LUNG CHEONG INTERNATIONAL HOLDINGS LIMITED

(Incorporated in the Cayman Islands with limited liability)

Stock Code : 348

2008/09 Interim Report

CORPORATE INFORMATION

Executive Directors
Mr Leung Lun *(Chairman)*
Mr Leung Chung Ming *(Managing Director)*
Mr Zhong Bingquan
Ms Cheng Yun Tai
Mr Wong, Andy Tze On

Independent Non-executive Directors
Mr Wong Lam, O.B.E., J.P.
Mr Ye Tian Liu
Mr Lai Yun Hung

Non-executive Director
Mr Ko, Peter Ping Wah

Company Secretary
Mr Mak, Yee Chuen Vincent

Auditor
Shu Lun Pan Horwath Hong Kong CPA Limited

Audit Committee
Mr Ye Tian Liu *(Chairman)*
Mr Wong Lam, O.B.E., J.P.
Mr Ko, Peter Ping Wah
Mr Lai Yun Hung

Remuneration Committee
Mr Wong Lam, O.B.E., J.P. *(Chairman)*
Mr Leung Lun
Mr Leung Chung Ming
Mr Ye Tian Liu
Mr Lai Yun Hung
Mr Ko, Peter Ping Wah

Nomination Committee
Mr Leung Lun *(Chairman)*
Mr Leung Chung Ming
Mr Wong Lam, O.B.E., J.P.
Mr Ye Tian Liu
Mr Lai Yun Hung
Mr Ko, Peter Ping Wah

Legal Advisers on Hong Kong Law
D. S. Cheung & Co., Solicitors

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Principal Bankers
ABN AMRO Bank N. V.
Bank of China (Hong Kong) Limited
DBS Bank (Hong Kong) Limited
Hang Seng Bank Limited
Standard Chartered Bank (Hong Kong) Limited

Principal Share Registrar and Transfer Office
Bank of Bermuda (Cayman) Limited
P. O. Box 513 G.T.
3rd Floor, British American Tower
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Hong Kong Branch Share Registrar and Transfer Office
Tricor Abacus Limited
26th Floor, Tesbury Centre,
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Listing Information
The Stock Exchange of Hong Kong Limited
Stock Code: 348

The board of directors (the "Directors") of Lung Cheong International Holdings Limited (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (the "Group") for the six months ended 30 September 2008 together with comparative figures for the corresponding period in 2007. These interim consolidated accounts have not been audited but have been reviewed by the Company's Audit Committee.

CONDENSED CONSOLIDATED INCOME STATEMENT

For The Six Months Ended 30 September 2008

		Unaudited Six months ended 30 September	
		2008	2007
	Note	**HK$'000**	HK$'000
Turnover	2	**384,904**	408,168
Cost of sales		**(290,581)**	(296,188)
Gross profit		**94,323**	111,980
Other revenues	2	**763**	6,333
Selling and distribution expenses		**(19,031)**	(20,704)
Administrative expenses		**(64,277)**	(74,095)
Finance costs	3	**(8,374)**	(12,973)
Profit before taxation	4	**3,404**	10,541
Taxation credit/(charge)	5	**73**	(276)
Profit for the period		**3,477**	10,265
Attributable to:			
Equity holders of the Company		**3,477**	10,265
Dividends	6	**–**	–
Earnings per share for the profit attributable to the equity holders of the Company during the period			
– Basic	7	**0.14 cents**	0.43 cents
– Diluted	7	**N/A**	N/A

CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 September 2008

	Note	Unaudited 30 September 2008 HK$'000	Audited 31 March 2008 HK$'000
Non-current assets			
Leasehold land and land use rights		**93,237**	97,356
Property, plant and equipment	8	**447,660**	441,085
Goodwill		**19,240**	19,240
Club memberships		**2,474**	2,474
Deferred tax assets		**2,230**	6,163
		564,841	566,318
Current assets			
Inventories		**263,033**	294,529
Trade and other receivables, deposits and prepayments	9	**211,180**	198,762
Derivative financial instruments	10	**451**	634
Tax recoverable		**1,109**	1,182
Cash and cash equivalents		**36,883**	51,504
		512,656	546,611
Current liabilities			
Trade payable	11	**98,539**	97,286
Other payable and accrued charges		**37,719**	65,538
Derivative financial instruments	10	**1,582**	1,002
Borrowings		**217,748**	200,696
Loans from immediate holding company		**50,000**	50,000
Tax payable		**2,705**	3,983
		408,293	418,505
Net current assets		**104,363**	128,106
Total assets less current liabilities		**669,204**	694,424
Non-current liabilities			
Borrowings		**92,159**	120,000
Provision for long service payment		**1,527**	1,476
Deferred tax liabilities		**6,906**	10,210
		100,592	131,686
Net assets		**568,612**	562,738
EQUITY			
Share capital		**246,480**	246,480
Reserves		**322,132**	316,258
Total equity		**568,612**	562,738

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the Six Months Ended 30 September 2008

	Unaudited Six months ended 30 September 2008 HK$'000	2007 HK$'000
Net cash inflow/(outflow) from operating activities	**9,434**	(60,879)
Net cash inflow/(outflow) from investment activities	**(19,443)**	(10,334)
Net cash inflow/(outflow) from financing activities	**(4,720)**	45,699
Decrease in cash and cash equivalents	**(14,729)**	(25,514)
Cash and cash equivalents at 1 April	**51,504**	42,585
Effect on foreign exchange rate changes	**108**	1,558
Cash and cash equivalents at 30 September	**36,883**	18,629
Bank balances and cash	**36,883**	18,629

