1 GENERAL INFORMATION

The principal activities of the Company are the design, development, manufacturing and sale of plush stuffed and steel and plastic toys and investment holding. The principal activities and other particulars of the subsidiaries are set out in Note 9 to the consolidated financial statements.

The Company is a limited liability company incorporated in Hong Kong. The address of its registered office is 8/F, Tower 5, China Hong Kong City, 33 Canton Road, Tsimshatsui, Kowloon, Hong Kong.

The Company has its primary listing on the Main Board of The Stock Exchange of Hong Kong Limited (the "SEHK").

These consolidated financial statements are presented in thousands of units of Hong Kong dollars (HK$'000), unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 18 April 2007.

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 Dream International Limited 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 financial assets and financial liabilities (including derivative instruments) at fair value through income statement, which are carried at fair value.

The consolidated financial statements are presented in Hong Kong dollars, which is different from the Company's functional currency of United Stated dollars. The Company has used Hong Kong dollars as its presentation currency in view of the fact that the Company's shares are listed on the SEHK and that the exchange rate of United States dollars and Hong Kong dollars has been relatively stable.

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) **Standard, amendments to standards and interpretations effective in 2006**

The following new standard, amendments to standards and interpretations are mandatory for the financial year ended 31 December 2006:

HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 21 (Amendment)	Net Investment in a Foreign Operation
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transaction
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 and HKFRS 4 (Amendments)	Financial Guarantee Contracts
HKFRS 1 & 6 (Amendments)	First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
HKFRS 6	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
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

The adoption of the above standard, amendments to standards and interpretations did not have significant impact to the Group.

(b) **Standards and interpretations that are not yet effective and have not been early adopted by the Group**

The following standards and interpretations have been published but are not effective for 2006 and have not been early adopted:

HKFRS 7	Financial Instruments: Disclosures
HKFRS 8	Operating Segments
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
HK(IFRIC)-Int 8	Scope of HKFRS 2
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment
HK(IFRIC)-Int 11	HKFRS 2 – Group and Treasury Share Transactions
HK(IFRIC)-Int 12	Service Concession Arrangements

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 31 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 (Note 2.6). 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 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 2.7). The results of subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

(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 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.2 Consolidation (Continued)

(c) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in associates are stated at cost less provision for impairment losses (Note 2.7). The results of associated companies are accounted for by the Company on the basis of dividend received and receivable.

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 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Hong Kong dollars, which is different from the Company's functional currency of United Stated dollars. The Company has used Hong Kong dollars as its presentation currency in view of the fact that the Company's shares are listed on the SEHK and that the exchange rate of United States dollars and Hong Kong dollars has been relatively stable.

(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 income statement.

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 income statement, and other changes in the carrying amount are recognised in equity.

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 income statement 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.

2.4 Foreign currency translation (Continued)

(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 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 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.

2.5 Property, plant and equipment

All property, plant and equipment is stated at historical cost less depreciation. 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 charged in the income statement during the financial period in which they are incurred.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.5 Property, plant and equipment (Continued)

Depreciation is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives, as follows:

- Freehold land is not depreciated.
- Buildings situated on freehold land are depreciated over their estimated useful lives, being no more than 20 years after the date of completion.
- Buildings situated on leasehold land are depreciated over the shorter of the unexpired term of lease and their estimated useful lives, being no more than 20 years after the date of completion.

– Leasehold improvements	Over the period of the lease
– Plant and machinery	5 – 10 years
– Office equipment, furniture and fixtures	5 – 10 years
– Motor vehicles	3 – 10 years

Construction in progress is stated at cost, which includes construction costs and other direct costs, capitalised less any identified impairment loss. No depreciation is provided until the construction is completed and the assets are ready for intended use. Cost of completed construction work is transferred to the appropriate category of property, plant and equipment.

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 2.7).

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

2.6 Intangible assets

(a) **Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.6 Intangible assets (Continued)

(a) **Goodwill** (Continued)

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. Dream International Limited allocates goodwill to each business segment in each country in which it operates (Note 2.7).

(b) **Patents**

Acquired patents are shown at historical cost. Patents have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of patents over their estimated useful lives (5 years).

(c) **Club memberships**

Club memberships with indefinite useful lives are stated in the balance sheet at cost less accumulated impairment losses, and are tested annually for impairment (Note 2.7).

2.7 Impairment of investments in subsidiaries, associates 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 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.8 Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivable and available-for-sale. The classification depends on the purposes 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 classified 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 2.10).

(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.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets in 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 income statement – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2.10.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.9 Inventories

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

2.10 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 the 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 original 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 income statement. 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 recognised in the income statement.

2.11 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.

2.12 Share capital

Ordinary shares are classified as equity.

2.13 Trade payables

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

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.14 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 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.

2.15 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 consolidated 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, associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2.16 Employee benefits

(a) **Pension obligations**

Group companies operate various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations. The Group has both defined benefit and defined contribution plans. A defined contribution plan is a pension plan under which the Group pays contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan. Typically, defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of services and compensation.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.16 Employee benefits (Continued)

(a) **Pension obligations** (Continued)

The liability recognised in the balance sheet in respect of defined benefit pension plan is the present value of the defined benefit obligations at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to income over the employees' expected average remaining working lives.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

(b) **Share-based compensation**

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. At each balance sheet date, the entity revises its estimates of the number of options that are expected to vest. At each balance sheet date, the entity revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.16 Employee benefits (Continued)

(c) **Termination benefits**

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are discounted to present value.

2.17 Provisions

Provisions are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is probable 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.

2.18 Revenue recognition

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

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.18 Revenue recognition (Continued)

(a) **Sale of goods**

Revenue is recognised when goods are delivered at the customers' premise which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

(b) **Commission income**

Commission income on sales referred to manufacturers is recognised when the goods are delivered by the manufacturers to the ultimate customers.

(c) **Interest income**

Interest income is recognised on a time-proportion basis using the effective interest method.

2.19 Leases (as the lessee for operating leases)

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 to the income statement on a straight-line basis over the period of the lease.

2.20 Borrowing costs

Borrowing costs are expensed in income statement in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

2.21 Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

2.22 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: credit risk, liquidity risk, cash flow and fair value interest rate risks and foreign exchange risk.

The Group's risk management program seeks to minimise the potential adverse effects of financial risks on the Group's performance.

