1 GENERAL INFORMATION, GROUP REORGANISATION AND BASIS OF PRESENTATION

1.1 General information

Smart Union Group (Holdings) Limited (the "Company") was incorporated in the Cayman Islands on 8th March 2006 as an exempted company with limited liability. The address of its registered office is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands. The shares of the Company have been listed on the Main Board of the Stock Exchange of Hong Kong Limited ("HKSE") since 29th September 2006.

The Company and its subsidiaries (the "Group") are principally engaged in the manufacturing and trading of recreational and educational toys and equipment. Details of the subsidiaries of the Group are set out in Note 10 to the consolidated financial statements.

The Directors regard Smart Place Investments Limited, a company incorporated in the British Virgin Islands, as being the ultimate holding company of the Company.

These consolidated financial statements are presented in Hong Kong Dollar ("HK$"), unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 20th April 2007.

1.2 Group reorganisation and basis of presentation

Pursuant to an agreement dated 1st September 2006, the Company acquired the entire issued capital of Smart Union Investments Limited through a share swap, and became the holding company of the companies now comprising the Group (the "Reorganisation").

The Reorganisation was a combination of entities under common control of the major shareholders. The major shareholders have remained the same and the respective rights of each shareholder have remained unchanged immediately before and after the Reorganisation. Accordingly, the Reorganisation had been accounted for using merger accounting, as prescribed in Hong Kong Accounting Guideline 5 "Merger Accounting for Common Control Combinations" issued by the Hong Kong Institute of Certified Public Accountants.

The consolidated financial statements present the consolidated income statements, consolidated statements of changes in equity and consolidated cash flow statements of the companies comprising the Group as if the corporate structure of the Group had been in existence from the beginning of the earliest period presented or, where this is a shorter period, since the respective dates of incorporation or establishment of the companies comprising the Group. The consolidated balance sheet of the Group as at 31st December 2005 has been prepared to present the assets and liabilities of the Group as at 31st December 2005 as if the current group structure had been in existence at 31st December 2005.

1 GENERAL INFORMATION, GROUP REORGANISATION AND BASIS OF PRESENTATION *(Continued)*

1.2 Group reorganisation and basis of presentation *(Continued)*

The Company's balance sheet as at 31st December 2005 is not presented as the Company was incorporated on 8th March 2006.

A uniform set of accounting policies is adopted by the combining entities. All intra-group transactions, balances and unrealised gains on transactions between combining entities or businesses are eliminated on consolidation.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Company have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"). The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.1 Basis of preparation *(Continued)*

(a) *Interpretations to existing standards that are not yet effective and have not been early adopted by the Group*

The following interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1st May 2006 or later periods that the Group has not early adopted:

- HK(IFRIC)-Int 8, Scope of HKFRS 2 (effective for annual periods beginning on or after 1st May 2006). HK(IFRIC)-Int 8 requires consideration of transactions involving the issuance of equity instruments - where the identifiable consideration received is less than the fair value of the equity instruments issued - to establish whether or not they fall within the scope of HKFRS 2. The Group will apply HK(IFRIC)-Int 8 from 1st January 2007, but it is not expected to have any impact on the Group's consolidated financial statements; and

- HK(IFRIC)-Int 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1st November 2006). HK(IFRIC)-Int 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Group will apply HK(IFRIC)-Int 10 from 1st January 2007, but it is not expected to have any impact on the Group's financial statements.

(b) *Interpretation to existing standards that are not yet effective and not relevant for the Group's operations*

The following interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1st March 2006 or later periods but are not relevant for the Group's operations:

- HK(IRFIC)-Int 7, Applying the Restatement Approach under HKAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1st March 2006). HK(IFRIC)-Int 7 provides guidance on how to apply requirements of HKAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As none of the group entities have a currency of a hyperinflationary economy as its functional currency, HK(IFRIC)-Int 7 is not relevant to the Group's operations; and

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.1 Basis of preparation *(Continued)*

(b) Interpretation to existing standards that are not yet effective and not relevant for the Group's operations (Continued)

- HK(IFRIC)-Int 9, Reassessment of embedded derivatives (effective for annual periods beginning on or after 1st June 2006). HK(IFRIC)-Int 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment if required. As none of the group entities have changed the terms of their contracts, HK(IFRIC)-Int 9 is not relevant to the Group's operations.

(c) Standards, amendments and interpretations effective in 2006 but not relevant for the Group's operations

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1st January 2006 but are not relevant to the Group's operations:

- HKAS 19 Amendment - Employee Benefits
- HKAS 21 Amendment – Net Investment in a Foreign Operation;
- HKAS 39 Amendment – Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- HKAS 39 Amendment – The Fair Value Option;
- HKAS 39 and HKFRS 4 Amendment – Financial Guarantee Contracts;
- HKFRS 6 Exploration for and Evaluation of Mineral Resources;
- HKFRS 1 Amendment – First-time Adoption of Hong Kong Financial Reporting Standards and HKFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
- HK(IFRIC)-Int 4, Determining whether an Arrangement contains a Lease;
- HK(IFRIC)-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- HK(IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 31st December.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the consolidated income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses (Note 2.8). The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.2 Consolidation *(Continued)*

(b) *Transactions and minority interests*

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the consolidated income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) *Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in HK$, which is the Company's functional and presentation currency.

(b) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement, except when deferred in equity as qualifying cash flow hedges or qualifying net investment hedges.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount are recognised in equity.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.4 Foreign currency translation *(Continued)*

(b) *Transactions and balances (Continued)*

Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss. Translation difference on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available for sale are included in the available-for-sale reserve in equity.

(c) *Group companies*

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

— assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

— income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

— all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the consolidated income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.5 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are expensed in the consolidated income statement during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost to their residual values over their estimated useful lives, as follows:

Buildings	25 years
Leasehold improvements	5 years or the lease period, whichever is shorter
Plant and machinery	5-10 years
Office equipment, furniture and fixtures	5 years
Motor vehicles	5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.8).

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised in the consolidated income statement.