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the Six Months Ended 30 September 2008

	Share capital HK$'000	Share premium HK$'000	Exchange fluctuation reserve HK$'000	Capital reserve HK$'000	Share options reserve HK$'000	Buildings revaluation reserve HK$'000	Retained profits HK$'000	Total equity HK$'000
	Unaudited							
At 1 April 2008	246,480	14,211	9,637	28,840	792	21,140	241,638	562,738
Exchange difference arising from translation of accounts of overseas subsidiaries	–	–	2,397	–	–	–	–	2,397
Transfer to retained profits on lapse of share options	–	–	–	–	(547)	–	547	–
Profit for the period	–	–	–	–	–	–	3,477	3,477
At 30 September 2008	246,480	14,211	12,034	28,840	245	21,140	245,662	568,612

	Share capital HK$'000	Share premium HK$'000	Exchange fluctuation reserve HK$'000	Capital reserve HK$'000	Share options reserve HK$'000	Buildings revaluation reserve HK$'000	Retained profits HK$'000	Total equity HK$'000
	Unaudited							
At 1 April 2007	72,560	133,454	(29,521)	28,840	–	21,140	234,785	461,258
Exchange difference arising from translation of accounts of overseas subsidiaries	–	–	1,115	–	–	–	–	1,115
Profit for the period	–	–	–	–	–	–	10,265	10,265
Total income and expenses recognised for the period	–	–	1,115	–	–	–	10,265	11,380
Placement of Shares	9,600	45,083	–	–	–	–	–	54,683
Bonus Shares	164,320	(164,320)	–	–	–	–	–	–
Option issue	–	–	–	–	3,202	–	–	3,202
At 30 September 2007	246,480	14,217	(28,406)	28,840	3,202	21,140	245,050	530,523

NOTES TO THE CONDENSED INTERIM ACCOUNTS

1. Basis of presentation and principal accounting policies

The unaudited consolidated interim financial statements have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and with the applicable disclosure requirement of Appendix 16 of the Rules Governing the Listing of Securities ("Listing Rules") on the Stock Exchange. The accounting policies and basis of preparation adopted in the preparation of the interim financial statements are consistent with those used in the annual financial statements for the year ended 31 March 2008.

The following new amendments and interpretations are mandatory for the first time for the financial year beginning 1 April 2008 but are not currently relevant to the Group.

HKAS 39 & HKFRS 7, Amendments	Reclassification of Financial Assets
HK(IFRIC) – Int 12	Service Concession Arrangements
HK(IFRIC) – Int 14	HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

The Group has not early applied the following new standards or interpretations that have been issued but not yet effective:

		Effective for annual periods beginning on or after
HKAS 1 (Revised)	Presentation of Financial Statements	1 January 2009
HKAS 23 (Revised)	Borrowing Costs	1 January 2009
HKAS 27 (Revised)	Consolidated and Separate Financial Statements	1 July 2009
HKAS 32 & 1, Amendments	Puttable Financial Instruments and Obligations arising on Liquidation	1 January 2009
HKFRS 2 (Amendment)	Share-based Payment – Vesting Conditions and Cancellations	1 January 2009
HKFRS 3 (Revised)	Business Combinations	1 July 2009
HKFRS 8	Operating Segments	1 January 2009
HK(IFRIC) – Int 13	Customer Loyalty Programmes	1 July 2008
HK(IFRIC) – Int 15	Agreements for Construction of Real Estate	1 January 2009
HK(IFRIC) – Int 16	Hedges of a Net Investment in a Foreign Operation	1 October 2008

The Directors are currently assessing the impact of the above new standards, amendments and interpretations but are not yet in position to state whether they would have material impact on the unaudited condensed consolidated interim financial statements.

2. Turnover, revenue and segmental information

The Group is principally engaged in the development, engineering, manufacture and sale of toys and moulds.

Revenues recognised during the periods are as follows:

	Unaudited Six months ended 30 September 2008 HK$'000	2007 HK$'000
Turnover		
Sale of goods	**381,646**	400,425
Mould income	**3,258**	7,743
	384,904	408,168
Other revenues		
Interest income	**108**	1,299
Other	**655**	5,034
	763	6,333
Total revenues	**385,667**	414,501

Primary reporting format – business segments

The Group's turnover and results are substantially derived from the manufacturing of toys. Accordingly, no analysis by business segment is presented.

Secondary reporting format – geographical segments

	Unaudited Six months ended 30 September 2008 HK$'000	2007 HK$'000
Turnover		
United States	**127,588**	172,284
Europe	**57,976**	89,694
Japan	**57,494**	45,653
Hong Kong/China	**84,883**	25,866
Other	**56,963**	74,671
	384,904	408,168

No analysis of contribution to operating profit by geographical segment has been prepared as no contribution to operating profit from any of the above segments is substantially out of line with the normal ratio of profit to turnover.

The turnover derived from Europe represents sales of toys to multiple customers with goods shipped directly to Europe under the instruction of these customers. Deliveries to Hong Kong and China eventually may be destined for US, Europe and Japan markets after consolidation process.