(i) **Credit risk**

The Group has policies in place to ensure that sales of goods and provision of services are made to customers with an appropriate credit history.

(ii) **Liquidity risk**

The Group monitors current and expected liquidity requirements to ensure sufficient cash and adequate amount of committed credit facilities are maintained.

(iii) **Cash flow and fair value interest-rate risks**

The Group's interest-rate risk arises from borrowings and interest bearing assets. Borrowings issued at variable rates expose the Group to cash flow interest-rate risk. Borrowings issued at fixed rates expose the Group to fair value interest-rate risk. The long-term structured deposits expose the Group to fair value interest-rate risk and the cash and cash equivalents expose the Group to cash flow interest-rate risk.

(iv) **Foreign exchange risk**

The Group mainly operates in the Mainland China and Hong Kong with most of the transactions settled in US dollars and Renminbi ("RMB"). The Group's assets and liabilities, and transactions arising from its operations that are exposed to foreign exchange risk are primarily with respect to RMB. The Group has not used any forward contracts to hedge its exposure as foreign exchange risk is considered minimal.

3.2 Fair value estimation

The carrying value less impairment provision of trade receivables and payables are a reasonable approximation of their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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.

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) Estimated impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in Note 2.7. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates (Note 8).

(b) Income taxes

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(c) Fair value of other financial instruments

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at each balance sheet date. The Group uses discounted cash flow analysis for various available-for-sale financial assets that were not traded in active markets.

(d) Fair value of share options

The fair value of share options is measured at grant date using binomial models, taking into account the terms and conditions upon which the options were granted.

5 SEGMENT INFORMATION

(a) Primary reporting format – business segments

The Group comprises two main business segments:

– plush stuffed toys
– steel and plastic toys

	Plush stuffed toys		Steel and plastic toys		Unallocated		Total	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Sales to external customers	903,920	981,811	180,437	58,633	–	–	1,084,357	1,040,444
Other income	1,434	1,611	30	196	5,403	6,515	6,867	8,322
Total	905,354	983,422	180,467	58,829	5,403	6,515	1,091,224	1,048,766
Segment result	(10,517)	(28,980)	(4,179)	(1,387)	–	–	(14,696)	(30,367)
Goodwill impairment losses	(99,532)	–	(662)	–	–	–	(100,194)	–
Operating loss							(114,890)	(30,367)
Finance costs							(7,684)	(3,339)
Share of (loss)/profit of associates							(237)	652
Loss before income tax							(122,811)	(33,054)
Income tax expense							(8,673)	(3,416)
Loss for the year							(131,484)	(36,470)

5 SEGMENT INFORMATION (Continued)

(a) Primary reporting format – business segments (Continued)

	Plush stuffed toys		Steel and plastic toys		Total	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Segment assets	548,418	566,735	138,390	43,129	686,808	609,864
Investments in associates	1,298	1,483	–	–	1,298	1,483
Unallocated assets					74,233	180,435
Total assets					762,339	791,782
Segment liabilities	144,833	109,559	41,778	9,981	186,611	119,540
Unallocated liabilities					133,617	114,295
Total liabilities					320,228	233,825
Capital expenditure	19,769	58,002	60,438	17,706	80,207	75,708
Depreciation of property, plant and equipment	21,943	20,811	4,127	684	26,070	21,495
Amortisation of leasehold land and land use rights and patents	217	163	756	–	973	163

5 SEGMENT INFORMATION (Continued)

(b) Secondary reporting format – geographical segments

	Turnover		Segment assets		Capital expenditure	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
North America	534,694	478,886	2,017	212	137	26
Japan	271,226	323,473	4,297	4,412	–	–
Europe	187,552	166,885	–	–	–	–
South Korea	14,350	28,602	91,267	176,227	140	1,087
PRC and Hong Kong	67,200	40,814	538,328	384,472	70,738	44,284
Vietnam	539	–	50,899	44,541	9,192	30,311
Others	8,796	1,784	–	–	–	–
	1,084,357	1,040,444	686,808	609,864	80,207	75,708

The analysis of turnover by geographical segment is based on the destination of shipments of goods. No analysis of the contribution by geographical segments has been presented as the ratios of profit to turnover achieved for the above geographical segments are not substantially out of line with the Group's overall ratio of profit to turnover.

6 LEASEHOLD LAND AND LAND USE RIGHTS

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

	Group 2006 HK$'000	Group 2005 HK$'000
Outside Hong Kong held on:		
Leases of between 10 to 50 years	16,168	11,269

Bank borrowings are secured on leasehold land and land use rights for the carrying amount of HK$15,622,000 (2005: HK$4,268,000) (Note 18).

	Group 2006 HK$'000	Group 2005 HK$'000
Opening	11,269	10,229
Additions	4,841	1,137
Amortisation of prepaid operating lease payments	(297)	(163)
Exchange differences	355	66
	16,168	11,269

7 PROPERTY, PLANT AND EQUIPMENT

	Group						
	Freehold land and buildings HK$'000	Leasehold improvements HK$'000	Plant and machinery HK$'000	Office equipment, furniture and fixtures HK$'000	Motor vehicles HK$'000	Construction in progress HK$'000	Total HK$'000
At 1 January 2005							
Cost	43,356	21,483	102,291	21,845	11,470	4,864	205,309
Accumulated depreciation	(7,007)	(15,026)	(52,430)	(13,646)	(6,987)	–	(95,096)
Net book amount	36,349	6,457	49,861	8,199	4,483	4,864	110,213
Year ended 31 December 2005							
Opening net book amount	36,349	6,457	49,861	8,199	4,483	4,864	110,213
Exchange differences	691	21	563	100	68	93	1,536
Additions	6,813	1,004	17,349	3,679	966	27,296	57,107
Disposals	–	(1)	–	(267)	(3)	–	(271)
Depreciation	(2,643)	(2,576)	(11,225)	(3,557)	(1,494)	–	(21,495)
Transfer	14,983	–	7,753	414	602	(23,752)	–
Closing net book amount	56,193	4,905	64,301	8,568	4,622	8,501	147,090
At 31 December 2005							
Cost	66,012	22,411	124,030	25,464	12,906	8,501	259,324
Accumulated depreciation	(9,819)	(17,506)	(59,729)	(16,896)	(8,284)	–	(112,234)
Net book amount	56,193	4,905	64,301	8,568	4,622	8,501	147,090

