

Corporate Governance Report

CORPORATE GOVERNANCE PRACTICES

The board considers that good corporate governance of the Company is central to safeguarding the interests of the shareholders and enhancing the performance of the Group. The board is committed to maintaining and ensuring high standards of corporate governance. The Company has applied the principles and complied with all the applicable code provisions of the Code on Corporate Governance Practices ("Code") as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules") for the year ended 31 December 2006, except for the deviation from provision A.2.1 of the Code in respect of segregation of the roles of chairman and chief executive officer. The board will continuously review and improve the corporate governance practices and standards of the Company to ensure that business activities and decision making processes are regulated in a proper and prudent manner.

ENHANCEMENT ON THE COMPANY'S CORPORATE GOVERNANCE IN 2006

With a view to further improve the Company's corporate governance practices, the following actions were taken in 2006:

- Appointment of one additional executive director and one additional independent non-executive director to further broaden the collective knowledge, perspective and skill of the board.
- Provision of a comprehensive, formal and tailored orientation package to newly appointed directors.
- Appointment of one additional independent non-executive director with appropriate professional qualifications and experience in financial management to the Audit Committee. As a result, four out of five members of the Audit Committee are independent non-executive directors and three out of five members have appropriate professional accounting qualifications and financial management experience.
- Introduction of a programme of continuous professional development for directors.
- Directors disclosure to the Company of their directorship held in public companies.

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DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") as set out in Appendix 10 of the Listing Rules for securities transactions by directors of the Company in 2004. All the members of the board have confirmed, following specific enquiry by the Company, that they have complied with the required standard as set out in the Model Code throughout the year ended 31 December 2006. The Model Code also applies to other specified senior management of the Group.

BOARD OF DIRECTORS

Composition and role

The board of directors of the Company comprises:

Executive Directors:	CHAN Chun Hoo, Thomas – Chairman CHENG Bing Kin, Alain TO Shu Sing, Sidney
Non-executive Directors:	TSIM Tak Lung – Deputy Chairman CHOW Yu Chun, Alexander (Independent) IP Shu Wing, Charles LEE Peng Fei, Allen (Independent) LO Kai Yiu, Anthony (Independent) YU Hon To, David (Independent)

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In view of their extensive professional and industrial experiences as well as their ability to broaden the perspective and contribute to the effectiveness of the board, the executive directors had identified and invited Mr. Cheng Bing Kin, Alain and Mr. Chow Yu Chun, Alexander to join the board in early 2006. The executive directors then make recommendation to the board for their appointment. Mr. Cheng Bing Kin, Alain and Mr. Chow Yu Chun, Alexander were appointed as executive director and independent non-executive director respectively at the board meeting held on 2 March 2006. Pursuant to the Bye-laws of the Company, both of them retired and were re-elected as directors at the annual general meeting of the Company held on 4 May 2006.

The board comprises three executive directors (one of whom is the Chairman) and six non-executive directors. Of the six non-executive directors, four are independent non-executive directors; they represent more than one-third of the board. This proportion far exceeds the requirement of the Listing Rules which requires every board of directors of a listed issuer to have at least three independent non-executive directors. In addition, three of the independent non-executive directors possess appropriate professional accounting qualifications and financial management expertise. Biographies of the board of directors of the Company are shown on pages 6 to 7 of this annual report and are also maintained on the Company's website.

The principal focus of the board is on the overall strategic development of the Group. The board also monitors the financial performance and the internal controls of the Group's business operations. With a wide range of expertise and a balance of skills, the non-executive directors bring independent judgment on issues of strategic direction, development, performance and risk management through their contribution at board meetings and committee work.

The independent non-executive directors also serve the important function of ensuring and monitoring the basis for an effective corporate governance framework. The board considers that each independent non-executive director is independent in character and judgment and that they all meet the specific independence criteria as required by the Listing Rules. The Company has received from each independent non-executive director an annual confirmation of his independence pursuant to Rule 3.13 of Chapter 3 of the Listing Rules and the Company considers such directors to be independent. The independent non-executive directors are explicitly identified in all corporate communications.

All directors are regularly updated on governance and regulatory matters. There is an established procedure for directors to obtain independent professional advice at the expense of the Company in the furtherance of their duties. The Company has also arranged appropriate director and officer liability insurance cover in respect of any potential legal actions that might be taken against its directors.