3. Finance costs

	Unaudited Six months ended 30 September 2008 HK$'000	2007 HK$'000
Interest on loans from banks and financial institutions	**7,799**	11,976
Arrangement fees on bank loans	**575**	997
	8,374	12,973

4. Operating profit

Operating profit is stated after charging the following:

	Unaudited Six months ended 30 September 2008 HK$'000	2007 HK$'000
Charging:		
Depreciation of owned fixed assets	20,175	19,490
Amortisation of leasehold land and land use rights	1,200	560

5. Taxation

	Unaudited Six months ended 30 September 2008 HK$'000	2007 HK$'000
Taxation credit/(charge)	73	(276)

Hong Kong profits tax has been provided at the rate of 16.5% (2007: 17.5%) on the estimated assessable profit for the period. Taxation on profits of Mainland China subsidiaries has been calculated on the estimated assessable profit for the period at the rates of taxation as applicable to the local subsidiaries. No provision for taxation of the subsidiary in Indonesia has been made as it has tax losses as at 30 September 2008 and 30 September 2007.

6. Dividends

The Board of Directors does not recommend the payment of interim dividend for the six month ended 30 September 2008 (2007: Nil).

7. Earnings per share

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

	Unaudited Six months ended 30 September 2008 HK$'000	2007 HK$'000
Profit attributable to equity holders of the Company	3,477	10,265
Weighted average number of ordinary shares in issue	2,464,799,997	2,370,373,767
Basic earnings per share (HK cents)	0.14	0.43

No dilutive earnings per share for the six months ended 30 September 2008 and 30 September 2007 has been presented as the share options outstanding during the periods had an anti-dilutive effect on the basic earnings per share for the periods.

8. Property, plant and equipment

	HK$'000
At 1 April 2008	441,085
Additions	27,723
Depreciation	(20,175)
Disposal	(865)
Exchange adjustment	(108)
At 30 September 2008	447,660

9. Trade and other receivables, deposits and prepayments

The carrying amounts of trade and other receivables, deposits and prepayments are as follows:

	Unaudited 30 September 2008 HK$'000	Audited 31 March 2008 HK$'000
Trade receivables	176,556	146,121
Other receivables, deposits and prepayments	34,624	52,641
	211,180	198,762

The ageing analysis of the trade receivables was as follows:

	Unaudited 30 September 2008 HK$'000	Audited 31 March 2008 HK$'000
0 – 90 days	168,312	126,962
91 – 180 days	2,035	6,625
181 – 365 days	1,031	5,724
Over 365 days	5,178	6,810
	176,556	146,121

The Group's sales are on letter of credit or open account terms. Credit terms are reviewed on a regular basis. The normal trade term is between 30 to 90 days but business partners with strong financial background may be offered longer credit terms.

10. Derivative financial instruments

	Unaudited 30 September 2008 HK$'000	Audited 31 March 2008 HK$'000
Assets		
Forward foreign exchange contracts – not qualifying as hedges (note)	451	634
Liabilities		
Forward foreign exchange contracts – not qualifying as hedges (note)	70	–
Interest-rate swaps – not qualifying as hedges	1,512	1,002

Note:

Note 13(b) set out details of commitments under these contracts as at 30 September 2008.

11. Trade payables

The ageing analysis of the trade payables was as follows:

	Unaudited 30 September 2008 HK$'000	Audited 31 March 2008 HK$'000
0 – 90 days	56,207	74,486
91 – 180 days	30,758	16,445
181 – 365 days	9,557	5,918
Over 365 days	2,017	437
	98,539	97,286

12. Contingent liabilities

At 30 September 2008, the Group had no material contingent liabilities.

13. Commitments

(a) Commitments under operating leases

At 30 September 2008, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	Unaudited 30 September 2008 HK$'000	Audited 31 March 2008 HK$'000
Not later than one year	4,516	3,778
Later than one year but not later than five years	7,813	12,979
	12,329	16,757

(b) Commitments under forward foreign currency contracts

As at 30 September 2008, the Group had maximum outstanding forward foreign currency contracts to purchase approximately US$66,300,000 (31 March 2008: approximately US$104,100,000) for approximately HK$517,140,000 (31 March 2008: approximately HK$811,980,000).

14. Banking and other facilities

As at 30 September 2008, the Group had a total banking and other facilities of approximately HK$382,387,000 (31 March 2008: HK$424,420,000), of which the following had been utilized:

(a) a syndication loan of HK$134,694,000 (31 March 2008: HK$150,000,000); and

(b) general banking facilities of approximately HK$210,464,000 (31 March 2008: HK$190,578,000).

Except for the amount of HK$19,221,000 (31 March 2008: HK$4,182,000) which are secured by the Group's plant and machinery, the other general banking facilities are secured by the Group's freehold and leasehold land, land use rights and buildings, and are all supported by a corporate guarantee executed by the Company.

15. Share based payment

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operation. The Scheme, which was adopted by an ordinary resolution of the shareholders on 3 September 2002, constitutes a share option scheme governed by Chapter 17 of the Listing Rules.

Under the Scheme, share options can be exercised at any time during the periods to be determined and notified by the Directors to the grantees at the time of making offers to grant share options to them, provided that such periods shall not exceed the period of ten years from the date of grant. The scheme mandate limit of the Scheme was refreshed pursuant to a shareholders' resolution passed in the annual general meeting ("AGM") of the Company last held on 27 August 2007, details of which have been set out in the circular dated 3 August 2007. No options have been granted since 27 August 2007. Accordingly, as at 30 September 2008, the maximum number of shares available for issued under the Scheme is 82,159,999, representing 10% of the issued ordinary share capital of the Company as at the date of the AGM and approximately 3.33% of the issued ordinary share capital of the Company as at 30 September 2008. The subscription price for the shares under the Scheme shall be a price determined by the Directors at its discretion, provided that it shall not be less than the highest of (i) the closing price of the shares stated in the daily quotation sheets of the Stock Exchange of Hong Kong Limited ("Stock Exchange") on the date of grant; (ii) the average closing price of the shares stated in the Stock Exchange's daily quotation sheets for the five business days immediately preceding the date of grant of share options and (iii) the nominal value of the shares.