2.6 Construction in progress

Construction in progress represents buildings, various plant and equipment under construction and pending installation, and is stated at cost less impairment losses. Cost comprises direct costs of construction as well as capitalised borrowing costs, and foreign exchange differences on related borrowed funds to the extent that they are regarded as an adjustment to interest charges during the construction period.

Construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.7 Intangible assets

Research expenditure is expensed as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are expensed as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product based on the number of units sold over the total units expected to be sold.

2.8 Impairment of investments in subsidiaries and non-financial assets

Assets that have an indefinite useful life or have not yet available for use are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.9 Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet. (Note 2.12)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.9 Financial assets *(Continued)*

(c) *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of financial assets are recognised on the trade-date - the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the consolidated income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the "financial assets at fair value through profit or loss" category are presented in the consolidated income statement within other income - net, in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the consolidated income statement as part of other income when the Group's right to receive payments is established.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognised in profit or loss; translation differences on non-monetary securities are recognised in equity. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the consolidated income statement as gains and losses from investment securities.

Interest on available-for-sale securities calculated using the effective interest method is recognised in the consolidated income statement as part of other income. Dividends on available-for-sale equity instruments are recognised in the consolidated income statement as part of other income when the Group's right to receive payments is established.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.9 Financial assets *(Continued)*

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group established fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the consolidated income statement. Impairment losses recognised in the consolidated income statement on equity instruments are not reversed through the consolidated income statement. Impairment testing of trade receivables is described in Note 2.12.

2.10 Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as hedging instrument, and if so, the nature of the item being hedged.

The full fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedge item is more than 12 months, and as a current asset or liability, if the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current asset or liability.

Derivative instruments do not qualify for hedge accounting are accounted for at fair value through profit or loss. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the consolidated income statement within "other income, net".

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.11 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighed average method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads based on normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.12 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The carrying amount of the assets is reduced through the use of an allowance account, and the amount of the loss is recognised in the consolidated income statement within administrative expenses. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against administrative expense in the consolidated income statement.

2.13 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

2.14 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

2.15 Trade payable

Trade payables are recognised initially at fair value and subsequently measured at amortised cost arising the effective interest method.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.16 Borrowings

Borrowings are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the consolidated income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

2.17 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.18 Employee benefits

(a) Pension obligations

(i) Hong Kong

The Group participates in a mandatory provident fund ("MPF scheme") for its employees in Hong Kong. The assets of MPF scheme are held separately from those of the Group in an independent administered fund.

Both the Group and the employees are required to contribute 5% of the employee's relevant income, subject to a maximum of HK$1,000 per employee per month. The Group has no further payment obligation once the contributions have been paid. The contributions are recognised as employee benefit expenses when they are due and prepaid contributions are recognised as an asset to the extent that a cash refund is available.

(ii) The People's Republic of China (the "PRC")

The Group participates in a defined contribution scheme administrated by the relevant authority of the PRC. Contributions to the scheme are calculated as a percentage of employees' salaries. The Group's contributions to the defined contribution retirement scheme are expensed as incurred. The Group has no further obligation in connection with other retirement benefits.

(b) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date. Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.19 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.20 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods in the ordinary course of the Group's activities. Revenue is shown, net of rebates and discounts and after eliminating sales within the Group:

(a) Sales of goods and scrap materials

Sales of goods and scrap materials are recognised when a group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

(b) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

2.21 Borrowing costs

Borrowing costs incurred for the construction of any qualifying asset are capitalised during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.22 Lease

(a) *Operating lease*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases net of any incentives received from the lessor are charged in the consolidated income statement on a straight-line basis over the period of the lease.

Land use rights represent prepaid lease payments for the use of land in the PRC and is amortised over the unexpired terms of the leases on a straight-line basis. Amortisation of land use rights are expensed in the consolidated income statement.

(b) *Finance lease*

Leases of assets where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased assets and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in current and non-current borrowings. The interest element of the finance cost is recognised in the consolidated income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

2.23 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: foreign exchange risk, price risk, credit risk, liquidity risk, and cash flow and fair value interest rate risk. The Group mainly focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

(i) Foreign exchange risk

The Group mainly operates in Hong Kong and the PRC. Sales are made to overseas customers while purchases are mainly from suppliers in Hong Kong, the PRC and overseas. The Group is therefore exposed to foreign exchange risk arising from various currency exposures such as United States Dollar ("US$") and Renminbi ("RMB"), primarily with respect to HK$ which is the Company's functional and presentation currency. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations.

In addition, RMB is not freely convertible into other foreign currencies and conversion of RMB into foreign currencies is subject to rules and regulations of foreign exchange control promulgated by the PRC government.

To manage their foreign exchange risk arising from future commercial transactions and recognised assets and liabilities, the Group uses certain foreign exchange derivative contracts to manage their foreign exchange risk in 2006.

(ii) Price risk

The Group is exposed to price risk because investments held by the Group are classified on the consolidated balance sheet as available-for-sale financial assets.

(iii) Credit risk

The carrying amounts of trade receivables and other current assets except for inventories and prepayments, pledged bank deposits and bank balances and cash, represent the Group's maximum exposure to credit risk in relation to financial assets. The Group has policies that limit the amount of credit exposure to any financial institutions. The Group also has policies in place to ensure that sales of products are made to customers with an appropriate credit history. Although sales to large or long-established customers with good repayment history comprise a significant proportion of the Group's sales, the Group has policies on granting different settlement methods to different customers.

3 FINANCIAL RISK MANAGEMENT *(Continued)*

3.1 Financial risk factors *(Continued)*

(iv) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in funding by keeping committed credit lines available.

The Group's primary cash requirements are for purchases of materials, machinery and equipment and payments of related debts and staff costs. The Group finances its working capital requirements through a combination of funds generated from operations and bank borrowings.

