



Mr Leung Lun
Chairman

On behalf and as the Chairman of the Board of Directors, I am pleased to present the audited results of Lung Cheong International Holdings Limited (the “Company”) and its subsidiaries (collectively referred to as the “Group”) for the year ended 31 March 2007.

The financial year under review was the most challenging and difficult period the Group had ever endured in its history. For the first time after the listing of the Company’s shares on The Stock Exchange of Hong Kong Limited, it registered a loss of HK\$37 million attributable to equity holders of the Company as compared to profit of HK\$17 million in the preceding year, attributable mainly to a provision made for damages awarded against the Group for a lawsuit against the Company and its subsidiary Kid Galaxy Inc. (“KGI”).

For the year ended 31 March 2007, the Group reported a turnover of HK\$705 million compared to HK\$751 million in the previous year. Sales were 6% lower. Excluding the non-recurring provision for lawsuit judgement of HK\$48 million, profit attributable to shareholders would have been approximately HK\$11 million.

BUSINESS REVIEW

During the period under review, the Group was involved in a lawsuit relating to the acquisition of KGI in 2001 ("Lawsuit") resulting in a public jury ("Jury") finding the Group in breach of a Confidential Agreement and awarded the plaintiff US\$5.1 million (approximately HK\$40 million) damages ("Verdict"). The Group has filed an appeal against the verdict, but full provision for the amount plus interest in the sum of US\$6 million (approximately HK\$48 million) ("Provision") was made in the accounts for the financial year ended 31 March 2007. This was the main reason for the Group to experience loss in its overall results for the year ended 31 March 2007.

The other challenges the Group had to face included limited and ageing production facilities, labour shortage and increased minimum wages in Guangdong Province beginning in September 2006. Fluctuating raw material costs, fierce price competition, high interest rate and appreciation of the Renminbi also compounded the situation.

Overall sales came down by 6% from HK\$751 million to HK\$705 million due to the alteration of the shipment dates of certain products to major Japanese customers for the reason of their changes to product specifications and marketing plans. Also, the Group adopted a cautious shipment schedule in early 2007 to facilitate the relocation to the new Changping Factory.



The Group continued to derive the bulk of its revenue from sales of radio control and electronic toys. With leadership in the product categories, it was able to secure consistent orders and product development requests from well-known brands in the toy industry. Original Design Manufacturing ("ODM") business helped to stabilize the Group's gross margin amid tough competition. It was more difficult to maintain a higher margin when compared with previous years, but the Group's effort to expand into Own Brand Manufacturing ("OBM") business had mitigated pressure on its margin.

Aged facilities posed restriction on the Group's ability to meet peak season production needs and attract workers. We had to offer higher than average remunerations to attract and retain workers, resulting in higher manufacturing overhead for the year ended 31 March 2007.

Relocation to the new Changping Factory took longer than planned. The Group's overall capital expansion and relocation plans were affected by the unfavourable ruling of the United States ("US") Lawsuit, which led to a sudden credit squeeze.

In January 2007, the Group completed a one share for every two shares held rights issue, underwritten by the majority shareholder Lung Cheong Investment Ltd., and raised HK\$47 million. The amount was used primarily for the Appeal Bond placed with the Court in Florida, US as required for filing the appeal against the court ruling.

With a loss recorded for the financial year under review, the Directors do not recommend payment of dividend (2006: Nil) for the year. In return for the support of our equity holders and investors over the years, the Board proposed to issue two bonus shares for every one existing share held subject to equity holders' approval in the next Annual General Meeting.

PLANS AND PROSPECTS

The Directors expect the operating environment of the Group to remain competitive in the coming year. Looking forward, the Group will strive to make the best of the production, warehousing and dormitory capacities of all its three factories including the new Changping Factory to meet forthcoming peak season demands. The Changping Factory is expected to be fully operational by the interim of 2007/08, which will increase the overall production capacity of the Group to support sales in the coming year.



The Group will eventually vacate the wholly-owned factory site at Qian Tou, Dongguan and apply for it to be re-zoned as a residential/commercial site of higher value for disposal or redevelopment. The site is right next to the Dongguan University of Technology, the only tertiary educational institution in Dongguan City.

The Directors plan to dispose of or sub-let the leased Zhou Wu Factory before the end of financial year 2007/08. We do not expect this move to have a major impact on the Group's overall production capabilities.

The new and modernized Changping Factory will allow the Group to consolidate manufacturing, design, engineering and warehousing capabilities at one location in China. The Directors believe resources can be more efficiently utilized, which will enable the Group to enjoy improved cost-effectiveness in the years to come.

The Directors are of the view that the Group's new plant would work in favour of recruitment of workers. With Changping as a key railway terminus in Guangdong, the Group has the advantage of sourcing workers from different areas in Guangdong and other provinces.

The Group runs a production plant in Indonesia. Taking into account the different constraints faced by its manufacturing facilities in China, the Group, with customers' consent, has moved more production to the Indonesian plant. The Directors expect this trend to continue with more orders to be filled by under-utilized Indonesia capacity. The Group anticipates strong contribution from our South East Asian factory to its performance in coming years.

The Group will continue to actively develop ODM business and strengthen research and development ("R&D") capabilities to expand its portfolio of innovative products. Our product designers and engineers will also continue to support Original Equipment Manufacturing ("OEM") customers in new product development. We expect OEM to remain as the core business of the Group in financial year 2007/08.



The Group expects its own brand segment Kid Galaxy ("KG"), with a firm foundation and the help of continuous marketing and product development efforts, to contribute positively to its overall results in the coming financial year. KG's own brand products are expected to gain market share and generate better sales in the US.

To strengthen the Group's business, the management intends to improve overall profit margin through measures including re-engineering management and production flow and rationalizing different resources of its manufacturing operations, commanded after consolidation of all its production facilities.

Regarding the Lawsuit in Florida, the Directors were advised by Orlando based law firm Lowndes, Drosdick, Doster, Kantor and Reed, P.A. ("Attorney") that the decision by the Jury upon the claims brought by Action Products International Inc. ("APII") against the Company is contrary to both the facts presented and the clear law of the State of Florida. The Company will continue to aggressively appeal the Judgement and is confident that the verdict will be eventually set aside.

In the event the appeal is unsuccessful, the Company will be required to satisfy the plaintiff's claims from the Appeal Bond. An appeal, according to our Attorney, usually takes between nine to twelve months from the filing day. The Company will make announcement(s) to inform the shareholders of any latest development as and when appropriate.

I would like to thank my fellow Board members and senior management, and all of Lung Cheong's employees for their commitment to the Group. My appreciation also goes to our investors, bankers and financial partners for their invaluable support.

A handwritten signature in black ink, appearing to read "Leung Lun".

Leung Lun
Chairman



23 July 2007