The terms and conditions of the grants that existed at 30 September 2008 are as follows, whereby all options are settled by physical delivery of shares:

	Balance as at 1 April 2008	Granted during the period	Forfeited during the period	Balance as at 30 September 2008	Exercise price HK$	Closing price of each share at date of grant HK$	Exercise period
Executive Directors	15,000,000	Nil	15,000,000	Nil	1.33	0.99	24/07/2007 to 23/07/2008
Other employees	600,000	Nil	Nil	600,000	1.00	0.99	24/07/2007 to 23/07/2009
Consultants	600,000	Nil	Nil	600,000	1.00	0.99	24/07/2007 to 23/07/2009
	16,200,000	Nil	15,000,000	1,200,000			

The fair value of services received in return for options granted is measured by reference to the fair value of options granted. The estimate of the fair value of the options granted is measured based on Black Scholes model. The contractual life of the options and expectations of early exercise are incorporated into the model.

Fair value of share options granted at 24 July 2007 and assumptions are as follows:

	Granted at 24 July 2007
Fair value at measurement date	HK$0.037
Share price at the date of grant	HK$0.990
Weighted average exercise price	HK$1.2442
Expected volatility	45%
Weighted average expected life	0.31 year
Expected dividends	0.00%
Risk-free interest rate	3.752%

The fair value of the options granted during the corresponding period of 2007 was approximately HK$3,202,000, all of which was recognised an equity-settled share-based expense during that period.

INTERIM DIVIDEND

The Directors do not recommend the payment of an interim dividend for the six months ended 30 September 2008 (2007: Nil).

RESULTS, BUSINESS REVIEW AND PROSPECTS

Results

For the six months ended 30 September 2008, the Group's turnover decreased by 5.7% to HK$385 million, compared with HK$408 million for the corresponding period of last year. Gross profit margin was maintained at 25% while profit declined 16%. Profit attributable to equity holders of the Group was HK$3 million, representing a year-on-year decrease of 66% (2007: HK$10 million).

During the period under review, the US continued to be the largest customer market of the Group, accounting for approximately 33% of the Group's total turnover (2007: 45%). The other significant customer markets for the Group included Europe and Japan, which accounted for approximately 15% (2007: 18%) and 15% (2007: 13%) respectively.

Business Review

For the six months ended 30 September 2008, the Group's PRC manufacturing plants had to deal with increase in wages, social security contributions and other welfare benefits, common to all producers particularly those located in the Pearl River Delta Region. With the newly Labour Contract Law being implemented, a complementing social security system among workers was compulsory resulting in the amount of contributions to various schemes being increased in line with the wage increases. Furthermore, shortage supply of migrant workers in the Region during the interim period has pushed up the wage levels of these workers as competition among manufacturers led to the need to offer above minimum wage in order to attract new workers or retain existing employees.

Amid sluggishness of US and European markets, the business environment remains competitive and challenging. The tougher testing requirements and slack US economy made customers more conservative in placing orders. The Group continues to strive for profitability under the prolonged appreciation of Renminbi ("RMB"), currency of the PRC, high crude oil price, reduction of the value added tax rebate on goods exported from the PRC and increase in costs of materials. The Group had to bear high production costs and the limited scope of price increases due to economic slowdown in our major markets. However, amid this deteriorating business environment, the Group's overall order position for of the period under review remained stable.

The toy manufacturing industry was particularly hard hit by recent dramatic closures and liquidation of few toy producers in the Guangdong Province. This has further shaken financier's confidence in the toy industry. The tightening of credit facilities from financial institutions has limited the Group's previous policies of providing attractive credit terms to customers. This revised credit policy has led to the Group reducing trade or winding down business with certain customers. This restructuring process resulted in concentration of few major customers, enlarging efforts to develop business with new customers and losing certain business segment where competitors offering attractive prices and payment terms.

Recent turbulence in the toy manufacturing sector has affected the Group's suppliers to grant flexible terms. Suppliers commenced to demand advance payment or reduced credit terms. This further increases pressure on the Group's operations. In return the Group requests customers to revive or shorten existing payment terms in order to match fund flow. The Group's major stakeholder has extended the term of a HK$50 million loan as set out in announcement dated 24 September 2008 to show its support.

The Group's persistence in investing heavily into development of wireless and robotic innovations contributed to preserving margins. Production of the world's famous hobby grade radio control transmitters have been fully relocated to the Group's Changping factory. The Group's dedicated efforts toward the radio control (R/C) toy business segment, an area that has seen steady advances as reflected by its move from producing innovative aerodynamic planes, wing flapping flying insecticides, sensor based flying machine to probably the world's smallest helicopter. Overall, the Group's R/C toy business accounted for 75% of total sales during the review period, showing clear leadership and strength in this segment.

Due to the deteriorating manufacturing environment in the PRC in the first half of financial year 2008/09, the relocation of more production capacity to the Group's South East Asian plant in Indonesia was necessary. By so doing, the Group has alleviated part of the cost pressure stemming from the enforceable of new labour law in China which took effect during the review period. The Serang factory in Indonesia, at peak production stage during the period under review, was employing over a thousand workers, including seasonal contract labour. The PRC factories, employed fewer workers compared to the same period of previous years.