(v) Cash flow and fair value interest rate risk

Except as disclosed below, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

The Group's interest rate risk arises from bank deposits, bank balances and borrowings. The Group regularly seeks out the most favourable interest rates available for its bank deposits, bank balances and borrowings. Bank deposits, bank balances and borrowings issued at variable rates expose the Group to cash flow interest rate risk. Information relating to the interest rates and terms of the Group's bank deposits, bank balances and borrowings are disclosed in Notes 15, 16 and 19.

The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

3 FINANCIAL RISK MANAGEMENT *(Continued)*

3.2 Fair value estimation

The fair value of available-for-sale financial assets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The fair value of foreign exchange derivative contracts is determined by using valuation techniques. The Group makes assumptions that are based on certain financial principles and market conditions existing at each balance sheet date.

The carrying amounts of the Group's financial assets and financial liabilities under current assets and liabilities approximate their fair values due to their short maturities. The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values.

The fair value of financial assets, including non-current portion of deposits and other receivables, and financial liabilities including non-current portion of borrowings for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments. The fair values of non-current deposits and other receivables and borrowings are disclosed in Notes 12 and 19.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Useful lives of property, plant and machinery

The Group's management determines the estimated useful lives and related depreciation charges for its property, plant and equipment. This estimate is based on historical experience of the actual useful lives of property, plant and equipment of similar nature and functions. It could change significantly as a result of technical innovations and competitor actions in response to industry cycles. Management will increase the depreciation charge where useful lives are less than previously estimated lives, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS *(Continued)*

(b) Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses. These estimates are based on the current market condition and historical experience of manufacturing and selling products of similar nature. It could change significantly as a result of changes in customer taste and competitor actions in response to industry cycles. Management reassesses the estimates at each balance sheet date.

(c) Provision for impairment of trade and other receivables

The Group's management determines the provision for impairment of trade and other receivables based on the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. Management reassesses the provision at each balance sheet date.

(d) Estimated fair values of foreign exchange derivative contracts

The Group determines the fair values of foreign exchange derivative contracts with a range of reasonable fair value estimates. Estimating the values associated with the foreign exchange derivative contracts requires a process that involves forecasting future foreign exchange rates. Any changes in assumptions and estimates can affect the fair values of these foreign exchange derivative contracts.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

5 TURNOVER

	2006	2005
	HK$'000	HK$'000
Sales of goods	**727,225**	709,566

6 SEGMENT INFORMATION

Primary reporting format – business segments

The products and services provided by the Group are all related to the manufacturing and trading of recreational and educational toys and equipment and subject to similar business risk. No business segment information has been prepared by the Group for the year ended 31st December 2006.

Secondary reporting format – geographical segments

The Group primarily operates in Hong Kong and the PRC. Sales are mainly made to customers in America and Europe.

The Group's sales are delivered to customers located in the following geographical areas:

	2006	2005
	HK$'000	HK$'000
America	**503,866**	536,891
Europe	**154,419**	137,242
Others	**68,940**	35,433
	727,225	709,566

Sales are allocated based on the places/countries in which goods are delivered.

The Group's total assets are located in the following geographical areas:

	2006	2005
	HK$'000	HK$'000
Hong Kong	**177,027**	105,574
The PRC	**306,237**	195,653
	483,264	301,227

Total assets are allocated based on where the assets are located.

6 SEGMENT INFORMATION *(Continued)*

Secondary reporting format – geographical segments *(Continued)*

The Group's capital expenditures are located in the following geographical areas:

	2006	2005
	HK$'000	HK$'000
Hong Kong	**481**	105
The PRC	**21,469**	20,487
	21,950	20,592

Capital expenditures are allocated based on where the assets are located.

7 PROPERTY, PLANT AND EQUIPMENT

	Group						
	Construction in progress	Buildings	Leasehold improve- ments	Plant and machinery	Office equipment, furniture and fixtures	Motor vehicles	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1st January 2005							
Cost	—	—	8,903	24,790	10,837	1,228	45,758
Accumulated depreciation	—	—	(6,375)	(17,133)	(6,663)	(592)	(30,763)
Net book amount	—	—	2,528	7,657	4,174	636	14,995
Year ended 31st December 2005							
Opening net book amount	—	—	2,528	7,657	4,174	636	14,995
Additions	14,822	—	161	3,333	2,276	—	20,592
Disposals	—	—	(83)	(118)	(233)	—	(434)
Depreciation	—	—	(1,176)	(3,169)	(1,632)	(213)	(6,190)
Closing net book amount	14,822	—	1,430	7,703	4,585	423	28,963
At 31st December 2005							
Cost	14,822	—	8,935	27,865	12,659	1,228	65,509
Accumulated depreciation	—	—	(7,505)	(20,162)	(8,074)	(805)	(36,546)
Net book amount	14,822	—	1,430	7,703	4,585	423	28,963
Year ended 31st December 2006							
Opening net book amount	14,822	—	1,430	7,703	4,585	423	28,963
Additions	12,592	2,367	150	5,160	1,681	—	21,950
Disposals	—	—	(60)	(225)	(225)	—	(510)
Transfers	(21,962)	17,875	937	3,035	115	—	—
Depreciation	—	(202)	(1,223)	(3,729)	(1,788)	(216)	(7,158)
Closing net book amount	5,452	20,040	1,234	11,944	4,368	207	43,245
At 31st December 2006							
Cost	5,452	20,242	6,333	34,484	13,156	1,229	80,896
Accumulated depreciation	—	(202)	(5,099)	(22,540)	(8,788)	(1,022)	(37,651)
Net book amount	5,452	20,040	1,234	11,944	4,368	207	43,245

7 PROPERTY, PLANT AND EQUIPMENT *(Continued)*

Depreciation expense of HK$5,753,000 (2005: HK$4,663,000) has been charged in cost of sales and HK$1,405,000 (2005: HK$1,527,000) in administrative expenses.

