

## FINANCIAL REVIEW

Plush toy manufacturers including the Group continued to face challenges in 2006. However, supported by a sizeable operation and strong reputation as an industry leader, the Group managed to attain a mild increase in turnover to HK\$1,084.4 million (2005: HK\$1,040.4 million) for the year ended 31 December 2006, thanks to the rapid growth of the steel and plastic toy business. Gross profit decreased to HK\$160.0 million (2005: HK\$186.9 million), mainly because of rising labour costs in the coastal areas in the PRC. Moreover, appreciation of the Renminbi and high raw material costs also created additional burden on costs of sales.

Loss attributable to equity holders was HK\$129.7 million (2005: HK\$36.3 million), including the impairment losses of goodwill of HK\$100.2 million that arose from the purchase of Dream INKO Co., Ltd. in 2003. Excluding this non-recurring loss, loss attributable to equity holders improved to HK\$29.5 million when compared with last year. The Group has been restructuring its business since 2005 and started to see the fruits of its efforts in the second half of 2006. It indeed reported net profit (excluding the one-off goodwill impairment losses) of HK\$7.1 million for the second half of the year, a marked improvement from net loss of HK\$36.6 million for the first half of the year.

The Group was in a healthy financial position with cash and bank deposits (excluding long-term structured deposits) of HK\$82.8 million (31 December 2005: HK\$103.1 million) as at 31 December 2006.

## BUSINESS REVIEW

To maintain its leading position in the toy industry, the Group focused on larger orders and strived to expand its client base and enrich its product portfolio during the year. It also implemented various measures

to address market challenges and other pressure on its operation. The Group continued to move its production facilities to inland China where labour costs are lower. To increase revenue denominated in Renminbi, the Group endeavoured to exploit the huge potential of the PRC market with the steel and plastic toy business. The Group also continued to restructure its business, such as streamlining the workforce and reallocating resources among its offices, to enhance operational efficiency and cost-effectiveness.

### Product Analysis

During the year under review, revenue from plush stuffed toys amounted to HK\$903.9 million, representing 83.4% of the Group's total turnover. As the Group focused on volume orders and higher margin customers, the proportion of Original Equipment Manufacturing ("OEM") business to the revenue from the plush stuffed toy segment decreased to 77.8%, yet it remained as the Group's core business. While maintaining close relationship with renowned character owners and licensors, the Group also secured new orders for promotional toys from a famous international fast food chain store. Leveraging its leading position in the plush stuffed toy industry, the Group continued to explore cross-selling opportunities for its steel and plastic products with existing OEM customers.

The Group's Original Design Manufacturing ("ODM") business recorded revenue of HK\$199.8 million, and its proportion increased significantly to 22.2% of the plush stuffed toy segment's turnover. During the year, the Group launched a new series of interactive educational electronic plush toys for pre-school children that was well received in the market. In addition to shifting its focus to higher margin customers, the Group also allocated more resources to R&D to ensure it has the ability to match changing market trends and tailor products to meet unique customer requirements.

Driven by strong market demand together with the full-year contribution from the joint venture set up in the second half of 2005, revenue from the steel and plastic toy business rose by over 200% to HK\$180.4 million when compared with 2005. Backed by the joint venture, the Group expanded its product scope to cover scooters, inline skates and skateboards, which attracted direct orders from a US chain store as well as more businesses from customers in the US and Europe. Carrying the acquired "Great" and "Far Great" brands, the Group's steel and plastic toys including scooters, bicycles, tricycles and inline skates actually made inroads into the PRC market during the year.

### Market Analysis

Driven by the growth in the steel and plastic toy business, North America remained as the most prominent market of the Group and accounted for 49.3% of its total turnover. Japan came second and contributed 25.0%, while Europe became another major market with a 17.3% share. China market, which is laden with potential, represented 2.6% of the Group's total turnover.

### Operational Analysis

During the year, the Group operated ten plants in China and one plant in Vietnam at an average utilization rate of around 85%. The leased Vietnam plant as a temporary facility was closed in 2006 after the Group's own plant was ready for full operation. All the production in Vietnam was then centralized in one plant to achieve economies of scale and enhance operational efficiency. The plant manufactured plush stuffed toys and contributed HK\$42.7 million to the turnover of the Group during the year.

To deal with rising labour costs in coastal areas in the PRC, the Group continued to move its production base inland and invested an additional US\$1.3 million (approximate to HK\$10.1 million) in the Chaohu and Mingguang plants, which commenced trial run in the

second half of 2006. Including the plants in Shuyang and Beiliu that commenced full operation in the first half of 2006, the four plants in inland China will account for 28% of the Group's total production capacity when all of them are in full operation.

## Prospects

The Group witnessed the unrelenting consolidation of the toy industry in last couple of years. Many small players were ousted leaving only the sizable and financially strong ones in the market. With fewer struggling small players in the cut-throat competition, the survived players will enjoy better margins and stronger bargaining power when negotiating with suppliers as well as customers.

Although, as a leading player, the Group stands to benefit in the consolidating market, it remains cautiously optimistic about the prospects of its business. The Group trusts that its comparative advantages in production capacity, quality control and design ability will inevitably make it a preferred choice to major multi-national buyers who have to comply with stringent legal and non-governmental requirements in their own countries and their products' end markets.

In addition, the Group will actively seek to capture business opportunities in the PRC market. It sees a strong ride for its steel and plastic products under the "Great" and "Far Great" brands as well as those produced on an OEM basis. In the first quarter of 2007, the Group leveraged its existing strong relationship with a renowned plush stuffed toy customer to secure orders for steel and plastic toys from the customer. These developments will not only boost the contributions from the steel and plastic toy business, but will also help reduce the pressure from appreciation of the Renminbi. Besides the PRC market, the Group will explore further business opportunities for its "Great" and "Far Great" products in other countries.

To thrive in the ever-changing market, the Group will sharpen its competitive edges and strive to sustain its leadership in the industry. Seeing the positive market response to its electronic plush toy first launched in 2006, the Group will look for and exploit more opportunities in electronic toys and other innovative toys. To achieve this, more resources will be invested in enhancing product development and production capabilities. Meanwhile, the Group will also explore new alliances with potential customers who are looking for quality and reliable manufacturing partners.

The Group's improved results (excluding the goodwill impairment loss of HK\$100.2 million) in the second half of 2006 are evidence of its effective business strategies and cost control measures. These strategies and measures will be continued in the coming year to help the Group to sustain its position as the largest plush stuffed toy manufacturer in the world.