7 PROPERTY, PLANT AND EQUIPMENT (Continued)

	Group						
	Freehold land and buildings HK$'000	Leasehold improvements HK$'000	Plant and machinery HK$'000	Office equipment, furniture and fixtures HK$'000	Motor vehicles HK$'000	Construction in progress HK$'000	Total HK$'000
Year ended 31 December 2006							
Opening net book amount	56,193	4,905	64,301	8,568	4,622	8,501	147,090
Exchange differences	2,226	82	2,332	488	(17)	711	5,822
Additions	11,104	1,351	33,324	2,278	2,685	24,624	75,366
Disposals	(1,983)	–	(18)	(51)	(278)	–	(2,330)
Depreciation	(2,947)	(1,913)	(16,557)	(3,074)	(1,579)	–	(26,070)
Transfer	26,221	–	5,855	1,100	–	(33,176)	–
Closing net book amount	90,814	4,425	89,237	9,309	5,433	660	199,878
At 31 December 2006							
Cost	103,985	23,960	166,756	28,954	12,576	660	336,891
Accumulated depreciation	(13,171)	(19,535)	(77,519)	(19,645)	(7,143)	–	(137,013)
Net book amount	90,814	4,425	89,237	9,309	5,433	660	199,878

7 PROPERTY, PLANT AND EQUIPMENT (Continued)

	Company					
	Freehold land and buildings HK$'000	Leasehold improvements HK$'000	Plant and machinery HK$'000	Office equipment, furniture and fixtures HK$'000	Motor vehicles HK$'000	Total HK$'000
At 1 January 2005						
Cost	4,603	16,783	32,149	11,732	3,386	68,653
Accumulated depreciation	(23)	(12,472)	(21,364)	(9,185)	(2,925)	(45,969)
Net book value	4,580	4,311	10,785	2,547	461	22,684
Year ended 31 December 2005						
Opening net book value	4,580	4,311	10,785	2,547	461	22,684
Additions	–	372	6,651	880	226	8,129
Disposals	–	–	–	(21)	–	(21)
Depreciation	(168)	(1,561)	(3,535)	(1,065)	(322)	(6,651)
Closing net book value	4,412	3,122	13,901	2,341	365	24,141
At 31 December 2005						
Cost	4,603	17,019	34,457	12,555	3,612	72,246
Accumulated depreciation	(191)	(13,897)	(20,556)	(10,214)	(3,247)	(48,105)
Net book value	4,412	3,122	13,901	2,341	365	24,141

7 PROPERTY, PLANT AND EQUIPMENT (Continued)

	Company					
	Freehold land and buildings HK$'000	Leasehold improvements HK$'000	Plant and machinery HK$'000	Office equipment, furniture and fixtures HK$'000	Motor vehicles HK$'000	Total HK$'000
Year ended 31 December 2006						
Opening net book value	4,412	3,122	13,901	2,341	365	24,141
Additions	–	74	–	98	240	412
Disposals	–	–	(16)	–	–	(16)
Depreciation	(115)	(1,129)	(4,016)	(832)	(234)	(6,326)
Closing net book value	4,297	2,067	9,869	1,607	371	18,211
At 31 December 2006						
Cost	4,603	17,093	34,407	12,615	1,540	70,258
Accumulated depreciation	(306)	(15,026)	(24,538)	(11,008)	(1,169)	(52,047)
Net book value	4,297	2,067	9,869	1,607	371	18,211

Bank borrowings are secured on the Group's buildings, plant and machinery and furniture and fixtures for the value of HK$93,232,000 (2005: HK$36,151,000) (Note 18).

The freehold land is located outside Hong Kong.

8 INTANGIBLE ASSETS

	Group			
	Goodwill HK$'000	Club memberships HK$'000	Patents HK$'000	Total HK$'000
At 1 January 2005				
Cost	109,469	12,180	–	121,649
Accumulated amortisation	(9,315)	–	–	(9,315)
Net book amount	100,154	12,180	–	112,334
Year ended 31 December 2005				
Opening net book amount	100,154	12,180	–	112,334
Exchange differences	–	325	–	325
Closing net book amount	100,154	12,505	–	112,659
At 31 December 2005				
Cost	109,469	12,505	–	121,974
Accumulated amortisation	(9,315)	–	–	(9,315)
Net book amount	100,154	12,505	–	112,659
Year ended 31 December 2006				
Opening net book amount	100,154	12,505	–	112,659
Exchange differences	–	486	–	486
Additions (Note)	40	2,002	3,382	5,424
Disposals	–	(431)	–	(431)
Impairment charge	(100,194)	–	–	(100,194)
Amortisation charge	–	–	(676)	(676)
Closing net book amount	–	14,562	2,706	17,268
At 31 December 2006				
Cost	–	14,562	3,382	17,944
Accumulated amortisation and impairment	–	–	(676)	(676)
Net book amount	–	14,562	2,706	17,268

Note:

In June 2006, the Group's shareholdings in C & H HK Corp., Ltd increased from 61.8% to 66.47% following the increase in investment in C & H HK Corp., Ltd. In this connection, the Group recorded a goodwill of HK$40,000.

8 INTANGIBLE ASSETS (Continued)

	Company	
	Club memberships	
	2006	2005
	HK$'000	HK$'000
Year ended 31 December		
Opening net book value	–	–
Additions	308	–
Closing net book value	308	–
At 31 December		
Cost	308	–
Accumulated amortisation	–	–
Net book value	308	–

(a) Club memberships

The club memberships are with indefinite useful life. The club memberships currently have resale market values and have no foreseeable limit to their useful lives. The directors review the useful lives of club memberships at each balance sheet date to determine whether events or circumstances continue to support the view of indefinite useful lives. The club memberships have been tested for impairment in the current year by reference to their resale market values and no impairment losses were charged for the current year.

8 INTANGIBLE ASSETS (Continued)

(b) Impairment tests for goodwill

Goodwill is allocated to the Group's cash-generating units ("CGUs") identified according to the country of operation and business segment as follows:

	Notes	2006 HK$'000	2005 HK$'000
Plush stuffed toys – Korea	(i)	99,532	99,532
Less: provision for impairment loss		(99,532)	–
		–	99,532
Steel and plastic toys – PRC		662	622
Less: provision for impairment loss		(662)	–
		–	622
		–	100,154

Note (i):

Plush stuffed toys – Korea

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use pre-tax cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates stated below. The growth rate does not exceed the long-term average growth rate for the plush stuffed toys business in which the CGU operates.