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BOARD OF DIRECTORS (Continued)

Composition and role (Continued)

The board meets regularly throughout the year to review the overall strategy and to monitor the operation as well as the financial performance of the Group. Senior executives are from time to time invited to attend board meetings to make presentations or answer the board's enquiries. The Chairman focuses on Group strategy and is responsible for chairing and managing the efficient operation of the board and ensuring that all key issues are considered by the board in a timely manner. Notice of at least 14 days has been given to all directors for all regular board meetings and the directors can include matters for discussion in the agenda whenever they consider appropriate and necessary. Agenda and accompanying board papers in respect of regular board meetings are dispatched in full to all directors within a reasonable time before the meeting. Directors have to declare their direct or indirect interests, if any, in any proposals or transactions to be considered by the board at board meetings and abstain from voting as appropriate. Draft minutes of all board meetings are circulated to directors for comment within a reasonable time prior to confirmation.

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Minutes of board meetings and meetings of board committees are kept by duly appointed secretaries of the respective meetings; all directors have access to board papers and related materials, and are provided with adequate information in a timely manner; this enables the board to make informed decision on matters placed before it.

There is no relationship between members of the board except for the in-law relationship between Mr. Tsim Tak Lung and Mr. To Shu Sing, Sidney.

During the year, five full board meetings were held and the attendance record of each director is set out below:

Name of director	Number of board meetings attended	Attendance rate
CHAN Chun Hoo, Thomas	5/5	100%
CHENG Bing Kin, Alain*	3/3	100%
TO Shu Sing, Sidney	4/5	80%
TSIM Tak Lung	4/5	80%
CHOW Yu Chun, Alexander*	3/3	100%
IP Shu Wing, Charles	5/5	100%
LEE Peng Fei, Allen	5/5	100%
LO Kai Yiu, Anthony	4/5	80%
YU Hon To, David	5/5	100%

* appointed as a director on 2 March 2006 by the board

Chairman and Chief Executive Officer

The Chairman and chief executive officer of the Company is Mr. Chan Chun Hoo, Thomas. This deviates from provision A.2.1 of the Code which stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual.

Mr. Chan Chun Hoo, Thomas focuses on Group strategy and is responsible for chairing and managing the efficient operation of the board and ensuring that all key issues are considered by the board in a timely manner; whereas responsibilities for running of the business operations of the Group are delegated to different designated senior executives. The board considers that this structure will not impair the balance of power and authority between the board and the management of the business of the Group given that there is a strong and independent non-executive directorship element on the board and a clear division of responsibility in running the business of the Group. The board believes that the structure outlined above is beneficial to the Company and its business.

Re-election of Directors

Each of the non-executive directors of the Company has entered into a service contract with the Company for a term of three years. However, such term is subject to his re-appointment by the Company at general meeting upon retirement by rotation pursuant to the Bye-laws of the Company. In accordance with the relevant provisions in the Bye-laws of the Company, the appointment of directors is considered by the board and the newly appointed directors are required to stand for election by shareholders at the first annual general meeting following their appointment and, except for the Chairman, shall retire and stand for re-election by shareholders at least once every three years. To uphold the good corporate governance practices, the Chairman had voluntarily retired from his office and offered himself for re-election at the annual general meeting held on 28 April 2005 notwithstanding that he is not statutorily required to do so pursuant to the Company's Bye-laws.

Audit Committee

The Audit Committee was established in 1999 and its current members include:

LO Kai Yiu, Anthony – Committee Chairman

CHOW Yu Chun, Alexander

LEE Peng Fei, Allen

TSIM Tak Lung

YU Hon To, David

Corporate Governance Report

BOARD OF DIRECTORS (Continued)

Audit Committee (Continued)

The majority of the Audit Committee members are independent non-executive directors. The board considers that each Audit Committee member has broad commercial experience and there is a suitable mix of expertise in business, accounting and financial management on the Audit Committee. The composition and members of the Audit Committee far exceeds the requirements under Rule 3.21 of the Listing Rules which requires a minimum of three members and at least one of whom is an independent non-executive director with appropriate professional qualifications or accounting or related financial management expertise. The written terms of reference which describe the authority and duties of the Audit Committee were adopted in 1999 and subsequently revised in 2005 to conform to the provisions of the Code, a copy of which is posted on the Company's website.