Machinery and motor vehicles include the following amounts where the Group is a lessee under finance leases:

	2006	2005
	HK$'000	HK$'000
Machinery		
Cost - capitalised finance leases	**—**	743
Accumulated depreciation	**—**	(396)
Net book amount	**—**	347
Motor vehicles		
Cost - capitalised finance leases	**316**	316
Accumulated depreciation	**(135)**	(74)
Net book amount	**181**	242

8 LAND USE RIGHTS

The Group's interests in land use rights represent prepaid operating lease payments and their net book values are analysed as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
At 1st January	**—**	—
Additions	**4,593**	—
Amortisation	**(77)**	—
At 31st December	**4,516**	—
Analysed as:		
Land use rights in the PRC of between 10 to 50 years	**4,516**	—

9. INTANGIBLE ASSETS

	Group 2006 HK$'000
At 1st January	—
Additions	886
Amortisation expense	(254)
At 31st December	632
As at 31st December 2006	
Cost	886
Accumulated amortisation	(254)
Net book amount	632

Intangibles include internally generated capitalised toys development costs.

Amortisation of intangible assets is charged to cost of sales.

10 INVESTMENTS IN SUBSIDIARIES

	Company	
	2006	2005
	HK$'000	HK$'000
Investments, at cost:		
Unlisted shares	**80,422**	—

10 INVESTMENTS IN SUBSIDIARIES *(Continued)*

The following is a list of the subsidiaries at 31st December 2006:

Company name	Place of incorporation/ establishment	Issued/ registered and fully paid up share capital/ paid-in capital	Attributable equity interests		Principal activities and place of operation
			Direct	Indirect	
Smart Union Investments Limited	British Virgin Islands	US$4,000,000	100%	—	Investment holding in Hong Kong
Amart International Company Limited	Hong Kong	HK$10,000	—	100%	Trading of gifts in Hong Kong
Current Creation Limited	Hong Kong	HK$2	—	100%	Inactive
Dream Link Limited	Hong Kong	HK$1,000,000	—	69%	Trading of gifts in Hong Kong
Perfect Design and Product Development Limited	Hong Kong	HK$10,000	—	100%	Manufacturing and design of toy moulds in Hong Kong
Smart Union China Investments Limited	Hong Kong	HK$10,000	—	100%	Investment holding in Hong Kong
Smart Union Group Limited	Hong Kong	HK$10,000	—	100%	Investment holding in Hong Kong
Smart Union (Hong Kong) Limited	Hong Kong	HK$10,000	—	100%	Provision of management services in Hong Kong
Smart Union Industrial Limited	Hong Kong	HK$10,000	—	100%	Manufacturing and trading of toys in the PRC and Hong Kong

10 INVESTMENTS IN SUBSIDIARIES *(Continued)*

Company name	Place of incorporation/ establishment	Issued/ registered and fully paid up share capital/ paid-in capital	Attributable equity interests Direct	Attributable equity interests Indirect	Principal activities and place of operation
Smart Union (Qingyuan) Industrial Limited	The PRC	Registered capital of HK$30,000,000 with total paid up capital of HK$18,000,000	—	100%	Manufacturing of toys in the PRC
Smart Union Technology Limited	Hong Kong	HK$10,000	—	100%	Inactive
Topmark Industrial Limited	Hong Kong	HK$10,000	—	100%	Trading of toys and food containers in Hong Kong
Worldtrade Promotions Limited	Hong Kong	HK$10,000	—	100%	Trading of promotional products in Hong Kong

11 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Group	
	2006	2005
	HK$'000	HK$'000
At 1st January	**2,999**	2,999
Additions	**2,000**	—
Revaluation (Note 18)	**121**	—
At 31st December	**5,120**	2,999

Available-for-sale financial assets represent unlisted investment funds in Hong Kong, which have been pledged for certain bank borrowings of the Group (Note 19).

The carrying amounts of available-for-sale financial assets approximate their fair values.

12 PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2006	2005	**2006**	2005
	HK$'000	HK$'000	**HK$'000**	HK$'000
Prepayments	**4,994**	8,455	**195**	—
Deposits	**3,701**	3,162	**—**	—
Other receivables	**4,438**	5,425	**—**	—
	13,133	17,042	**195**	—
Less: non-current portion	**(276)**	(3,896)	**—**	—
Current portion	**12,857**	13,146	**195**	—

The carrying amounts of prepayments, deposits and other receivables approximate their fair values.

13 INVENTORIES

	Group	
	2006	2005
	HK$'000	HK$'000
Raw materials	**99,210**	60,143
Work in progress	**105,834**	64,147
Finished goods	**35,278**	28,399
	240,322	152,689

The carrying amounts of inventories that were carried at fair value less costs to sell as at 31st December 2006 amounted to approximately HK$4,873,000 (2005: HK$1,963,000).

The cost of inventories recognised as expenses and included in cost of sales during the year ended 31st December 2006 and 2005 are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Cost of inventories	**604,196**	600,177

14 TRADE RECEIVABLES

	Group	
	2006	2005
	HK$'000	HK$'000
Trade receivables	**104,701**	86,409
Less: provision for impairment of receivables	**(672)**	(1,872)
	104,029	84,537

The Group's trade receivables from its customers are generally with credit periods of less than 75 days.

The carrying amounts of trade receivables approximate their fair values due to the short- term maturity.

14 TRADE RECEIVABLES *(Continued)*

The aging analysis of trade receivables as at 31st December 2006 and 2005 are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
0 - 30 days	**78,737**	63,994
31 - 60 days	**5,670**	9,278
61 - 90 days	**11,394**	6,955
91 days - 1 year	**8,633**	5,365
1 -2 years	**267**	817
	104,701	86,409

The sales to large or long-established customers with good repayment history comprise a significant proportion of the Group's sales. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history to minimise the credit risk.

The Group has recognised losses of approximately HK$147,000 for the impairment of its trade receivables during the year ended 31st December 2006 (2005: HK$658,000). The losses have been included in administrative expenses in the consolidated income statement.

Trade receivables are denominated in the following currencies:

	Group	
	2006	2005
	HK$'000	HK$'000
HK$	**43,104**	37,927
US$	**61,597**	48,482
	104,701	86,409

As at 31st December 2006, the Group had factored trade receivables of approximately HK$27,350,000 (2005: Nil) to banks on a non-recourse basis. As the financial asset derecognitions as stipulated in HKAS 39 have been fulfilled, these factored receivables without recourse are derecognised.

