in review alone, the Group has introduced a range of market leading robotic products and Kid Galaxy has continued to introduce innovative toys and brands to the market.

The Directors are of the opinion that the new Changping factory will resolve some of the issues currently faced by the Group. Consolidation of the Group's operations into one factory should ultimately lead to economies of scale, thus making our operation more efficient, when competing for orders. The Group aims to dispose of the old factory and sublet leased facilities after the Changping factory is fully operational. It aims to obtain all the approvals and accreditations to produce for certain customers in the first quarter of the next financial year.

The Directors feel that the labor shortage in this financial period may be dealt with after relocation to new factory. Changping, being a major railway terminus for workers arriving from other provinces should provide the Group with the opportunity to capture these new migrant workers. The new factory has a much improved living conditions and amenities to attract and retain workers compared to the existing facilities.

Plans are in place for the relocation of the operations to Changping with the minimum interruption to our customers and production needs. The Directors expect the benefits of the centralization of production lines and warehousing upon completion of the Changping factory will improve efficiency and reduce operation costs.

Since 2002, Action Products International Inc. ("APII") filed the lawsuit at the Circuit Court of the Alachua County, Florida, USA (the "Circuit Court") against the Company, Kid Galaxy Inc. ("KGI") and Mr. Tim Young ("Mr. Young") and claimed damages ("Damages") of US\$5.1 million (approximately HK\$39.7 million). On 9 October 2006, the jury arrived at the decision against the Company, KGI and Mr. Young and awarded APII the Damages. On 16 October 2006, the Company filed a motion to set aside the jury's previous verdict which was subsequently denied by the Circuit Court. Details of the lawsuit and the previous verdicts were set out in the announcements of the Company dated 16 October 2006 and 16 November 2006.

The Company has filed an appeal of the jury's verdict on 4 December 2006. The appeal is expected to take 9-12 months. While the appeal is pending, the Group will post an appeal bond (the "Appeal Bond") to the Circuit Court. The Board is seeking alternatives to finance the Appeal Bond. Should the Company succeed in the appeal of the jury's verdict, the Damages will no longer be awarded to APII. The Appeal Bond will be released to the Company and funds will then be used for general working capital purpose.

Pending the result of the appeal, the Company will make full provision for the awarded Damages in the accounts of the Group for the year ending 31 March 2007. In the opinion of the Board, such a provision has no material cashflow impact on the Group.

The Directors are confident that turnover for the remainder of the year will improve. New customer orders are now being negotiated for shipment in 2007 taking into account the strengthening of the RMB and increase in wages and material costs. Therefore the Directors are reasonably optimistic that margin will stabilize in the second half of this reporting period.

GROUP RESOURCES AND LIQUIDITY

As at 30 September 2006, the Group's cash and bank balances were approximately HK\$56 million (2006 March: approximately HK\$90 million). The Group's total borrowings were HK\$449 million (2006 March: HK\$472 million). The gearing ratio, calculated as the total borrowings less cash and bank balances and divided by shareholders' equity, was approximately 88% (2006 March: approximately 87%). As at 30 September 2006, the Group recorded total current assets of approximately HK\$572 million (2006 March: approximately HK\$535 million) and total current liabilities of approximately HK\$581 million (2006 March: approximately HK\$572 million). The current ratio of the Group, calculated by dividing the total current assets by total current liabilities, was approximately 0.98 (2006 March: approximately 0.94). The Group recorded an increase in shareholders' funds from approximately HK\$438 million as at 31 March 2006 to approximately HK\$448 million as at 30 September 2006. The increase was mainly derived from the profit after tax.

The increase in current liabilities as at 30 September 2006 was due to the Group's non-compliance to certain financial covenants of a long-term bank loan agreement of the Group, which triggered the reclassification of a bank loan of approximately HK\$160,800,000 repayable from December 2007 quarterly up to 30 June 2008, as current liabilities as at 30 September 2006. The Group obtained waivers from the relevant banks in respect of such non-compliance subsequent to 30 September 2006. In the opinion of the Board, the Group has sufficient financial resources to meet the future operational needs.

Save as disclosed above, the information relating to matters set out in paragraph 32 of Appendix 16 to the Listing Rules has not been changed materially from that disclosed in the annual report of the Company for the year ended 31 March 2006.

EMPLOYEES

As at 30 September 2006, the Group had approximately 6,800 employees. Approximately 72, 6,514, 203 and 11 employees were based in Hong Kong, Dongguan factories, Indonesia factory and the U.S. office respectively. The number of workers employed by the Group varies from time to time depending on production needs and are remunerated based on industry practice.

The Group operates different remuneration schemes for different employees. Apart from pension funds and year end bonuses, in-house and external training programs are offered.