The Indonesian factory continued to provide plentiful labor and favourable exchange rate for the Group. However, the recent turmoil in the Southern China toy factories had provided customers with motivation to alternative sourcing. The Group's acquisition of the remaining 40% interests in our Indonesian subsidiary, PT. Lung Cheong Brothers Industrial set out in announcement dated 25 September 2008 should strengthen the Group's production ability and capacity during these uncertain times. One of our major customers strongly supported the move by transferring production of a long running product line down to Indonesia.

The Group's consolidation of its PRC facilities was almost completed in the first half of this financial year. The planned investment to enhance production facilities was also in place. These new equipment ought to ensure better efficiencies in producing innovative and quality products, in order to secure orders from reputable and financially able customers for the remaining financial period and going forward.

Prospects

Globally, the toy industry is being expected to confront a difficult year ahead as the world economy cools and demand for luxurious items like toys may decline. The Group's management believes that toys would not be as negatively affected as traditional gifts for birthdays, parties, achievements and festive seasons. It will stay in place in the Group's major export markets but will probably be at lower price level compared to those in the past years. However, economic slowdown of the US and Europe continues to limit the scope of price increases that manufacturers have to absorb part of the increasing costs.

To reduce reliance on any particular geographical regions, the Group takes forward business development plans to expand into new markets and the businesses in certain areas of Europe. Specifically, the new distributors will market all Kid Galaxy brands in Europe and the sale of educational robotic products will continue to grow in Mainland China.

However, being the category market leader which has sizable production capacity and capable of delivering quality products, the Group looks forward to growing power on price determination of our products in this consolidating environment. The Group will have to consolidate its customer base by putting its focus of resources, risks and survival management on two categories of customers: core customers which provide steadfast support during this uncertain period and strategic customers which provide outlets for the continued investment into innovative product development.

The Group has plan to reallocate resources and scale down production proportionately in the fourth quarter of this year as measures to control operating costs. The Group will endeavor to trim overhead, improve productivity and control production costs as the toy industry rides out the storm. In order to improve the overall toy manufacturing production efficiency, the Group has to review the viability of the Group's former main production plant in Zhouwu. Since most production is now consolidated in the new Changping factory, the Group's management continue to monitor the requirement of the leased Zhouwu factory as certain segments of the production such as metal component production, plastic injection and decoration are located within this facility. Decisions and arrangements will be fixed in line with the orders received in the coming toy fairs in first quarter of 2009. Reduced scale of the production will result in savings in transportation and administrative costs, but will have disadvantage the Group's overall capacity during forthcoming peak season. The Group's management will enhance the facility utilization and production efficiency of the two plants in the PRC. The Group will continue to restructure production process with the goal to lower manufacturing costs.

The Group's alternate production base in Indonesia enjoys the lower labour cost in addition to the current currency weakness. The soon to be wholly owned factory's prospects shall crystallize after toy fairs in early 2009 to see whether sufficient orders to keep Indonesian facilities fully occupied going forward. Apart from wholly own application in process, the Group would restructure the ownership of the Indonesian subsidiary under a wholly own subsidiary, being Lung Cheong Asia Holdings Ltd. The Group's management expects to complete this restructuring process before financial year end 2008/09. Management will continue to review its operations but these factors or events may affect the Group in the next reporting period or thereon:

Vulnerability to fluctuations in raw material prices

The main raw materials involved in our production of electronic plastic toys are electronic components, metal parts, packaging and various plastic resins. Fluctuations in the prices of these raw materials have a significant impact on our cost of sales and accordingly our profit margins and our profitability. As the plastic resins used in our production of toys are petroleum by-products, we are also vulnerable to fluctuations in petroleum prices as these will impact the prices of plastic resins. We may not be able to pass on any future raw material cost increase to our customers in order to maintain our profit margin. In the event that we are not able pass on any material increases of our raw materials to our customers, the results of our operations are expected to be adversely affected.

RMB revaluation

Since July 2005, the PRC government has allowed RMB to float against other currencies. Since our revenue is generally denominated in U.S. dollars and a substantial portion of our costs are in RMB, an upward appreciation of the RMB against the U.S. dollar will mean an increase in our manufacturing costs in Hong Kong dollars currency terms, since the Hong Kong dollar is pegged to the U.S. dollar. Such increases will have a negative impact on our operating margins if we may not recover from our customers.

PRC labour cost

Increase in the minimum basic hourly labour rate to factory workers was directed by the local PRC government. These actions increased our manufacturing costs. Many of our processes are highly labour intensive and are performed by workers receiving minimum wages. These increases also have a negative impact on our operating margins, except to the extent we are able to pass on the cost increases to our customers. The local PRC government may direct further increases in the minimum basic wages in the future. If this happens, there will be a further increase in our manufacturing costs and a negative impact on our operating margins and financial condition unless we are able to fully pass on the cost increases to our customers.

Increasing manufacturing costs

The continued increase in the manufacturing cost of our products is likely to have an adverse impact on demand for our products. This is particularly so in the case of customers in view of current economic climate who tend to be more sensitive to price increases. We seek to mitigate any cost increases by passing, as far as possible, such cost increases to our customers in the form of higher quotations on current and future orders. To the extent that we are not successful in passing these cost increases to our customers or lose orders from customers because they are unwilling to accept increased pricing, our profitability and cash flow will decline. This will deter the Group's continued and future investment in research and development as well as tooling for new products, the useful lives of current ODM and OBM products.

Availability of PRC labour

Our operations are labour-intensive. With the increasing development and affluence in the northern inland regions of the PRC, it has become harder to attract workers to relocate to southern China where our major manufacturing facilities are located. In the event that we are not able to employ sufficient suitable workers or that we have to significantly increase our pay scale to attract such workers, our production, revenues and profitability could be materially and adversely affected.