The Audit Committee meets not less than twice a year to review the reporting of financial and other information to shareholders, the system of internal controls, risk management and the effectiveness and objectivity of the audit process. The Audit Committee also provides an important link between the board and the Company's external auditors in matters coming within the scope of its terms of reference and keeps under review the independence and objectivity of the external auditors.

The Audit Committee has reviewed with the management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters including a review of the financial statements for the year ended 31 December 2006.

At the meeting held on 12 March 2007, the Audit Committee reviewed this report, the Directors' Report and financial statements for the year ended 31 December 2006 together with the annual results announcement, with a recommendation to the board of directors for approval.

During the year, four Audit Committee meetings were held and the attendance record of each member is set out below:

Name of director	Number of meetings attended	Attendance rate
LO Kai Yiu, Anthony	4/4	100%
CHOW Yu Chun, Alexander#	2/2	100%
LEE Peng Fei, Allen	3/4	75%
TSIM Tak Lung	3/4	75%
YU Hon To, David	4/4	100%

appointed as a member of the Audit Committee on 4 May 2006 by the board

Compensation Committee

The Compensation Committee was established in early 2004 and the current members include:

TSIM Tak Lung – Committee Chairman

LEE Peng Fei, Allen

LO Kai Yiu, Anthony

The majority of the Compensation Committee members are independent non-executive directors. The Compensation Committee advises the board on the Group's overall policy and structure for the remuneration of directors and senior management. The Compensation Committee ensures that no director or any of his associate is involved in deciding his own remuneration. The terms of reference of the Compensation Committee were adopted in 2004 and subsequently revised in 2005 to conform to the provisions of the Code, a copy of which is posted on the Company's website.

In determining the remuneration for directors, the Compensation Committee takes into consideration factors such as salaries paid by comparable companies, time commitment and responsibilities of the directors and the desirability of performance-based remuneration.

The Compensation Committee meets to determine the policy for the remuneration of directors and assess the performance of executive directors and members of senior management. During the year, one Compensation Committee meeting was held, with 100% attendance by all committee members.

Group Compensation Policy

Objectives

The objectives of the compensation policy are:

- to provide an equitable and competitive compensation package so as to attract and retain the best available human resources to serve corporate needs;
- to provide a package of compensation to the employees that is competitive in the industry and takes account of general market condition;
- to reward employees for good individual and corporate performance; and
- to encourage future employee contributions to achieve overall corporate goals.

Components

The compensation package for each employee is structured in a way to attract and retain the best talents available, and will contain a combination or modification of some or all of the following three main components:

Corporate Governance Report

BOARD OF DIRECTORS (Continued)

Compensation Committee (Continued)

Group Compensation Policy (Continued)

I. Base salary

Base salary and wage rate ranges are established for each position by evaluating the responsibilities and the duties required to be performed. The actual salary or wage rate for the person filling the position is determined based on the experience and ability of the individual selected for the position.

The base salary and wage rate ranges are reviewed periodically with reference to the prevailing market level and similar positions of competitors in the relevant industry. The actual salaries and wage rates of employees are reviewed annually and may be adjusted from time to time based on the cost of living and financial performance of the Company.

Salaries and wages are base compensation and not intended to reward performance, either individually or corporately. Performance is rewarded through the other components of the compensation plan.

II. Incentive bonus

Incentive bonus is linked to individual and corporate performance. Every year, profitability and other corporate performance targets are set and incentive bonuses will only be paid for that year if the targets are achieved.

The incentive bonus for each employee is determined with reference to his position and his individual performance during the year.

III. Stock option

Options to purchase shares in the Company are granted to employees from time to time at the discretion of the board, in order to retain valuable human resources and to motivate future performance of the employees.

Stock options granted to individual employees are determined with reference to their positions, their performance and ability to contribute to the overall corporate success.

The granting of stock options is subject to shareholders' mandates as required and all other applicable laws and regulations of the relevant jurisdictions.

IV. Other benefits

In addition to the above three main components, the Group offers other customary and/or mandatory benefits to employees, such as retirement fund scheme, insurance and paid holiday, with reference to prevailing industry practices in the relevant jurisdictions.