15 PLEDGED BANK DEPOSITS

The effective interest rate on pledged bank deposits as at 31st December 2006 was 3.8% (2005: 3.2%). These pledged deposits for bank borrowings are denominated in HK$ and have an average maturity of 60 days (Note 19).

16 BANK BALANCES AND CASH

Bank balances and cash are denominated in the following currencies:

	Group		Company	
	2006	2005	**2006**	2005
	HK$'000	HK$'000	**HK$'000**	HK$'000
HK$	**42,187**	6,323	**21,395**	—
US$	**11,824**	1,514	**—**	—
RMB	**10,871**	3,652	**—**	—
	64,882	11,489	**21,395**	—

Cash at banks earns interest at floating rates based on daily bank deposit rates.

Cash and cash equivalents for the purposes of the consolidated cash flow statements are as follows:

	2006	2005
	HK$'000	HK$'000
Bank balances and cash	**64,882**	11,489
Less: bank overdrafts (Note 19)	**(8,144)**	(2,379)
Cash and cash equivalents	**56,738**	9,110

17 SHARE CAPITAL

	Number of shares	Nominal value HK$'000
Authorised - ordinary shares of HK$0.1 each		
Upon incorporation (Note 17(a))	500,000	50
Increase in authorised share capital (Note 17(a))	1,999,500,000	199,950
	2,000,000,000	200,000
Issued and fully paid - ordinary shares of HK$0.1 each		
Upon incorporation (Note 17(b))	1	—
Issuance of shares upon the Reorganisation (Note 17(b))	14,999,999	1,500
New shares issued upon initial public offering ("IPO") (Note 17(c))	60,000,000	6,000
Capitalisation upon issue of new shares (Note 17(d))	165,000,000	16,500
	240,000,000	24,000

Notes:

(a) The Company was incorporated on 8th March 2006 with an authorised share capital of HK$50,000 divided into 500,000 shares of HK$0.1 each. On 1st September 2006, the authorised share capital was increased to HK$200,000,000 divided into 2,000,000,000 shares of HK$0.1 each, by the creation of 1,999,500,000 shares of HK$0.1 each.

(b) Upon incorporation, one share of HK$0.1 was alloted and issued for cash at par. Pursuant to the Reorganisation referred to in Note 1.2, on 1st September 2006, 14,999,999 shares of HK$0.1 each were alloted, issued and credited as fully paid at par.

(c) On 29th September 2006, the Company issued 60,000,000 shares of HK$0.1 each at approximately HK$1.1 per share in connection with the listing of the Company's shares on the HKSE (the "Listing"), and raised net proceeds of approximately HK$53 million.

(d) Immediately after the Listing, 165,000,000 shares were allotted and issued, credited as fully paid at par value of HK$0.1 each to the then shareholders of the Company in proportion to their respective shareholdings, by the capitalisation of HK$0.1 from the share premium account. Such allotment and capitalisation were conditional upon the share premium account being credited as a result of the new shares issued in connection with the Listing as described in Note 17(c) above.

18 RESERVES

(a) Group

	Share premium HK$'000	Available-for-sale financial assets HK$'000	Exchange reserve HK$'000	Merger reserve HK$'000 Note (i)	Retained earnings HK$'000	Total HK$'000
At 1st January 2005	—	—	—	25,520	42,135	67,655
Currency translation differences	—	—	247	—	—	247
Profit for the year attributable to equity holders of the Company	—	—	—	—	36,672	36,672
Dividends	—	—	—	—	(13,000)	(13,000)
At 31st December 2005	—	—	247	25,520	65,807	91,574
At 1st January 2006	—	—	247	25,520	65,807	91,574
Revaluation (Note 11)	—	121	—	—	—	121
Currency translation differences	—	—	(58)	—	—	(58)
Profit for the year attributable to equity holders of the Company	—	—	—	—	30,025	30,025
Net proceeds from issuance of new shares	47,242	—	—	—	—	47,242
Capitalisation of share premium (Note 17(d))	(16,500)	—	—	—	—	(16,500)
Special dividend relating to 2005	—	—	—	—	(10,000)	(10,000)
At 31st December 2006	30,742	121	189	25,520	85,832	142,404

18 RESERVES *(Continued)*

(b) Company

	Share premium HK$'000	Merger reserve HK$'000 Note (ii)	Retained earnings HK$'000	Total HK$'000
At 8th March 2006 (date of incorporation)	—	—	—	—
Profit for the period attributable to equity holders of the Company	—	—	344	344
Reserve from Reorganisation	—	78,922	—	78,922
Net proceeds from issuance of new shares	47,242	—	—	47,242
Capitalisation of share premium (Note 17(d))	(16,500)	—	—	(16,500)
At 31st December 2006	30,742	78,922	344	110,008

Notes:

(i) On 30th December 2002, Smart Union Investments Limited issued certain shares to the then shareholders of certain subsidiaries now comprising the Group in exchange for their equity interests in such companies and became the intermediate holding company.

On 1st September 2006, the Company issued 14,999,999 shares of HK$0.1 each as consideration for the acquisition of 4,000,000 shares of US$1 each in Smart Union Investments Limited.

The merger reserve of the Group represents the total of (i) the difference between the nominal value of the shares of the subsidiaries acquired and the nominal value of shares Smart Union Investments Limited issued on 30th December 2002; and (ii) the difference between the nominal value of the shares of Smart Union Investments Limited acquired and the nominal value of shares the Company issued on 1st September 2006 for the acquisition of Smart Union Investments Limited.

(ii) The Company's merger reserve represents the difference between the aggregate net asset value of Smart Union Investments Limited and the nominal value of the Company's shares issued for the acquisition of Smart Union Investments Limited through a share swap under the Reorganisation.