Inability to meet schedules

We have to adhere to our customers' delivery schedules. In particular, our customers may require the delivery of our finished products by a certain deadline to coincide with the launch of their corporate marketing or promotional programs. Should there be a delay in meeting such delivery schedules, our customers' business may be adversely affected and they may institute claims against us for their losses, in particular under such uncertain market condition.

Delays in production and shipment will also delay our recognition of revenue. Furthermore, we may need to subcontract some of our production in order to meet the time schedules, thereby reducing our profit margins. Therefore, any inability on our part to meet our customers' stipulated time schedules caused by, amongst other things, product development delays, labour shortage, transportation failure, diversion of shipping routes and dock strikes, could negatively impact our reputation, revenue and profits.

Dependence on a few major customers and certain product segment

Our business is concentrated among a limited number of customers for financial year of 2007 and first half of 2008, approximately 60% and 64% of our total revenue, respectively, was derived from five major customers. Despite our ongoing efforts to expand our customer base, we expect that substantial part of our sales will continue to be made to these major customers and those specializing in the R/C segment. If we lose any one of our major customers or if they reduce, suspend, delay or cancel their orders to us in a material way, our business, financial condition, results of operations and prospects could be materially and adversely affected.

The current economy climate has created uncertainties which is never experienced by the Group before. Although the Group has been designated the preferred supplier by certain major toy companies, management is unable to ascertain if forecast orders will be delivered as planned due to the weaknesses of both US and European markets. One comforting factor is that the Group deals with market leaders in these markets or categories which are expected to maintain performance or repeat previous successes.

Credit risks of our principal customers

Our working capital position, financial condition and results of operations depend heavily on the creditworthiness of our major customers. If one or more of these customers were unable to pay us the amounts owing, our business, financial condition and results of operations could be materially and adversely affected.

Low entry barriers

We face significant competition mainly from other independent manufactures of electronic and/or plastic products, and to a certain extent, toy companies, with manufacturing facilities located primarily in the PRC. There are no significant barriers to entering the toy manufacturing business and we may encounter increased competition from other industry participants. Some of our existing and potential competitors have greater financial, technical, manufacturing and marketing resources than we do. There can be of no assurance that we will be able to continue to compete effectively. If we are not able to remain competitive, our business, results of operations and prospects could be materially and adversely affected.

Infringement of third party intellectual property rights

We manufacture toys for which our customers and certain subsidiaries of the Group are responsible for obtaining the appropriate third party intellectual property licenses to manufacture and market. In the event that our customers or subsidiaries failing to obtain or maintain such licenses, the third party owners of the relevant intellectual property rights may institute legal actions against both our customers and us. If we fail to successfully defend any such legal action, we may be liable to pay substantial damages and incur significant costs, thereby adversely affecting our results of operations and financial condition.

Compliance with environmental regulations

We use a variety of paints and oils in the manufacture and detailing of our toys. We have established procedures for the proper storage, use and disposal of such materials. To our knowledge, we have complied with all environmental regulations applicable to our business. The failure to comply with such regulations or to pass annual inspections by the relevant authorities at our facilities, however, could result in a fine or suspension of our operations which will materially adversely affect our business, results of operations and financial condition.

Maintaining to compliances with regulations

Our Group operates its production factories in Dongguan, PRC and Serang, Indonesia, thus subjecting these facilities to the constantly revised laws and regulations of the local and international authorities. Previous year's hazardous toys incidents have caused US and European Unions to rewrite import rules and test on toys such as RoHS ("Restriction of the use of certain Hazardous Substances in Electrical and Electronic Equipment"), REACH ("Registration, Evaluation, Authorization of chemical"), CPSIA ("Consumer Production Safety Improvement Act") and TSCP ("Toy Safety Certification Program"). These sudden implementation of new regulations could impact hard to the Group's materials in stock or orders on hand. These rules and regulations relating to labour, safety, hostel and production requirements, led to our Group having to incur costs and expenses constantly to upgrade facilities which may have an adverse effect on our short-term results of operations. Authorities may cause the Group's products to be recalled due to revised safety procedures, including enhanced testing procedures and requirements may result in additional costs which may negatively impact profitability. Failure to comply could result in suspension of operations which will materially affect our business.

Indonesia country risk

The Group's soon to be wholly owned Indonesia factory is currently enjoying favorable advantages over PRC and other Asian countries due to political stability, plentiful labour and the lower local currencies, the Rupiah. However, the continuance of this positive environment will depend largely on the continued stability and the outcome of the country's election to be held sometime in 2009. Recurring instability would discourage customers to place orders to Indonesia resulting in facilities under utilized, thereby adversely affecting the Group's overall result.

Fluctuating values of long term assets

During the period under review, the Group disposed of a certain Hong Kong property and gained from the sale. However, later in the year, disposal of a couple of China based properties resulted in losses on both sales. The Group plans to review and appraise the values of all properties at financial year end to ascertain the market value of all leasehold assets. In view of prolonged effect of the current financial crisis, management does not expect leasehold properties to fairly reflect its true values and could have an adverse impact on the overall assets value of the Group.

Looking ahead, operational conditions are challenging but manufacturing costs can be maintained in stable situation. The world's economies have been hard hit by the fallout of the financial crises resulting in unprecedented credit crunch. The Group would still be facing adverse factors, such as the fluctuation of the RMB and increased costs in administering testing of toys to enhance products safety. Hopefully the drop in crude oil price would continue in the second half year, so that raw material costs would be reduced accordingly. Seeing signs of certain macroeconomic factors improving, such as slower appreciation of the RMB and certain material prices declining, the Group remains cautiously optimistic about the market environment in the second half of financial year 2008/09.