The key assumptions used for value in use calculations are as follows:

Gross margin	14%
Growth rate	1%
Discount rate	15%

Management determined budgeted gross margin based on past performance and its expectations for the market development. The discount rate used is pre-tax and reflect specific risks relating to the relevant segments.

The impairment charge arose in the CGU in plush stuffed toys business segment in Korea following a decision to reduce the trading activities allocated to this operation. Following this decision, the Group reassessed the trading volume and gross margin of the CGU. No other class of asset than goodwill was impaired. The gross margin, growth rate, discount rate used in the previous year for the CGU was 15%, 1%-3% and 15% respectively.

9 INVESTMENTS IN SUBSIDIARIES

	Company 2006 HK$'000	Company 2005 HK$'000
Unlisted shares, at cost	192,914	165,659
Less: provision for impairment loss	(10,030)	–
	182,884	165,659
Loan to a subsidiary	143,891	138,585
Less: provision for impairment loss	(90,000)	–
	53,891	138,585
	236,775	304,244

The loan to a subsidiary is unsecured, interest-free and has no fixed repayable terms.

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

Company name	Country/place of Incorporation/ establishment and operation	Principal activities	Particulars of issued share capital	Percentage of equity shares held by the Company	Percentage of equity shares held by the Group
*Dream International USA, Inc.	United States of America	Trading of plush stuffed toys	US$1,000,000	100%	100%
J.Y. Toys Co., Limited	Hong Kong	Trading and manufacture of steel and plastic toys	US$1,500,000	100%	100%
J.Y. International Company Limited	Hong Kong	Trading of plush stuffed toys and investment holding	US$500,000	100%	100%
*#Jung Yoon Toys (Shanghai) Co., Limited	PRC	Manufacture of plush stuffed toys	US$420,000	100%	100%
*#C & H Toys (Suzhou) Co., Ltd.	PRC	Manufacture of plush fabrics and plush stuffed toys	US$9,200,000	100%	100%

9 INVESTMENTS IN SUBSIDIARIES (Continued)

Company name	Country/place of Incorporation/ establishment and operation	Principal activities	Particulars of issued share capital	Percentage of equity shares held by the Company	Percentage of equity shares held by the Group
Dream INKO Co., Ltd	South Korea	Design, development and trading of plush stuffed toys	KRW100,000,000	–	100%
*Dream Vina Co., Ltd	Vietnam	Manufacture of plush stuffed toys	US$3,900,000	100%	100%
*#C & H Toys (Shuyang) Co., Ltd	PRC	Manufacture of plush stuffed toys	US$1,200,000	100%	100%
C & H HK Corp., Ltd	Hong Kong	Trading of steel and plastic toys and investment holding	US$8,500,000	66.47%	66.47%
*#J.Y. Plasteel (Suzhou) Co., Ltd	PRC	Manufacture of bicycles and steel and plastic toys	US$7,500,000	–	66.47%
*#Guangxi Beiliu Zhengrun Toys Co., Ltd	PRC	Manufacture of plush stuffed toys	HK$500,000	100%	100%
*#C & H Toys (Mingguang) Co., Ltd	PRC	Manufacture of plush stuffed toys	US$800,000	100%	100%
*#C & H Toys (Chaohu) Co., Ltd	PRC	Manufacture of plush stuffed toys	US$1,000,000	–	100%

These are wholly-owned foreign investment enterprises registered under the laws of the PRC.

* Subsidiaries not audited by PricewaterhouseCoopers.

10 INVESTMENTS IN ASSOCIATES

	Group		Company	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Unlisted shares, at cost	–	–	1,248	1,248
Share of net assets	1,298	1,483	–	–
	1,298	1,483	1,248	1,248

The Group's interests in its principal associates, all of which are unlisted, were as follows:

2006	Assets HK$'000	Liabilities HK$'000	Equity HK$'000	Revenues HK$'000	Profit/(loss) HK$'000
100 per cent	17,215	(10,723)	6,492	40,503	(1,185)
Group's effective interest	3,443	(2,145)	1,298	8,101	(237)

2005					
100 per cent	16,545	(9,129)	7,416	43,544	3,260
Group's effective interest	3,309	(1,826)	1,483	8,709	652

Details of the associates are as follows:

Company name	Country/place of Incorporation/ establishment	Principal activities	Particulars of issued and paid up capital/register capital	Percentage of interest in ownership held by the Company	Percentage of interest in ownership held by the Group
Kedington Enterprises Inc.	British Virgin Islands	Investment holding	800,000 ordinary shares of US$1 each	20%	20%
Yuan Lin Toys (Suzhou) Co., Ltd	PRC	Manufacture of plush stuffed toys	Registered capital of US$1,000,000	–	20%

11 OTHER FINANCIAL ASSETS

	Group		Company	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Long-term structured deposit (Note (i))	69,231	69,847	69,231	69,847
Unlisted equity securities (Note (ii))	1,823	1,823	–	–
	71,054	71,670	69,231	69,847

Note (i) The Group entered into the contract with a bank in 2005. The contract will mature in 2017 and the principal amount is US$12,000,000 (equivalent to HK$93,300,000. Interest is payable quarterly in the first year at 6.5% per annum and in subsequent years at rates based on the spread between the 30 year and 10 year United States dollar swap rates. The bank may elect to early terminate the contract on any interest payment date before the maturity date by repaying the full principal amount plus accrued interest up to the termination date.

The long-term structured deposit is a hybrid instrument that includes a non-derivatives host contract and an embedded derivative. Upon inception this financial instrument was designated as at fair value with changes in fair value recognised in the income statement. Comparative figures have been reclassified to conform with current year's presentation.

As at 31 December 2006, the effective interest rate of the long-term structured deposit is 1.3% (2005: 1.8%).

The long-term structured deposit is pledged for bank borrowings (Note 18).

Note (ii) The fair value of the unlisted equity investments cannot be measured reliably because they are not traded in the open market and there were no transactions for the investments during the year. The unlisted investments are stated at cost less accumulated impairment losses. There were no disposals or impairment losses during the year (2005: Nil).