Chief Executive Officer and Top Paid Employees

The following table summarizes compensation information for the chief executive officer and the four most highly compensated executive officers of the Group for the year ended 31 December 2006:

Name of officer	Salary HK\$'000	Performance bonus HK\$'000	Other benefits HK\$'000 (Note)	Employer's	Share-based payment HK\$'000	Total HK\$'000
				contribution to provident fund HK\$'000		
CHAN Chun Hoo, Thomas	120	3,000	158	7	–	3,285
NOVAK, Lou	3,510	637	271	103	3,278	7,799
SINCLAIR, John	2,529	109	481	103	10	3,232
SOONG, Ronnie	2,381	364	78	12	364	3,199
JACOBS, Phil	1,864	156	271	103	295	2,689

Note: Other benefits include car allowance, insurance premium and club membership.

AUDITORS' REMUNERATION

For the year ended 31 December 2006, the auditors of the Company only provided audit services to the Company. In order to maintain their independence, the auditors will not be employed for non-audit work unless prior approval is obtained from the Audit Committee.

INTERNAL CONTROLS

The board has overall responsibility for maintaining an adequate system of internal controls of the Company and for reviewing its effectiveness. The board is committed to implementing an effective and sound internal control system to safeguard the interest of shareholders and the Company's assets. The board has conducted an annual review of the system of internal controls which covered all relevant financial, operational, compliance controls and risk management functions within an established framework.

The internal control process is accomplished by the board, management and other designated personnel, and designed to provide reasonable assurance regarding the achievement of objectives.

Corporate Governance Report

INTERNAL CONTROLS (Continued)

The Group's internal control system is designed in consideration of the nature of business as well as the organization structure. The system is designed to manage rather than eliminate the risk of failure in operational systems and to provide reasonable, but not absolute, assurance against material misstatement or loss. The system is designed further to safeguard the Group's assets, maintain appropriate accounting records and financial reporting, maintain efficiency of operations and ensure compliance with applicable laws and regulations.

Control Process

Independent consultants were hired since 2005 to perform a review on the system of internal controls of the Group. The principal purpose of the review was to obtain sufficient knowledge of the control environment to understand the attitude of management and the governing body, awareness and actions concerning the factors of the control environment. The approach adopted for the assessment is based on those set by the COSO (the Committee of Sponsoring Organisations of the Treadway Commission), a globally recognized framework which categorizes internal controls into the following five components as the basis of reviewing its effectiveness:

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1. **Control Environment** sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
2. **Risk Assessment** is the entity's identification and analysis of relevant risks to the achievement of its objectives, forming a basis for determining how the risks should be managed.
3. **Information and Communication** systems support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
4. **Control Activities** are the policies and procedures that help to ensure management's directives are carried out.
5. **Monitoring** is a process that assesses the quality of internal control performance over time.

Control Effectiveness

The consultants updated the board periodically on the progress of their review on the internal controls of the Group and submitted reports to the board in 2006. The board reviewed the reports submitted by the consultants and relevant recommendations made by such consultants had been implemented by the Group in stages to enhance its internal control policies, procedures and practices. The consultants reported that no material control failings, weaknesses or significant areas of concern were identified during their review. The directors are satisfied with the effectiveness of the Group's internal controls and consider that key areas of the Group's system of internal controls are reasonably implemented, which provide prevention of material misstatement or loss, safeguard the Group's assets, maintain appropriate accounting records and financial reporting, efficiency of operations and ensure compliance with the Listing Rules and all other applicable laws and regulations. The Company will continue to engage external independent professionals to review its system of internal controls annually and further enhance its internal controls as appropriate.

There is currently no internal audit function within the Group. The directors have reviewed the need for an internal audit function and are of the view that in light of the size, nature and complexity of the business of the Group, it would be more cost effective to appoint external independent professionals to perform internal audit functions for the Group as the need arises. Nevertheless, the directors will continue to review at least annually the need for an internal audit function.

DIRECTORS' RESPONSIBILITY STATEMENT

The directors are responsible for the preparation of financial statements for each financial period which give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the financial statements for the year ended 31 December 2006, the directors have selected suitable accounting policies and applied them consistently; adopted appropriate Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards; made adjustments and estimates that are prudent, fair and reasonable; and have prepared the financial statements on the going concern basis. The directors are also responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company.