GROUP RESOURCES AND LIQUIDITY

As at 30 September 2008, the Group's cash and bank balances were approximately HK$37 million (31 March 2008: approximately HK$52 million). The Group's total borrowings were HK$360 million (31 March 2008: HK$371 million). The gearing ratio, calculated as the total borrowings less cash and bank balances and divided by shareholders' equity, was approximately 57% (31 March 2008: approximately 57%). As at 30 September 2008, the Group recorded total current assets of approximately HK$513 million (31 March 2008: approximately HK$547 million) and total current liabilities of approximately HK$408 million (31 March 2008: approximately HK$419 million). The current ratio of the Group, calculated by dividing the total current assets by total current liabilities, was approximately 1.26 (31 March 2008: approximately 1.31). The Group recorded an increase in shareholders' funds from approximately HK$563 million as at 31 March 2008 to approximately HK$569 million as at 30 September 2008. The increase was mainly derived from the profit after tax. The Group's continue operations is relied upon the support from the financial institutions. Facilities are provided on the basis of which certain financial and operational undertakings are complied with. In the opinion of the Board, the Group has sufficient financial resources to meet the future operational needs.

EMPLOYEES

As at 30 September 2008, the Group had approximately 6,350 employees. Approximately 60, 6,079, 200 and 11 employees were based in Hong Kong, Dongguan factories, Indonesia factory and the U.S. office respectively. The number of workers employed by the Group varies from time to time depending on production needs and the workers are remunerated based on industry practice.

SUBSTANTIAL SHAREHOLDERS

At 30 September 2008, the following persons, other than a Director or chief executive of the Company, had an interest in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the Securities and Futures Ordinance (Chapter 571 of Laws of Hong Kong) ("SFO")):

Name of shareholder	**Number of ordinary shares** (Note 1)	**Capacity**	**Approximate percentage of interest**
Lung Cheong Investment Limited	1,499,082,240 (L)	Beneficial owner	60.82%
Rare Diamond Limited	1,499,082,240 (L) (Note 2)	Interest of controlled corporation	60.82%

Notes:

1. The letter "L" represents the entity's interests in the shares of the relevant company.

2. These shares were registered in the name of Lung Cheong Investment Limited, the entire issued share capital of which was owned by Rare Diamond Limited. Rare Diamond Limited is beneficially owned as to 70% by Mr Leung Lun and 30% by Mr Leung Chung Ming.

Save as disclosed above, no other person, other than a Director or chief executive of the Company, had any interest in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO.

DIRECTORS' INTERESTS IN EQUITY SECURITIES

At 30 September 2008, the interests and short positions of each Director and chief executive of the Company in the shares, underlying shares or debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") were as follows:

Name	Name of company	Capacity	Number and class of shares or underlying shares (Note 1)	Percentage of approximate the issued share capital as at 30 September 2008
Leung Lun	The Company	Interest of controlled corporation	1,499,082,240 ordinary shares (L) (Note 2)	60.82%
	Lung Cheong Investment Limited	Interest of controlled corporation	1,000 ordinary shares (L)	100.00%
	Rare Diamond Limited	Beneficial interest	70 ordinary shares (L)	70.00%
Leung Chung Ming	The Company	Interest of controlled corporation	1,499,082,240 ordinary shares (L) (Note 2)	60.82%
	Lung Cheong Investment Limited	Interest of controlled corporation	1,000 ordinary shares (L)	100.00%
	Rare Diamond Limited	Beneficial interest	30 ordinary shares (L)	30.00%

Notes:

1. The letter "L" represents the Director's interests in the shares and underlying shares of the relevant company.

2. These shares were held by Lung Cheong Investment Limited, a company wholly owned by Rare Diamond Limited. Rare Diamond Limited is beneficially owned as to 70% by Mr Leung Lun and 30% by Mr Leung Chung Ming.

Save as disclosed above, none of the Director or the chief executive of the Company had any interests and short positions in the shares or underlying shares of the Company and its associated corporations (within the meaning of Part XV of the SFO as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

Apart from the Scheme, at no time during the period was the Company, its holding companies or its subsidiaries a party to any arrangements to enable the Directors, chief executives of the Company and their associates to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Pursuant to the term facilities agreement entered into by the Company and a group of financial institutions on 21 August 2007 amounting to HK$200 million, Mr Leung Lun and Mr Leung Chung Ming are required to jointly hold at least 45% of the issued share capital of the Company and Mr Leung Lun and Mr Leung Chung Ming are individually required to own at least 10% of the issued share capital of the Company.

CONNECTED TRANSACTIONS

At 30 September 2008, a wholly-owned subsidiary of the Company, Lung Cheong Toys Limited ("LC Toys"), had long-term loans and deferred trading balances amounted in aggregate to HK$60,648,000, plus accrued interest, due by PT. Lung Cheong Brothers Industrial ("PTLC"), a 60% owned subsidiary of LC Toys. The balance of the 40% interest in PTLC is owned by independent third parties who are not connected with the Directors, chief executives or substantial shareholders of the Company and its subsidiaries, other than PTLC, or any of their respective associates. The long-term loans were advanced to finance the set up of the production facilities of PTLC. The amounts are unsecured, bearing interest at 3-month HIBOR per annum (2007: 3-month HIBOR per annum) and have no fixed repayment terms. LC Toys considers the uncertainties on the repayment of the advances and makes the full provision for the whole balance.