19 BORROWINGS

	Group	
	2006	2005
	HK$'000	HK$'000
Non-current		
Bank borrowings, secured	**2,650**	5,850
Finance lease liabilities	**99**	163
	2,749	6,013
Current		
Bank overdrafts, secured (Note 16)	**8,144**	2,379
Short-term bank loans, secured	**16,000**	5,000
Trust receipt bank loans, secured	**90,416**	47,533
Current portion of non-current bank borrowings, secured	**3,200**	2,500
Factoring facilities utilised	**12,730**	40
Finance lease liabilities	**64**	130
	130,554	57,582
Total borrowings	**133,303**	63,595

Secured bank borrowings are secured by available-for-sale financial assets amounting to HK$5,120,000 as at 31st December 2006 (2005: HK$2,999,000) (Note 11), corporate guarantees executed by the Company and pledged bank deposits amounted to HK$5,267,000 as at 31st December 2006 (2005: HK$2,837,000) (Note 15).

The maturities of the Group's borrowings as at 31st December 2006 and 2005 are as follows:

	2006	2005
	HK$'000	HK$'000
Within 1 year	**130,554**	57,582
Between 1 and 2 years	**2,749**	6,013
	133,303	63,595

19 BORROWINGS *(Continued)*

Finance lease liabilities - minimum lease payments:

	Group	
	2006	2005
	HK$'000	HK$'000
Within 1 year	**74**	137
Between 1 and 2 years	**104**	174
	178	311
Future finance charges on finance leases	**(15)**	(18)
Present value of finance lease liabilities	**163**	293

The present value of finance lease liabilities is as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Within 1 year	**64**	130
Between 1 and 2 years	**99**	163
	163	293

The effective interest rates of the Group's borrowings as at 31st December 2006 and 2005 are as follows:

	Group	
	2006	2005
Bank overdrafts	**8.0%**	8.5%
Other bank borrowings	**7.5%**	7.3%
Finance lease liabilities	**3.3%**	3.7%

The carrying amounts of borrowings approximate their fair values.

The Group's borrowings are all denominated in HK$ and subject to floating interest-rate within 6 months.

20 DEFERRED INCOME TAX

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Deferred income tax assets to be recovered after more than 12 months	**134**	598

The gross movement on the deferred income tax asset/(liabilities) of the Group is as follows:

	2006	2005
	HK$'000	HK$'000
At 1st January	**598**	(143)
Recognised in the consolidated income statement (Note 27)	**(464)**	741
At 31st December	**134**	598

The movements in deferred income tax assets and liabilities of the Group during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, are as follows:

Deferred income tax assets:

	Provision for impairment of assets	**Tax losses**	**Total**
	HK$'000	HK$'000	HK$'000
At 1st January 2005	487	132	619
Recognised in the consolidated income statement	395	62	457
At 31st December 2005	882	194	1,076
At 1st January 2006	882	194	1,076
Recognised in the consolidated income statement	(748)	(194)	(942)
At 31st December 2006	134	—	134

20 DEFERRED INCOME TAX *(Continued)*

Deferred income tax liabilities:

	Accelerated depreciation allowances	
	2006	2005
	HK$'000	HK$'000
At 1st January	**(478)**	(762)
Recognised in the consolidated income statement	**478**	284
At 31st December	**—**	(478)

Deferred income tax assets are recognised for tax losses carry-forwards to the extent that the realisation of the related tax benefits through the future taxable profits is probable. As at 31st December 2006, the Group did not recognise deferred income tax assets of HK$988,000 (2005: HK$1,222,000) in respect of losses amounting to HK$5,646,000 (2005: HK$6,984,000) that can be carried forward against future taxable income.

21 TRADE PAYABLES

The ageing analysis of trade payables as at 31st December 2006 and 2005 are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
0-30 days	**83,478**	46,364
31-60 days	**35,128**	27,858
61-90 days	**17,913**	17,028
91 days - 1 year	**18,862**	18,404
1 - 2 years	**2,405**	2,272
Over 2 years	**1,051**	—
	158,837	111,926

The carrying amounts of trade payables approximate their fair values.

21 TRADE PAYABLES *(Continued)*

Trade payables are denominated in the following currencies:

	Group	
	2006	2005
	HK$'000	HK$'000
HK$	**112,950**	70,937
US$	**40,699**	7,248
RMB	**5,188**	33,741
	158,837	111,926

22 OTHER PAYABLES AND ACCRUALS

	Group	
	2006	2005
	HK$'000	HK$'000
Accruals	**19,251**	12,025
Receipts in advance	**4,862**	2,446
Dividends payable	**—**	11,000
	24,113	25,471

The carrying amounts of other payables and accruals approximate their fair values.

23 DERIVATIVE FINANCIAL INSTRUMENTS

	Group	
	2006	2005
	HK$'000	HK$'000
Foreign exchange derivative contracts – not qualified for hedge accounting at fair value	**1,247**	—

24 OTHER INCOME, NET

	Group	
	2006	2005
	HK$'000	HK$'000
Sales of scrap materials	**1,142**	3,915
Unrealised gain on derivative financial instruments	**1,247**	—
Realised gain on derivative financial instruments	**557**	—
Interest income	**764**	1,350
	3,710	5,265

25 EXPENSES BY NATURE

	Group	
	2006	2005
	HK$'000	HK$'000
Auditors' remuneration	**1,080**	521
Depreciation of property, plant and equipment (Note 7)	**7,158**	6,190
Amortisation of intangible assets (Note 9)	**254**	—
Amortisation of land use rights (Note 8)	**77**	—
Raw materials used	**449,104**	445,264
Changes in inventories of finished goods and work in progress	**(48,272)**	(5,438)
Employee benefit expenses (Note 28)	**30,360**	28,860
Operating lease rentals for land and buildings	**8,576**	8,043
Exchange losses, net	**5,577**	2,653
Impairment of trade receivables	**147**	658
Inventory write-down	**756**	3,267
Others	**230,352**	176,998
Total cost of sales and administrative expenses	**685,169**	667,016

26 FINANCE COSTS

	Group	
	2006	2005
	HK$'000	HK$'000
Interest expense:		
- Bank borrowings and overdrafts	**9,718**	6,154
- Factoring facilities	**1,532**	129
- Finance lease liabilities	**16**	16
	11,266	6,299
Less: interest capitalised	**(1,268)**	(526)
	9,998	5,773

Borrowing costs of approximately HK$1,268,000 arising on financing specifically entered into for the construction of new factories were capitalised during the year ended 31st December 2006 (2005: HK$526,000) and are included in the additions of property, plant and equipment. A capitalisation rate of 8% was used for the year ended 31st December 2006 (2005: 5.1%), representing the borrowing costs of the loans used to finance the project.