12 INVENTORIES

	Group		Company	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Raw materials	83,982	85,069	24,783	35,678
Work in progress	38,292	32,720	7,753	10,734
Finished goods	43,849	42,693	18,593	17,420
	166,123	160,482	51,129	63,832

During the year, the Group recognised a provision for raw materials of HK$3,225,000 (2005: HK$2,277,000) and a provision for finished goods of HK$234,000 (2005: HK$621,000).

13 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2006	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'000
Trade receivables	147,121	141,756	91,152	78,201
Less: provision for impairment of trade receivables	(7,353)	(42,512)	–	(21,157)
Trade receivables, net	139,768	99,244	91,152	57,044
Prepayments and other receivables	46,616	74,436	8,630	8,345
Amount due from ultimate holding company	13,961	1,254	–	–
Amounts due from fellow subsidiaries	4,014	101	–	–
Amounts due from associates	213	1,506	–	–
Amounts due from subsidiaries	–	–	45,777	50,579
	204,572	176,541	145,559	115,968

The fair values of trade and other receivables approximate their carrying values.

Amounts due from ultimate holding company, fellow subsidiaries, subsidiaries and associates are unsecured, interest-free and repayable on demand.

There is no concentration of credit risk with respect to trade receivables, as the Group has a large number of customers, internationally dispersed.

At 31 December 2006 and 2005, the ageing analysis of the trade receivables was (net of provision for impairment) as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Current	102,395	76,745
1 to 3 months	17,470	18,483
More than 3 months but less than 1 year	19,125	3,783
Over 1 year	778	233
	139,768	99,244

13 TRADE AND OTHER RECEIVABLES (Continued)

Movements on the provision for impairment of trade receivables are as follows:

	Group		Company	
	2006	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January	42,512	40,227	21,157	21,157
Provision for impairment	–	2,285	–	–
Receivables written off	(33,633)	–	(17,814)	–
Write back of provision	(1,526)	–	(3.343)	–
At 31 December	7,353	42,512	–	21,157

14 CASH AND CASH EQUIVALENTS

	Group		Company	
	2006	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'000
Cash at bank and in hand	80,545	89,021	11,769	17,010
Short-term bank deposits	2,253	14,107	–	9,611
	82,798	103,128	11,769	26,621

The effective interest rate on short-term bank deposits was 4.7% (2005: 4.2%); these deposits have an average maturity of 4 days.

Included in the balances, approximately HK$10,734,000 (2005: HK$10,588,000) represented Renminbi deposits placed with banks in the PRC by the Group. The remittance of these funds out of the PRC is subject to the exchange control restrictions imposed by the PRC government.

14 CASH AND CASH EQUIVALENTS (Continued)

Cash, cash equivalents and bank overdrafts include the following for the purposes of the cash flow statement:

	Group	
	2006	2005
	HK$'000	HK$'000
Cash and cash equivalents	82,798	103,128
Bank overdrafts	(7,962)	(7,155)
	74,836	95,973

15 SHARE CAPITAL

	Company	
	Number of shares (in thousands)	Ordinary shares HK'000
Authorised:		
Ordinary shares of US$0.01 each		
At 31 December 2006 and 2005	5,000,000	390,000
Issued and fully paid:		
Ordinary shares of US$0.01 each		
At 1 January 2005	667,549	51,942
Share issued under share option scheme	980	77
At 31 December 2005, 1 January 2006 and 31 December 2006	668,529	52,019

15 SHARE CAPITAL (Continued)

Share options

The Company has a share option scheme which was adopted on 22 January 2002 whereby the directors of the Company are authorised, at their discretion, to invite employees of the Group, including directors of any company in the Group, to take up options to subscribe for shares of the Company. The exercise price of the options is the highest of (i) the nominal value of the shares, (ii) the closing price of the shares on the SEHK on the date of grant and (iii) the average closing price of the shares on the SEHK for the five business days immediately preceding the date of grant. The options are exercisable progressively after one to three years from the date of grant and are exercisable for a period to be notified by the directors to each option holder upon the grant of option. Such period will not to exceed ten years from the date on which the option is granted.

Share options outstanding at the end of the year have the following terms:

Exercisable period	Exercise price per share	Number of options 2006 (in thousands)	2005 (in thousands)
Directors:			
7 February 2003 to 7 February 2012	HK$1.18	1,880	1,880
15 April 2004 to 15 April 2013	HK$1.43	1,365	1,365
2 January 2005 to 2 January 2014	HK$1.87	3,500	–
		6,745	3,245
Employees:			
7 February 2003 to 7 February 2012	HK$1.18	4,681	4,681
15 April 2004 to 15 April 2013	HK$1.43	455	455
2 January 2005 to 2 January 2014	HK$1.87	5,350	11,650
		10,486	16,786
Others:			
7 February 2005 to 7 February 2012	HK$1.18	–	2,600
		17,231	22,631

In respect of the options granted, the maximum percentage of the share options which may be exercised is determined in stages as follows:

On or after 1st year anniversary	30%
On or after 2nd year anniversary	another 30%
On or after 3rd year anniversary	another 40%

15 SHARE CAPITAL (Continued)

Share options (Continued)

Movements in the number of share options outstanding during the year are as follows:

	2006		2005	
	Weighted average exercise price per share	Number of options (in thousands)	Weighted average exercise price per share	Number of options (in thousands)
At 1 January	HK$1.56	22,631	HK$1.41	23,611
Exercised	–	–	HK$1.18	(980)
Lapsed	HK$1.54	(5,400)	–	–
At 31 December	HK$1.56	17,231	HK$1.56	22,631

16 RESERVES

	Group					
	Share premium HK$'000	Capital reserve HK$'000	General reserve fund HK$'000	Exchange reserve HK$'000	Retained profits HK$'000	Total HK$'000
Balance at 1 January 2005	175,813	4,054	15,045	5,641	361,089	561,642
Currency translation differences	–	–	–	2,752	–	2,752
Loss for the year	–	–	–	–	(36,348)	(36,348)
Shares issued under share option scheme	1,080	–	–	–	–	1,080
Equity settled share-based transactions	–	1,915	–	–	–	1,915
Dividend relating to 2004	–	–	–	–	(40,111)	(40,111)
Balance at 31 December 2005	176,893	5,969	15,045	8,393	284,630	490,930
Balance at 1 January 2006	176,893	5,969	15,045	8,393	284,630	490,930
Currency translation differences	–	–	–	7,499	–	7,499
Loss for the year	–	–	–	–	(129,671)	(129,671)
Equity settled share-based transactions	–	860	–	–	–	860
Balance at 31 December 2006	176,893	6,829	15,045	15,892	154,959	369,618