SHARE OPTION SCHEME

On 3 September 2002, the Company adopted a share option scheme under which the directors may grant options to eligible persons, including employees and directors of the Group, to subscribe for shares of the Company.

The Company has not granted any option under the share option scheme since its adoption.

DIRECTORS' INTERESTS IN EQUITY SECURITIES

At 30 September 2006, the interests and short positions of each Director and chief executive of the Company in the shares or underlying shares of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of Laws of Hong Kong) ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules were as follows:

Name	Name of company	Capacity	Number and class of securities (Note 1)	Percentage on the issued share capital of the same class of securities
Leung Lun	The Company	Interest of controlled corporation	279,442,000 ordinary shares (L) (Note 2)	57.76%
	Lung Cheong Investment Limited	Interest of controlled corporation	1,000 ordinary shares (L)	100%
	Rare Diamond Limited	Beneficial interest	70 ordinary shares (L)	100%
Leung Chung Ming	The Company	Interest of controlled corporation	279,442,000 ordinary shares (L) (Note 2)	57.76%
	Lung Cheong Investment Limited	Interest of controlled corporation	1,000 ordinary shares (L)	100%
	Rare Diamond Limited	Beneficial interest	30 ordinary shares (L)	100%

Notes:

1. The letter "L" represents the Director's interests in the shares and underlying shares of the relevant company.
2. These shares were held by Lung Cheong Investment Limited, a company wholly owned by Rare Diamond Limited. Rare Diamond Limited is beneficially owned as to 70% by Mr. Leung Lun and 30% by Mr. Leung Chung Ming respectively.

Apart from the Share Option Scheme, at no time during the period was the Company, its holding companies or its subsidiaries a party to any arrangements to enable the Directors, Chief Executives and their Associates to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Pursuant to the Term and Revolving facilities agreement entered into by the Company and a group of financial institutions on 7 December 2004 amounting to HK\$300 million, Mr Leung Lun and Mr Leung Chung Ming are required to jointly hold at least 45% of the issued share capital of the Company.

SUBSTANTIAL SHAREHOLDERS

At 30 September 2006, the following persons, other than a director or chief executive of the Company, had an interest in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO:

Name of shareholder	Number of ordinary shares (Note 1)	Capacity	Approximate percentage of interest
Lung Cheong Investment Limited	279,442,000 (L)	Beneficial owner	57.76%
Rare Diamond Limited	279,442,000 (L) (Note 2)	Interest of controlled corporation	57.76%
Chan Wing Sun	29,313,333	Beneficial owner	6.06%

Notes:

1. The letter "L" represents the entity's interests in the shares of the relevant company.
2. These Shares were registered in the name of Lung Cheong Investment Limited, the entire issued share capital of which was owned by Rare Diamond Limited.

CONNECTED TRANSACTIONS

At 30 September 2006, a wholly-owned subsidiary of the Company, Lung Cheong Toys Limited ("LC Toys"), had long-term loans and deferred trading balances amounted in aggregate to HK\$60,648,000, plus accrued interest, due by PT. Lung Cheong Brothers Industrial ("PTLC"), a 60% owned subsidiary of LC Toys. The balance of the 40% interest in PTLC is owned by independent third parties who are not connected with the Directors, Chief Executives or substantial shareholders of the Company and its subsidiaries, other than PTLC, or any of their respective associates. The long-term loans were advanced to finance the set up of the production facilities of PTLC. The amounts are unsecured, bearing interest at 3-month HIBOR per annum and have no fixed repayment terms. LC Toys does not intend to demand repayment of the advances in the foreseeable future.

The Directors, including the Non-Executive Directors, are of the opinion that the above transaction was entered into on normal commercial terms which are fair and reasonable.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the period.

CODE ON CORPORATE GOVERNANCE PRACTICES

In the opinion of the directors, the Company has complied with the code provisions as set out in Appendix 14 of the Listing Rules, throughout the accounting period covered by the interim report.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding securities transactions by directors on terms no less exacting than the required standard set out in Appendix 10 of the Listing Rules (the "Model Code"). The Company has made specific enquiry of its directors. All directors confirmed that they have complied with the required standard set out in the Model Code and the code of conduct regarding securities transactions by directors adopted by the Company throughout the accounting period covered by the interim report.

AUDIT COMMITTEE

The Company has an audit committee in compliance with Rule 3.21 of the Listing Rules for the purpose of reviewing and providing supervision over the Group's financial reporting process including a review of the unaudited condensed interim financial statements for the six months ended 30 September 2006, this interim report and the Group's internal controls.

On behalf of the Board of
Lung Cheong International Holdings Limited

Leung Lun
Chairman

20 December 2006