27 INCOME TAX EXPENSE

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profit during the year. Taxation on overseas profits has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the countries in which the Group operates.

Pursuant to the processing agreements entered into with Dongguan City Zhangmutou Town Economic Development General Company on 26th November 1996 (as extension agreement dated 29th April 2002) and 18th August 2004 (the "Processing Agreements"), Smart Union Industrial Limited ("SUI") subcontracted certain processing work to 東莞樟木頭合俊玩具廠 ("Zhang Yang factory") and 東莞樟木頭俊領玩具廠 ("Po Shan factory") in the PRC. Pursuant to the settlement basis as agreed with the Inland Revenue Department of Hong Kong (the "IRD"), 50% of SUI's assessable profits arising from the manufacturing activities carried out by Zhang Yang Factory and Po Shan factory under the Processing Agreements are considered as offshore in nature and are not subject to Hong Kong profits tax in accordance with the Departmental Interpretation and Practice Notes No.21 (Revised) - Locality of Profits issued by the IRD in March 1998.

27 INCOME TAX EXPENSE *(Continued)*

Such offshore treatment is not applicable to the assessable profits arising from the processing activities subcontracted to other PRC sub-contractors, which are fully subject to Hong Kong profits tax. The portion of SUI's assessable profits allowable for the 50% offshore treatment is calculated by reference to the proportion of the direct labour, manufacturing overheads, mould costs and administrative expenses of Zhang Yang Factory and Po Shan Factory (collectively "Manufacturing Costs") to the aggregation of the Manufacturing Costs and the sub-contracting fees paid to other PRC sub-contractors. For the year ended 31st December 2006, the effective portion of SUI's assessable profits allowed as offshore and not subject to Hong Kong profits tax was 37.06% (2005: 33.02%).

The amounts of income tax expense charged to the consolidated income statement represent:

	Group	
	2006	2005
	HK$'000	HK$'000
Current taxation:		
- Hong Kong profits tax	**3,899**	6,111
- PRC enterprise income tax	**534**	—
Under-provision in prior years	**239**	—
Deferred income tax relating to the origination and reversal of temporary differences (Note 20)	**464**	(741)
	5,136	5,370

The taxation on the Group's profit before tax differs from the theoretical amount that would arise using the profits tax rate in Hong Kong as follows:

	2006	2005
	HK$'000	HK$'000
Profit before tax	**35,768**	42,042
Calculated at a tax rate of 17.5%	**6,259**	7,357
Effect of different taxation rates in other countries	**251**	—
Income not subject to taxation	**(1,696)**	(2,276)
Expenses not deductible for taxation purposes	**317**	40
Unrecognised tax losses	**369**	249
Utilisation of previously unrecognised tax losses	**(603)**	—
Under-provision in prior years	**239**	—
Income tax expense	**5,136**	5,370

28 EMPLOYEE BENEFIT EXPENSES

	Group	
	2006	2005
	HK$'000	HK$'000
Wages, salaries and other short-term employee benefits	**29,554**	28,072
Pension costs - defined contribution plans	**806**	788
	30,360	28,860

(a) Directors' and senior management's emoluments

The remuneration of each director of the Company for the year ended 31st December 2006 is set out below:

Name of Director	Basic salaries, housing allowances, other allowances and benefits in kind HK$'000	Discretionary bonus HK$'000	Employer's contribution to pension scheme HK$'000	Total HK$'000
WU, Kam Bun	**1,656**	**198**	**12**	**1,866**
LAI, Chiu Tai	**1,656**	**198**	**12**	**1,866**
HO, Wai Wah	**960**	**140**	**12**	**1,112**
LO, Kwok Choi	**1,656**	**198**	**12**	**1,866**
WONG, Wai Chuen	**840**	**130**	**12**	**982**
LUI, Sun Wing	**33**	**—**	**—**	**33**
LI, Chak Hung	**33**	**—**	**—**	**33**
TANG, Koon Yiu Thomas	**33**	**—**	**—**	**33**
	6,867	**864**	**60**	**7,791**

28 EMPLOYEE BENEFIT EXPENSES *(Continued)*

(a) Directors' and senior management's emoluments *(Continued)*

The remuneration of each director of the Company for the year ended 31st December 2005 is set out below:

Name of Director	Basic salaries, housing allowances, other allowances and benefits in kind HK$'000	Discretionary bonus HK$'000	Employer's contribution to pension scheme HK$'000	Total HK$'000
WU, Kam Bun	1,426	138	12	1,576
LAI, Chiu Tai	1,426	138	12	1,576
HO, Wai Wah	860	80	12	952
LO, Kwok Choi	1,426	138	12	1,576
WONG, Wai Chuen	730	59	10	799
	5,868	553	58	6,479

During the year, no directors of the Company waived or agreed to waive any emoluments and no emoluments were paid by the Group to any of the directors of the Company as an inducement to join or upon joining the Group or as compensation for loss of office (2005: Nil).

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group include 5 (2005: 4) directors whose emoluments are reflected in the analysis presented in Note (a) above. The emoluments payable to the remaining one individual during the year ended 31st December 2005 are as follows:

	2005 HK$'000
Basis salaries, housing allowances, other allowances and benefits in kind	952
Employer's contribution to pension scheme	10
	962

The emoluments fell within the following bands:

Nil - HK$1,000,000	1

29 PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The profit attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of HK$344,000.