16 RESERVES (Continued)

	Company			
	Share premium HK$'000	Capital reserve HK$'000	Retained profits HK$'000	Total HK$'000
Balance at 1 January 2005	175,813	4,054	246,852	426,719
Profit for the year	–	–	3,670	3,670
Shares issued under share option scheme	1,080	–	–	1,080
Equity settled share-based transactions	–	1,915	–	1,915
Dividend relating to 2004	–	–	(40,111)	(40,111)
Balance at 31 December 2005	176,893	5,969	210,411	393,273
Balance at 1 January 2006	176,893	5,969	210,411	393,273
Loss for the year	–	–	(103,092)	(103,092)
Equity settled share-based transactions	–	860	–	860
Balance at 31 December 2006	176,893	6,829	107,319	291,041

(i) Share premium

The application of the share premium account is governed by Sections 48B of the Hong Kong Companies Ordinance.

(ii) Capital reserve

The capital reserve comprises the fair value of the actual or estimated number of unexercised share options granted to directors and employees of the Group recognised in accordance with the accounting policy adopted for share-based compensation in Note 2.16(b).

(iii) General reserve fund

According to the PRC laws applicable to wholly-owned foreign investment enterprises, the PRC subsidiaries of the Company are required to set up a general reserve fund and appropriate at least 10% of their annual net profits after taxation, as determined under PRC accounting regulations, to the general reserve fund until the balance of the fund equals to 50% of the respective enterprise's registered capital. This fund can be used to make good losses and to convert into paid-up capital.

(iv) Exchange reserve

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The reserve is dealt with in accordance with the accounting policies set out in Note 2.4.

17 TRADE AND OTHER PAYABLES

	Group		Company	
	2006	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'000
Trade payables and accrued charges	153,011	98,421	24,729	26,021
Amount due to ultimate holding company	36	–	–	–
Amounts due to fellow subsidiaries	4,425	4,389	–	–
Amounts due to associates	43	5,910	–	5,910
Amounts due to subsidiaries	–	–	102,580	56,891
	157,515	108,720	127,309	88,822

Amounts due to ultimate holding company, fellow subsidiaries, subsidiaries and associates are unsecured, interest-free and repayable on demand.

The fair values of trade and other payables approximate their carrying values.

At 31 December 2006 and 2005, the ageing analysis of the trade payables was as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Within 1 month	51,357	39,589
After 1 month but within 3 months	23,897	7,870
After 3 months but within 6 months	5,641	1,311
After 6 months but within 1 year	2,988	911
Over 1 year	1,164	1,260
	85,047	50,941

18 BORROWINGS

	Group		Company	
	2006	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'000
Non-current				
– Bank borrowings, secured	4,800	–	4,800	–
– Loan from a third party	3,884	–	–	–
	8,684	–	4,800	–
Current				
– Bank overdrafts	7,961	7,155	–	–
– Bank borrowings, secured	78,636	42,284	18,525	7,753
– Bank borrowings, unsecured	25,800	56,129	25,800	50,600
	112,397	105,568	44,325	58,353
	121,081	105,568	49,125	58,353

At 31 December 2006, the borrowings were repayable as follows:

	Group		Company	
	2006	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'000
Within 1 year	112,397	105,568	44,325	58,353
Between 1 and 2 years	8,684	–	4,800	–
	121,081	105,568	49,125	58,353

18 BORROWINGS (Continued)

The effective interest rates at the balance sheet date were as follows:

	2006	2005
Bank overdrafts	7.50%	7.50%
Bank borrowings	5.75%	5.04%
Loan from a third party	7.83%	–

The fair values of borrowings approximate their carrying values.

The carrying amounts of the borrowings are denominated in the following currencies:

	Group		Company	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Hong Kong dollar	29,684	96,475	25,800	58,353
United States dollar	47,436	–	23,325	–
Renminbi	36,000	–	–	–
Korean Won	7,961	9,093	–	–
	121,081	105,568	49,125	58,353

19 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		Company	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Deferred tax asset to be recovered after more than 12 months	(3,180)	(7,460)	–	–
Deferred tax liabilities to be settled after more than 12 months	322	741	322	741
	(2,858)	(6,719)	322	741

The gross movement on the deferred income tax account is as follows:

	Group		Company	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Balance at 1 January	(6,719)	(4,196)	741	858
Exchange differences	(76)	(38)	–	–
Recognised in the income statement	3,937	(2,485)	(419)	(117)
Balance at 31 December	(2,858)	(6,719)	322	741

19 DEFERRED INCOME TAX (Continued)

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

	Group				
	Accelerated tax depreciation HK$'000	Tax losses HK$'000	Defined benefit liability HK$'000	Others HK$'000	Total HK$'000
At 1 January 2005	641	(3,936)	(673)	(228)	(4,196)
Exchange differences	(5)	(11)	(13)	(9)	(38)
Recognised in the income statement	301	(1,251)	(96)	(1,439)	(2,485)
At 31 December 2005	937	(5,198)	(782)	(1,676)	(6,719)
At 1 January 2006	937	(5,198)	(782)	(1,676)	(6,719)
Exchange differences	(10)	(13)	(23)	(30)	(76)
Recognised in the income statement	(191)	4,521	283	(676)	3,937
At 31 December 2006	736	(690)	(522)	(2,382)	(2,858)

	Company			
	Accelerated tax depreciation HK$'000	Tax losses HK$'000	Others HK$'000	Total HK$'000
At 1 January 2005	1,060	–	(202)	858
Recognised in the income statement	(29)	–	(88)	(117)
At 31 December 2005	1,031	–	(290)	741
At 1 January 2006	1,031	–	(290)	741
Recognised in the income statement	(19)	(690)	290	(419)
At 31 December 2006	1,012	(690)	–	322

20 RETIREMENT BENEFIT OBLIGATIONS

The Group participates in a defined benefit retirement plan which covers the Group's Korean employee.