The statement of the auditors of the Company about their reporting responsibilities on the financial statements of the Group is set out in the auditors report on pages 37 to 38 of this annual report.

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INVESTOR RELATIONSHIP AND COMMUNICATION

The Company endeavours to continue maintaining a high level of transparency in communicating with shareholders and the investment community at large. Briefings and meetings with institutional investors and analysts are conducted regularly. The Company is committed to continue to maintain an open and effective investor communication policy and to update investors on relevant information on its business on a timely manner, subject to relevant regulatory requirements.

The Company is aware of its obligations under the Listing Rules that information which is expected to be price-sensitive should be announced immediately it is the subject of a decision. The Company takes extreme precautionary measures in the handling of price-sensitive information and has in place a Memorandum on Disclosure of Price Sensitive Information (which includes the Guide on Disclosure of Price-sensitive Information issued by the Stock Exchange in 2002) for its senior management and other staff member who is in a position to have access to price-sensitive information. Members of the board and other relevant senior management who have access to price-sensitive information are bound by the Model Code for securities transaction of the Company's securities and that of any related companies.

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In order to ensure effective, clear and accurate communications with the investors and analysts, all corporate communications are arranged and handled by the executive directors and designated senior executives according to established practices and procedures of the Company.

The Company has announced its annual and interim results and sent relevant accounts to shareholders in a timely manner during the year under review, which is well before the time limits set out in the Listing Rules. Separate resolutions are proposed at the general meetings on each substantially separate issue, including the election of individual directors. In addition, procedures for demanding a poll are included in the circular to shareholders dispatched together with the annual report.

The annual general meeting may provide an opportunity for communication between the board and the shareholders of the Company. The Company regards the annual general meeting as an important event in which the Chairman and all directors will make an effort to attend. All resolutions put to votes by shareholders at the annual general meeting 2006 were passed by poll. The poll results have been published in local newspapers and the website of the Company and that of the Stock Exchange on the day immediately after the date of the annual general meeting. In addition, shareholders holding not less than one tenth of the paid up capital of the Company carrying the right of voting at general meetings of the Company have the right by written requisition to the board or the secretary of the Company, to require a special general meeting to be called by the board for the transaction of business specified in such requisition.

The Company has also maintained a website at <http://www.playmates.net> which enables shareholders, investors and the general public to have access to the information of the Company on a timely basis. Financial information and all shareholder corporate communications of the Company are made available on the Company's website and updated regularly.

BUSINESS ETHICS

The Company is committed to a high standard of business ethics and integrity.

A long established code of conduct is enforced on all employees of the Group. No personal gifts or other forms of advantages from any person or organization doing business with the Group can be accepted by any employee. Business partners and suppliers are reminded from time to time that our policy forbids any employee or agent of the Group from accepting any gift from them.

The Group has developed a Code of Business Conduct for its manufacturing vendors and suppliers. All the vendors and suppliers of the Group are required to maintain a safe and healthy workplace, fair and ethical employment practice and ensure that proper environmental protection measures are in place. The Group also closely monitors its operations so that the relevant codes of conduct stipulated by our major licensors and customers are strictly followed by our manufacturing vendors and suppliers.

The Company has a worldwide reputation in the toy industry for product quality and safety. Children's health, safety and well being are our primary concern and the Company is committed to observing all relevant safety and product quality rules.

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SOCIAL RESPONSIBILITY

The Group has joined other leading companies in the toy industry to develop a common standard of business conduct for the toy manufacturing community to promote a safe and healthy workplace, fair and ethical employment practice, and proper environmental protection measures.

The Group makes regular contributions in terms of financial and other supports to various charitable organizations. Employees are encouraged to have direct and active involvement in fundraising activities for the needs of the community.

FAMILY MEMBERS AND CLOSE PERSONAL RELATIONSHIPS

The board recognises that talents, relevant experience and skills are the most important considerations in executive officers and staff selection. It is the Group's policy that job positions are filled by suitably qualified candidates selected through internal promotions or from the open market on the merits of qualification, experience, skills and achievements. No employee is hired on account of family or close personal connection to any board member.