MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS

The Group's turnover for the year ended 31 December 2006 was HK$622,200,000, a 9.98% increase from HK$565,741,000 recorded in year 2005. Gross profit margin for the year under review was 12.93%, an increase from 11.58% the year before. Net profit for the year under review was HK$4,008,000, a 16.65% increase from HK$3,436,000 recorded in year 2005.

The gross profit margin rose despite the increases in production and operating costs arising from the appreciation of Renminbi against Hong Kong dollar and the rise in labour and material costs. The improvement in the gross profit margin was mainly attributable to more effective cost control measures. The net profit was adversely affected by several abnormal charges totalling nearly HK$6,307,000 and higher administrative costs associated with the set up of R&D centre in Mainland China, renovation of production facilities, development of a comprehensive ERP system, and a steep increase in staff salaries caused by the appreciation of Renminbi against Hong Kong dollar and inflation in Mainland China.

As at 31 December 2006, total assets and net assets of the Group were HK$424,367,000 (2005: HK$353,203,000) and HK$278,485,000 (2005: HK$267,543,000) respectively, representing an increase of 20.15 % and 4.09% respectively as compared with those of the year 2005. The increase in net assets of the Group was mainly attributable to profits generated during the year ended 31 December 2006 and an increase of HK$1,219,000 in the Group's asset revaluation reserve as a result of the revaluation done for the Group's leasehold land and buildings in Hong Kong and buildings in Mainland China as at 31 December 2006.

BUSINESS REVIEW

Manufacturers engaged in labour-intensive production in Southern China faced yet another challenging year in 2006 as material and labour costs continued to climb. Intense competition in the toy retail market in the United States also kept profit margins for contract manufacturers depressed. In addition, the Group's profitability in the second half of 2006 was severely hampered by the accelerating appreciation of Renminbi against Hong Kong dollar and a 20-percent hike in the mandatory minimum wage.

Nevertheless, the Group was encouraged to see a continued upward trend in sales turnover. With the continuing structural change of market demand of toys for the year ended 31 December 2006, hard toys accounted for HK$543,815,000 and stuffed toys HK$78,385,000, representing 87.40% and 12.60% (2005: 83.75% and 16.25%) of the Group's turnover respectively.

Geographically, the United States and Canada remained the major market, where 73.10% (2005: 85.04%) of the Group's turnover was generated. The balances of 21.66% (2005: 13.18%) and 5.24% (2005: 1.78%) were attributable to sales to Japan & others, and Hong Kong & Mainland China respectively.

The Group strengthened its management team to spearhead the redesign of internal processes. The redesign aims to improve operational efficiency and control operational and production costs. The Group signed a contract in 2006 with a consultancy company to develop a comprehensive ERP system with the goal to improve control and efficiency and reduce waste. In addition, the Group automated some production processes to achieve higher productivity.

The new R&D centre set up in Mainland China in late 2006 is expected to be an important engine of the Group's organic growth and will help to develop opportunities in higher-margin product categories for the Group.

MANAGEMENT DISCUSSION AND ANALYSIS

Seeking to diversify its business and leverage its product development and production expertise, the Group set up a venture in late 2006 to develop consumer products and explore overseas marketing opportunities.

The Group believes that the ability to maintain a strong and stable labour force will become ever more valuable for contract manufacturers amid the worsening labour shortage in Southern China. The Group stands out in its ability to retain and attract skilled workers, thanks to its excellent reputation and commitment to social compliance.

FINANCIAL REVIEW

Expenses

During the year under review, selling and distribution expenses amounted to HK$22,562,000 (2005: HK$19,568,000). The increase was attributed to higher packaging and logistics expenses.

Administrative expenses rose to HK$55,522,000 in 2006 (2005: HK$43,753,000), representing an increase of 26.90% as compared with the year of 2005. This was mainly due to the appreciation of Renminbi and inflation in Mainland China. Staff costs also rose as the Group strengthened its management team in Hong Kong and reviewed compensation packages in Mainland China to keep pay levels in line with industry standards.

Liquidity and Financial Resources

The Group is financing its operations mainly from internally generated cashflow. As at 31 December 2006, cash and bank deposits held by the Group, mainly in Hong Kong dollars, United States dollars and Renminbi, amounted to approximately HK$26,623,000 (2005: HK$34,057,000). The Group's current ratio (current assets/current liabilities) was 1.68 (2005: 2.19) and gearing ratio (total bank borrowings/total shareholders' equity) was 2.86% (2005: 0%) respectively.

Contingent Liabilities

The Group had a contingent liability in respect of possible future long service payments to employees under the Hong Kong Employment Ordinance, with a maximum possible amount of HK$1,054,000 as at 31 December 2006 (2005: HK$1,386,000). A provision has not been recognised in respect of such possible payments, as it is not considered probable that the situation will result in a material future outflow of resources from the Group.

At 31 December 2006, the Company had provided corporate guarantees of HK$500,000 (2005: HK$500,000) to a bank in respect of banking facilities granted to one of its associates. At the same date, such banking facilities were fully utilised by the associate (2005: HK$500,000).

Charge on Assets

As at 31 December 2006, certain of the Group's buildings with a net book value of HK$27,313,000 (2005: HK$28,324,000) were pledged to secure general banking facilities granted to the Group. As at 31 December 2006, such facilities were utilised up to an amount of RMB8,000,000.

MANAGEMENT DISCUSSION AND ANALYSIS

Exchange Risk

The Group has transactional currency exposures. Such exposures arise from sales or purchases by operating units in currencies other than the units' functional currency. Approximately 46.44% of the Group's sales are denominated in currencies other than the functional currency of the operating units making the sale, which is mainly the United States dollar, whilst almost 53.48% of costs are denominated in the functional currency.

During the year, the Group entered into various forward currency contracts to manage its exchange rate exposures which did not meet the criteria for hedge accounting. Changes in the fair value of non-hedging currency derivatives amounting to HK$3,169,000 were charged to the consolidated income statement during the year.

EMPLOYEES

As at 31 December 2006, the group had a total of approximately 10,600 (31 December 2005: 8,900) employees in Hong Kong and Mainland China. The Group provides remuneration packages to employees largely based on industry practice, individual performance, qualifications and experience. In addition, discretionary bonuses and share options under the Company's share option scheme may be granted to eligible staff by reference to the Group's performance and individual performance. The Group also provides subsidies to staff for external training in order to enhance the Group's competitive edge.

OUTLOOK

Factors such as the appreciation of Renminbi against Hong Kong dollar, rising raw material and overhead costs, and another expected minimum wage increase in 2007 are expected to hurt the Group's short-term profitability. The Group's management team will continue its efforts to expand its market, streamline internal processes, improve operational efficiency, and raise productivity through automation. The ERP system is expected to be launched at the end of the year.

The Group has stepped up its efforts to expand its customer base in the toy sector and explore new markets and opportunities. The R&D centre will continue to lead the Group's drive to maintain its leadership in technological innovation in the toy industry and explore opportunities to expand into higher-margin sectors outside the traditional toy business.

To ensure competitiveness and profitability in the long run, the Group is considering building production facilities outside the Pearl River Delta region.