(i) The amounts recognised in the balance sheet are determined as below:

	Group		Company	
	2006 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'000
Present value of the defined benefit obligations	17,903	15,081	6,537	4,816
Fair value of plan assets	(6,608)	(5,907)	–	–
	11,295	9,174	6,537	4,816
Unrecognised actuarial (loss)/gain	(592)	1,624	–	–
Exchange differences	–	22	–	–
	10,703	10,820	6,537	4,816

(ii) Reconciliation of the present value of defined benefit obligations is as follows:

	Group	
	2006 HK$'000	2005 HK$'000
At 1 January	15,081	23,791
Current services cost	3,167	3,662
Interest cost	819	810
Benefits paid	(4,047)	(10,078)
Actuarial losses/(gains)	2,295	(3,616)
Exchange differences	588	512
At 31 December	17,903	15,081

20 RETIREMENT BENEFIT OBLIGATIONS (Continued)

(iii) Reconciliation of the fair value of plan assets is as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
At 1 January	5,907	8,198
Employer contributions	2,048	1,520
Expected return on plan assets	184	311
Benefits paid	(1,778)	(4,171)
Actuarial gains (losses)	17	(135)
Exchange differences	230	184
At 31 December	6,608	5,907

As at 31 December 2006 and 2005, the Group's liability under this plan is covered by deposits with several insurance companies. There is no plan asset invested in the Company's own financial instruments or any property occupied by, or other assets used by, the Group.

(iv) The amounts recognised in the income statement are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Current service cost	3,167	3,662
Interest cost	819	810
Expected return on plan assets	(184)	(311)
Net actuarial gains recognised during the year	(24)	–
	3,778	4,161

20 RETIREMENT BENEFIT OBLIGATIONS (Continued)

(iv) (Continued)

The principal actuarial assumptions used were as follows:

	2006 HK$'000	2005 HK$'000
Discount rate	5.5%	6%
Expected return on plan assets	3.5%	3.5%
Future salary increases	4.0%	2%-4%

21 OTHER LOSSES – NET

	2006 HK$'000	2005 HK$'000
Loss on long-term structured deposit contract	–	3,700
Net gain on sale of property, plant and equipment	(985)	(381)
Other financial assets at fair value through profit or loss (Note 11):		
– fair value losses	616	10,414
Net foreign exchange losses	5,907	5,332
Others	535	864
	6,073	19,929

22 OTHER INCOME

	2006 HK$'000	2005 HK$'000
Bank Interest income	2,842	1,901
Interest income from other financial assets (Note 11)	2,561	4,614
	5,403	6,515
Sundry income	1,464	1,807
	6,867	8,322

23 EXPENSES BY NATURE

	2006 HK$'000	2005 HK$'000
Changes in inventories of finished goods and work in progress	(6,728)	(16,805)
Raw materials and consumables used	640,040	622,872
Water and electricity	17,743	12,647
Freight and transportation	20,169	31,137
Depreciation (Note 7)	26,070	21,495
Amortisation of prepaid operating lease payments (Note 6)	297	163
Operating lease payments	27,363	31,452
Auditors' remuneration	3,000	3,772
Commission charges	10,946	8,650
Provision for inventories	3,459	2,898
(Write back)/provision for trade receivables	(1,526)	2,285
Telephone and communications	6,049	6,382
Postage and courier charges	5,206	4,365
Employee benefit expense (Note 24)	249,206	259,038
Others	98,553	68,853
Total cost of sales, selling, distribution and administrative expenses	1,099,847	1,059,204

24 EMPLOYEE BENEFIT EXPENSE

	2006 HK$'000	2005 HK$'000
Wages and salaries, including other termination benefits HK$976,000 (2005: HK$1,576,000)	240,344	248,167
Share options granted to directors and employees	860	1,915
Pension costs – defined contribution plans	4,224	4,795
Pension costs – defined benefit plan (Note 20)	3,778	4,161
	249,206	259,038

24 EMPLOYEE BENEFIT EXPENSE (Continued)

(a) Directors' and senior management's emoluments

The remuneration of every Director for the year ended 31 December 2006 is set out below:

	Directors' fees HK$'000	Salaries, allowances and benefits in kind HK$'000	Share-based payments HK$'000	Retirement scheme contributions HK$'000	Total HK$'000
Chairman and executive director					
Kyoo Yoon Choi	240	4,359	–	–	4,599
Executive director					
Shin Hee Cha	–	1,536	247	–	1,783
Tae Sub Choi	–	1,081	–	–	1,081
Young M Lee	–	1,580	–	257	1,837
James Wang	–	1,118	–	–	1,118
Independent non-executive directors					
Valiant, Kin Piu Cheung	139	–	–	–	139
Cheong Heon Yi	126	–	–	–	126
Chan Yoo	120	–	–	–	120
	625	9,674	247	257	10,803

24 EMPLOYEE BENEFIT EXPENSE (Continued)

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

The remuneration of every Director for the year ended 31 December 2005 is set out below:

	Directors' fees HK$'000	Salaries, allowances and benefits in kind HK$'000	Share-based payments HK$'000	Retirement scheme contributions HK$'000	2005 total HK$'000
Chairman and executive director					
Kyoo Yoon Choi	180	4,377	–	–	4,557
Executive directors					
Chul Hong Min	–	4,651	–	–	4,651
Tae Sub Choi	–	1,368	124	–	1,492
Young M. Lee	–	1,957	–	257	2,214
James Wong	–	851	–	150	1,001
Independent non-executive directors					
Valiant, Kin Piu Cheung	132	–	–	–	132
Cheong Heon Yi	120	–	–	–	120
Chan Yoo	120	–	–	–	120
	552	13,204	124	407	14,287

Mr. Kyoo Yoon Choi, Mrs. Shin Hee Cha and Mr. Tae Sub Choi together waived their entitlements of retirement benefits amounted to HK$1,763,360 (2005: HK$1,720,100).

24 EMPLOYEE BENEFIT EXPENSE (Continued)

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include three (2005: four) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining two (2005: one) individuals during the year are as follows:

	2006 HK$'000	2005 HK$'000
Basic salaries, housing allowances, share options, other allowances and benefits in kind	2,484	1,159
Bonuses	–	81
Retirement scheme contribution	408	–
	2,892	1,240

The emoluments fell within the following bands:

	2006 No. of employee	2005 No. of employee
Emolument bands (in HK dollar)		
HK$1,000,001 – HK$1,500,000	2	1

25 FINANCE COSTS

	2006 HK$'000	2005 HK$'000
Interest expense:		
Bank borrowings wholly repayable within five years	7,684	3,339

26 INCOME TAX EXPENSE

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profit for the year.

