Management Discussion and Analysis

RESULTS

The Board of Directors has pleasure in announcing that the Group's profit attributable to shareholders for the financial year ended 31st December 2006 was approximately HK$29.97 million, representing a decrease of 62.70% over the last year's figure of HK$80.35 million. The Group's turnover for the financial year ended 31st December 2006 amounted to approximately HK$643.22 million, representing an increase of 19.16% over that reported last year.

The profit from operations for the year 2006 amounted to HK$105.39 million, which included valuation gains on investment property amounting to HK$36.34 million, as compared to the last year's figures of HK$102.42 million and HK$58.28 million respectively. In addition, the share of losses of associates for the year 2006 amounted to HK$34.91 million, as compared to the last year's share of profits of HK$10.89 million. The share of losses of associates was arrived at after having recognised an impairment charge in respect of an associate's property, plant and equipment of approximately HK$53.08 million.

BUSINESS REVIEW

Toys

For the financial year ended 31st December 2006, the turnover for the Group's OEM/ODM toys business was approximately HK$252.21 million, a substantial increase of 56.08% as compared to last year.

2006 continued to be a challenging year for toys manufacturers. The industry faced adverse factors such as high labour and material costs, and the appreciating Renminbi Yuan. However, the Group was well aware of these challenges and succeeded in exercising several measures to minimise the impact. As a result, the Group was able to record another year of fair results.

The Group continued its stringent control policies in both production and financial management. Emphasis has been placed on streamlining the production lines to maximise productivity; strengthening the quality control team to ensure product quality and reduce wastage; and making detailed and accurate order forecast and materials planning to minimise the costs on working capital. Our sales team had also contributed in securing more bulk order business from our existing customers and broadening our customer base.

Model Trains

The turnover for model trains for the year ended 31st December 2006 was approximately HK$365.62 million, a slight increase of 3.36% as compared to last year.

During the year under review, the manufacturing costs stood at a high level which adversely affected the performance of the Model Trains section. To face the challenge, the Company followed a strategy of further improving the quality of the products. This strategy has succeeded in gaining the loyalty of customers and maintained our leading position in the industry.

The Group is proud to announce that during the year under review, our Liliput brand HO scale model train ET 4030 was awarded “Model of the Year 2006” from VÖMEC, the model railroader organisation of Austria.

The Group’s model trains continued to receive encouraging response from customers. The Bachmann’s E-Z Command® series continued to be the key contributor to sales growth. This is a Digital Command Control (DCC) system incorporating the latest digital technology to bring a DCC system to control speed, lighting, and direction of multiple locomotives that is easy to use and affordable for both the novice and experienced hobbyist. With the latest offerings of DCC Sound On Board locomotives, model railroads are able to come to life.

In Europe, our subsidiary, Bachmann Europe Plc has signed up with Joella Production to produce the model train sets of Underground Ernie, a hit children’s programme having the London Underground as the story background. The models accurately represent the characters on television and allow children to recreate their favourite stories from the programme. There is considerable value to attract the next generation of railway modellers and the Group has decided to add more trains and accessories to the initial set in the coming year.

In China, the model train series of “Qinghai-Tibet Railway”, which is the world’s highest and longest plateau railroad connecting the Tibet Autonomous Region with the rest of China, is targeted to be presented in mid-2007. The Group expects that the launching of this new train series will draw favourable market response.

The Group is committed to maintaining its competitiveness in terms of productivity, quality, reliability and delivery. Efforts have also been placed in enhancing safety precautions and quality control. Safety standards, regulations and code of practices are the Group’s major concern. The Group is always adhering to the Code of Business Practice of the International Council of Toy Industries (“ICTI”) and has passed and satisfied the ICTI audit, namely, the ICTI CARE Process.

Property Investment

For the financial year ended 31st December 2006, the rental income of the Group amounted to HK$25.38 million, representing a 3.62% increment over the previous year. Moreover, the Group recorded a revaluation gain of HK$36.34 million on its investment properties during the year, as compared to the last year’s figure of HK$58.28 million.