30 EARNINGS PER SHARE

The calculation of basic earnings per share is based on the consolidated profit attributable to equity holders of the Company of approximately HK$30,025,000 (2005: HK$36,672,000) and on the weighted average number of 195,452,000 (2005: 180,000,000) ordinary shares in issue during the year. In determining the number of shares in issue, a total of 180,000,000 shares issued in connection with the Reorganisation and the capitalisation issue were deemed to have been issued since 1st January 2005.

	2006	2005
Profit attributable to equity holders of the Company (HK$'000)	**30,025**	36,672
Weighted average number of ordinary shares in issue (thousands)	**195,452**	180,000
Basic earnings per share (HK$) per share	**0.15**	0.20

The Company has no diluted potential ordinary shares as at 31st December 2006.

31 DIVIDENDS

	2006	2005
	HK$'000	HK$'000
Dividends paid by the subsidiaries to their then shareholders before the Reorganisation (note a)	**—**	23,000
Proposed special dividend of HK$0.022 (2005: Nil) per ordinary share (note b)	**5,280**	—
Proposed final dividend of HK$0.038 (2005: Nil) per ordinary share (note b)	**9,120**	—
	14,400	23,000

Notes:

(a) Dividends for the year ended 31st December 2005 represented (i) a final dividend in relation to 2005 declared and paid by Smart Union Investments Limited to its then shareholders of HK$13,000,000 and (ii) a special dividend in relation to 2005 of HK$10,000,000 declared and paid to their then shareholders during 2006 and prior to the completion of the Reorganisation (see note 1). As part of the Reorganisation, such amounts were capitalised by the then shareholders.

(b) At a meeting held on 20th April 2007, the directors proposed a special dividend of HK$0.022 per ordinary share and a final dividend of HK$0.038 per ordinary share. The proposed dividends are not reflected as dividends payable in the financial statements but will be reflected as an appropriation of retained earnings for the year ending 31st December 2007.

32 CASH GENERATED FROM OPERATIONS

	2006 HK$'000	2005 HK$'000
Profit before tax	**35,768**	42,042
Adjustment for:		
- Depreciation on property, plant and equipment	**7,158**	6,190
- Loss on disposal of property, plant and equipment	**379**	46
- Amortisation of land use rights	**77**	—
- Amortisation of intangible assets	**254**	—
- Unrealised gain on derivative financial instruments	**(1,247)**	—
- Interest income	**(764)**	(1,350)
- Interest expense	**9,998**	5,773
	51,623	52,701
Changes in working capital:		
- Inventories	**(87,633)**	(43,433)
- Trade receivables	**(19,492)**	1,886
- Prepayments, deposits and other receivables	**3,909**	453
- Amount due from a director	**—**	3,562
- Amounts due from related companies	**73**	728
- Trade payables	**46,911**	18,307
- Other payables and accruals	**9,642**	(7,933)
Cash generated from operations	**5,033**	26,271

In the consolidated cash flow statements, proceeds from disposal of property, plant and equipment comprise:

	2006 HK$'000	2005 HK$'000
Net book amount	**510**	434
Loss on disposal of property, plant and equipment	**(379)**	(46)
Proceeds from disposal of property, plant and equipment	**131**	388

33 COMMITMENTS

(a) Capital commitments

Capital expenditures at the balance sheet date but not yet incurred are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Property, plant and equipment - contracted but not provided for	**10,754**	1,898

(b) Commitments under operating leases

The Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	2006	2005
	HK$'000	HK$'000
Not later than one year	**1,253**	329
Later than 1 year and not later than 5 years	**968**	52
	2,221	381

34 SIGNIFICANT RELATED PARTY TRANSACTIONS

In addition to the related party transactions undertaken in connection with the Reorgansation (Note 1.2) and directors' emoluments (Note 28) as disclosed above, the Group had the following significant transactions carried out with related parties during the year.

(a) Transactions with related parties

	2006	2005
	HK$'000	HK$'000
Rental expenses to Current Creation Limited	**—**	271

(i) On 26th May 2005, the Group acquired 9% equity interests in Dream Link Limited from a director, Lo Kwok Choi, at a total cash consideration of HK$90,000.

(ii) On 19th December 2005, the Group acquired 1% equity interest in Amart International Limited from a director, Wu Kam Bun, at a total cash consideration of HK$1.

34 SIGNIFICANT RELATED PARTY TRANSACTIONS *(Continued)*

(a) Transactions with related parties *(Continued)*

(iii) On 30th December 2005, the Group acquired another 50% equity interests in Current Creation Limited from a director, Lo Kwok Choi, at a total cash consideration of HK$1.

(iv) On 4th January 2006, the Group acquired 9% equity interests in Dream Link Limited from a director, Lo Kwok Choi. Dream Link Limited was in a net liability position and the consideration was determined at a nominal value of HK$1.

(v) During the year, the Group charged Smart Place Investment Limited of approximately HK$2,552,000 for the placement of the Company's 12,000,000 shares (Note 17).

(b) Key management compensation

	Group	
	2006	2005
	HK$'000	HK$'000
Salaries and other short-term employee benefits	**7,632**	6,421
Pension costs - defined contribution plans	**60**	58
	7,692	6,479

(c) (i) Balances with related companies

	Group		
			Maximum amount outstanding during the year
	2006	**2005**	
	HK$'000	HK$'000	HK$'000
Receivable from a related company	—	73	73
Payable to a related company	—	266	

All balances maintained with related companies were unsecured, interest-free and had no fixed repayment terms.

34 SIGNIFICANT RELATED PARTY TRANSACTIONS *(Continued)*

(c) (ii) Balances with directors

	Group	
	2006	2005
	HK$'000	HK$'000
Amounts due to directors	**—**	3,456

The amounts due to directors were unsecured, interest-free and had no fixed repayment terms.

(d) Balances with subsidiaries

	Company	
	2006	2005
	HK$'000	HK$'000
Smart Union (Hong Kong) Limited	**180**	—
Smart Union Industrial Limited	**23,816**	—
Smart Union Investments Limited	**8,000**	—
	31,996	—

Amounts due from subsidiaries are unsecured, interest-free and have no fixed repayment terms.