Taxation on PRC and overseas profits has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the PRC and other countries in which the Group operates.

In accordance with the relevant regulations and the Enterprise Income Tax Law applicable in the PRC, the PRC subsidiaries are exempted from Enterprise Income Tax for two years starting from the first profit making year and thereafter subject to Enterprise Income tax at 50% at the standard tax rate for the following three years.

	2006 HK$'000	2005 HK$'000
Current income tax		
– Hong Kong profits tax	1,056	4,106
– PRC and overseas taxation	3,680	1,795
Deferred income tax charge/(credit) (Note 19)	3,937	(2,485)
	8,673	3,416

The tax on the Group's loss before income tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

	2006 HK$'000	2005 HK$'000
Loss before income tax	(122,812)	(33,054)
Tax calculated at domestic tax rates applicable to profits in the respective countries	(22,946)	(1,019)
Income not subject to tax	(3,421)	(3,089)
Expenses not deductible for tax purposes	24,379	6,646
Utilisation of previously unrecognised tax losses	(162)	–
Tax losses for which no deferred income tax asset was recognised	10,844	–
(Over)/under – provision in prior years	(21)	878
Income tax expense	8,673	3,416

The change in weighted average applicable tax rate is caused by a change in the profitability of the Group's subsidiaries in the respective countries.

27 LOSS ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The loss attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of HK$103,092,000 (2005: profit of HK$3,670,000).

28 LOSS PER SHARE

(a) Basic

Basic loss per share is calculated by dividing the loss attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

	2006 HK$'000	2005 HK$'000
Loss attributable to equity holders of the Company	(129,671)	(36,348)
Weighted average number of ordinary shares in issue (thousands)	668,529	668,264
Basic loss per share (HK$ per share)	(0.194)	(0.054)

(b) Diluted

Diluted loss per share for the years ended 31 December 2005 and 2006 is the same as the basic loss per share as the potential ordinary shares outstanding during the years were anti-dilutive.

29 DIVIDENDS

The Board of Directors did not declare or propose any dividends for the years ended 31 December 2005 and 2006.

30 CASH GENERATED FROM/(USED IN) OPERATIONS

	2006 HK$'000	2005 HK$'000
Loss before income tax	(122,811)	(33,054)
Adjustments for:		
– Depreciation (Note 7)	26,070	21,495
– Amortisation of leasehold land and land use rights (Note 6)	297	163
– Disposal of club memberships (Note 8)	431	–
– Amortisation of patents (Note 8)	676	–
– Goodwill on increase in shareholdings in a subsidiary (Note 8)	(40)	–
– Goodwill impairment losses (Note 8)	100,194	–
– Net gain on sale of property, plant and equipment (see below)	(985)	(381)
– Share-based payment	860	1,915
– Fair value losses on other financial assets at fair value through profit or loss (Note 11)	616	11,530
– Loss on long-term structured deposit contract (Note 21)	–	3,700
– Interest income (Note 22)	(5,403)	(6,515)
– Finance costs (Note 25)	7,684	3,339
– Share of loss/(profit) from associates (Note 10)	237	(652)
– Foreign exchange (gains)/losses on operating activities	(2,015)	2,623
Changes in working capital:		
– Inventories	(5,641)	(17,960)
– Trade and other receivables	(28,031)	(4,998)
– Trade and other payables and bills payables	67,188	13,274
Defined benefit obligations	(117)	(2,943)
Cash generated from/(used in) in operations	39,210	(8,464)

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	2006 HK$'000	2005 HK$'000
Net book amount (Note 7)	2,330	271
Net gain on sale of property, plant and equipment (Note 21)	985	381
Proceeds from sale of property, plant and equipment	3,315	652

31 COMMITMENTS

(a) Capital commitments

Capital expenditure at the balance sheet date but not yet incurred is as follows:

	2006 HK$'000	2005 HK$'000
Contracted but not provided for	310	26,313

(b) Operating lease commitments

The Group leases various properties under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2006 HK$'000	2005 HK$'000
No later than 1 year	22,192	21,760
Later than 1 year and no later than 5 years	13,945	23,580
	36,137	45,340

32 RELATED-PARTY TRANSACTIONS

(a) During the year, the Group entered into the following transactions with its related parties:

(i) **Sales of goods and services**

	2006 HK$'000	2005 HK$'000
– ultimate holding company	615	–
– a fellow subsidiary	1,095	794
– an associated company	975	2,618

(ii) **Purchase of goods**

	2006 HK$'000	2005 HK$'000
– ultimate holding company	36	–
– a fellow subsidiary	–	773
– an associated company	4,033	33,108

(iii) **Rental paid/payable to:**

	2006 HK$'000	2005 HK$'000
– ultimate holding company	5,079	7,038

(iv) **Processing fees paid/payable to:**

	2006 HK$'000	2005 HK$'000
– an associated company	–	5,609

Note:

The above transactions were conducted in accordance with the terms of respective contracts.

32 RELATED-PARTY TRANSACTIONS (Continued)

(b) Year-end balances arising from sales/purchases of goods/services

	2006 HK$'000	2005 HK$'000
Receivables from related parties (Note 13):		
– ultimate holding company	13,961	1,254
– fellow subsidiaries	4,014	101
– associates	213	1,506
	18,188	2,861
Payables to related parties (Note 17):		
– ultimate holding company	36	–
– fellow subsidiaries	4,425	4,389
– associates	43	5,910
	4,504	10,299

(c) Key management compensation

	2006 HK$'000	2005 HK$'000
Salaries and other short-term employee benefits	13,669	17,263
Retirement scheme contributions	665	579
Share-based payments	247	124
	14,581	17,966

33 SUBSEQUENT EVENT

Since the financial year ended 31 December 2004, the Group is subject to the financial covenants under its banking facilities. As at 31 December 2006, the Group was not in compliance with one of the covenants in relation to the banking facilities which required that the interest coverage ratio should exceed 5.0:1. Subsequent to the balance sheet date, the Group has obtained the bank's waiver from declaring an event of default with respect to the breach of this covenant for the year ended 31 December 2006. Accordingly, the Group's borrowings under such banking facilities with repayment term over 12 months have been classified as non-current liabilities.

34 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with current year's presentation.