The Group’s major rental property, Kader Building, reported a rental income of approximately HK$22.95 million in 2006, up 14.58% from 2005’s HK$20.03 million. During the year under review, the Group succeeded in keeping its occupancy rate above 90% and increased the rental rate of Kader Building upon lease renewals. With the increased rental rate upon lease renewals, the Group anticipates that rental revenue will increase steadily.

Management Discussion and Analysis *(Continued)*

Investment in Associates

As at 31st December 2006, over 90% of the Resort at Squaw Creek (the "Resort") condominium units were sold. About 90% of the owners of the sold units contributed their units to a rental programme such that the Resort continued to be operated as a hotel. The associate owning the Resort ("SCA") engaged an external professional valuer to value its property, plant and equipment as at 31st December 2006. As a result of the valuation, the Group recognised an impairment charge in respect of the property, plant and equipment of SCA of approximately HK$53.08 million for the year ended 31st December 2006.

FINANCIAL REVIEW

Liquidity and Financial Resources

As at 31st December 2006, the Group's net asset value per share was HK$0.98 (2005: HK$0.92); the current ratio was 1.02 (2005: 1.01); the total bank borrowings were approximately HK$141.12 million (2005: HK$190.97 million) while the Group secured total banking facilities of approximately HK$317.86 million; the Group's financial gearing, based on the total interest bearing borrowings compared to the shareholders' equity, was 24.05% (2005: 49.70%). There is no significant seasonality of borrowing requirements except that during peak production period in the second half year, the Group's facilities on trade finance will be substantially utilised. All borrowings are on floating interest rate terms. The maturity profile of the Group's bank borrowings is set out in note 25 to the financial statements.

Capital Structure

There were no changes in the Company's share capital in 2006. The Group's source of financing was mainly bank borrowings and advances from directors and shareholders, which were denominated in Hong Kong Dollars, United States Dollars and Sterling Pounds at prevailing interest rates. During the year under review, a substantial portion of the advances from directors, shareholders and related companies were repaid.

Management Discussion and Analysis *(Continued)*

Charges on Group Assets

As at 31st December 2006, certain investment properties, leasehold land and buildings and other assets of the Group valued at approximately HK$746.21 million (2005: HK$732.76 million) were pledged to several banks to secure banking facilities granted to the Group.

Material Acquisitions and Disposals

There are no material acquisitions and disposals during the year ended 31st December 2006.

Subsequent to the balance sheet date, on 12th March 2007, a subsidiary of the Company, Bachmann Industries Inc., acquired a 16.5% interest in The Robot Factory, LLC ("Robotgalaxy") in the United States for cash consideration of approximately HK$7.80 million. An additional HK$7.80 million was invested in Robotgalaxy via a convertible note issued by Robotgalaxy to the Group. Robotgalaxy is principally engaged in the sale of toys.

At the moment, there are no other major plans for acquiring substantial investments or capital assets.

Exchange Rate Exposure

Major assets, liabilities and transactions of the Group are denominated in Hong Kong Dollars, United States Dollars, Sterling Pounds, Renminbi Yuan and Canadian Dollars. During the period under review, the majority of the Group's sales revenues were denominated in Hong Kong Dollars, United States Dollars and Sterling Pounds while the majority of its raw materials and equipment purchases were settled in Hong Kong Dollars. As such, the Group was facing a certain degree of exchange risk; mainly arising from Sterling Pounds denominated sales transactions of which the exchange rate volatility is relatively high. Meanwhile, forward contracts were arranged and the exchange risk in this respect was substantially covered.

Management Discussion and Analysis *(Continued)*

Contingent Liabilities

As at 31st December 2006, the Group did not have any significant contingent liabilities except the following:

(i) As reported in the Group's 2003, 2004 and 2005 Annual Report, an action was commenced in 2003 by a supplier of resin materials (the "Supplier") against a Group company in the Hong Kong High Court for payment of a trading debt amounting to HK$643,980. HK$20,853 of this debt has already been paid by the Group company pursuant to a court order. About 75% of the remaining debt was not disputed by the Group company. However, this was not paid because the court ordered that this action should be tried together with a separate action commenced by the Group company against the Supplier in 2003 for damages amounting to approximately US$590,000 on the basis, inter alia, that bulk resin supplied by the Supplier did not reasonably correspond with the sample first provided and tested by the Group company. The effect of both actions being tried together was that the court could take into account, and set-off, any damages awarded in either action to produce a net result. The trial was heard in September 2006. At trial, the Group company was advised not to, and did not, pursue its defence to payment of any of the invoices remaining unpaid in the Supplier action, save that set-off was sought in respect of the damages the Group company was claiming in its action. Judgement was handed down on 30th March 2007 ("Judgement"). The Group company was unsuccessful in its action. Accordingly, the Group company was ordered to pay the Supplier HK$619,127 (plus interest) in the Supplier action (the Supplier was found to have abandoned HK$4,000 of its claim) and HK$160,305 (plus interest) in its action (representing the Supplier's counterclaim for unpaid invoices). The issue of costs was held over pending written submissions from the parties dealing with the payment of costs. The directors believe that the Group will not suffer any material loss as a result of the Judgement. The Group has made adequate provision for the legal costs incurred in taking both actions to trial (including any legal costs of the other parties to the action that the Group company might have to pay).

(ii) As reported in the Group's 2004 and 2005 Annual Report, during the last quarter of 2003, a Mexican company commenced a law suit in the State of Arizona against the Company on the ground that the Company is a guarantor for a Lease Agreement of factory premises occupied by Siempre Novedoso De Mexico (Sinomex) S.A. de C.V. ("Sinomex") as tenant (the "Litigation"). Sinomex was a member company of the Group at that time and it was disposed of in 1996. The plaintiffs alleged claims against Sinomex and the Company of approximately US$5,000,000 for unpaid obligations of Sinomex under such Lease Agreement plus interest (in the amount of 2% per month, or 24% annually), court costs and attorney fees.

In 2004, the Company filed a Motion to Dismiss (the "Motion") the complaint in the Litigation based upon the applicable laws of Arizona and those of the location of the property, Hermosillo, Mexico. In the Motion, the Company primarily argued that the Arizona court did not have sufficient subject matter and personal jurisdiction over the Company under the guarantee for the case to continue in that court, and as such, the case should be dismissed in favor of the Company.

In January 2005, the Arizona court denied the initial Motion submitted by the Company. Since then the Company has taken some discovery and will continue to take additional discovery as well as filing one or more motions to vindicate the Company. The Company plans to continue to vigorously defend the Litigation, and to assert the defenses available to it. This would eliminate or at least significantly reduce the exposure of the Company if those defenses prove to be successful. Currently, the Company is continuing to undertake discovery to develop the various factual and legal defenses to the lawsuit.

Having considered the Litigation with the Company's legal counsel, management and the Board believe that the Company's opposition to the plaintiffs' complaint, and its defenses, including defenses to the amount of damages awardable, are meritorious. As such, the Company intends to continue to vigorously defend the Litigation. On that basis, the Company has made adequate provision in relation to the Litigation.

EMPLOYEES AND REMUNERATION POLICIES

As at 31st December 2006, the Group employed approximately 6,646 (2005: 6,960) full time management, administrative and production staff in Hong Kong SAR, Mainland China, the United States and Europe. The Group had seasonal fluctuation in the number of workers employed in its production plant while the number of other management and administrative staff remained stable. The Group remunerates its employees based on their performance, experience and prevailing industry practices. In the area of staff training, the Group encourages staff to participate in courses on technical skills improvement and personal development.

PROSPECTS

The rising wage and appreciation of Renminbi Yuan continue to have an impact on the profit margins of the manufacturers having production facilities in Mainland China including the Group. To keep a competitive edge in the global market, the Group's strategy is focused on production cost control and broadening sources of revenue. In the area of production cost control, the Group will continue to monitor the efficiency on each of the manufacturing processes and encourage staff at all levels to make suggestions to further improve the operation and production efficiency. Moreover, the Group will continue its stringent control on wastage rates and material sourcing. In order to broaden the revenue source, further efforts will be put on widening the customer base and expanding new product lines.

The Group is cautiously optimistic that all these measures will continue to help to relieve the pressure on profit margins and at the same time facilitate business growth.

By order of the Board
Kenneth Ting Woo-shou
Managing Director

Hong Kong, 23rd April 2007