The Directors, including the Non-executive Directors, are of the opinion that the above transactions were entered into:

(1) in the ordinary and usual course of business of the Group;

(2) on normal commercial terms; and

(3) in accordance with the relevant agreement governing the transaction on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

(4) Upon completion of the acquisition of remaining 40% interest in PTLC, loans and deferred balances may be converted into equity thus interest payment thereon will be waived.

DIRECTORS' INTERESTS IN CONTRACTS

Extension of Maturity Date for repayment of Loan granted to the Company by LC Investment under the Loan Agreement

Reference is made to the Loan Announcement dated 10 March 2008. The Directors announce that, on 24 September 2008, the Company and LC Investment entered into the Extension Agreement pursuant to which LC Investment agreed to extend the maturity date for repayment of the Loan and all amounts outstanding under the Loan Agreement for further six months from the original repayment date to 6 March 2009. Save for the extension of the maturity date under the Loan Agreement, all other terms of the Loan Agreement remain unchanged and shall continue in full force and effect. Details of the Extension was set out in the announcement of the Company dated 24 September 2008.

Security provided by Fericle Under the Second Collateral Insurance Assignments

As set out in the Facility Announcement dated 21 August 2007 and pursuant to the Facility Agreement, the Facility is secured by the Security Documents and once the outstanding amount of the loan made under the Facility or the principal amount outstanding for the time being of that loan is below HK$120 million, all Securities Documents, including, among others, the Second Collateral Insurance Assignments, shall be released.

Pursuant to the Second Collateral Insurance Assignments, Fericle agrees to assign to the security trustee under the Facility Agreement (for the benefits of the lenders) all its right, title, interests and benefit under the Insurance Policies as a continuing security for all liabilities of the Company and the Guarantors under the Facility, subject to the existing collateral assignments.

In consideration of Fericle's entry into the Second Collateral Insurance Assignments, the Company had agreed to pay all expenses in connection with or incidental to the Second Collateral Insurance Assignments, including the payment of the insurance premium or interest under the Insurance Policies for a term of up to one year from the date of the Facility Agreement.

As at the date hereof, the outstanding loan under the Facility Agreement has not yet been reduced to less than HK$120 million and the Securities Documents, including the Second Collateral Insurance Assignments, have not yet been released.

Fericle is principally engaged in, among other things, holding of the Insurance Policies and is beneficially owned as to 70% by Mr Leung Lun and 30% by Mr Leung Chung Ming. Details of the Security Provision was set out in the announcement of the Company dated 24 September 2008.

SUBSEQUENT EVENT

Connected and share transaction in relation to the acquisition of the remaining 40% interest in PT. Lung Cheong Brothers Industrial

On 24 September 2008, Lung Cheong Asia Holdings Limited ("LC Asia"), a wholly-owned subsidiary of the Company, entered into the agreement with Mr Jimmy Sumitro, Mr Ng Soegiarto Hanafi, Mr Goenarto Waluyo Ng, Mr Norman Purnomo Ng and Mr Amin Widdhiarta Ng (collectively the "Vendors") pursuant to which LC Asia agreed to purchase and the Vendors agreed to sell approximately 40% of the entire issued share capital of PT. Lung Cheong Brothers Industrial ("PTLC") at a consideration of HK$3,900,000, which shall be satisfied by the issue and allotment of an aggregate 26,000,000 shares of the Company to the Vendors. Immediately prior to the entering into the agreement, the Company owned approximately 60% indirect interest in PTLC through Lung Cheong Toys Limited whereas the Vendors in aggregate held approximately 40% interest in PTLC. Upon completion, PTLC will become an indirect wholly-owned subsidiary of the Company. Mr Jimmy Sumitro, being one of the Vendors, is a director of PTLC and the other four Vendors are brothers of Mr Jimmy Sumitro, thereby rendering the transaction a connected and share transaction for the Company under the Listing Rules. For details of the transaction, please refer to the Company's announcement dated 25 September 2008.

Connected transactions in relation to the disposal of the China Properties

On 29 September 2008, Dongguan Lung Cheong Toys Co., Ltd. ("Dongguan LC"), a wholly-owned subsidiary of the Company, entered into the agreements with 東莞市科昌房地產開發有限公司 ("東莞市科昌") pursuant to which the Dongguan LC agreed to dispose of and 東莞市科昌 agreed to purchase certain land properties in the PRC at an aggregate consideration of RMB4 million. 東莞市科昌 is a company beneficially owned by Mr Leung Lun, being the chairman, and executive Director and one of the beneficial owners of the controlling shareholder of the Company, and thereby the transactions constitute connected transactions of the Company under the Listing Rules. For details of the transactions, please refer to the Company's announcement dated 10 October 2008.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities throughout the accounting period covered by the interim report.

DIRECTOR'S INTEREST IN COMPETING BUSINESS

As at 30 September 2008, the Directors were not aware of any business or interest of each Director, management shareholder and their respective associate, that competes or may compete with the business of the Group and any other conflict of interest which any such person have or may have with the Group.

CODE ON CORPORATE GOVERNANCE PRACTICES

In the opinion of the Directors, the Company has complied with the code provisions as set out in Appendix 14 of the Listing Rules throughout the accounting period covered by the interim report.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than the required standard set out in Appendix 10 of the Listing Rules (the "Model Code"). The Company has made specific enquiry of its Directors. All Directors confirmed that they have complied with the required standard set out in the Model Code and the code of conduct regarding securities transactions by directors adopted by the Company throughout the accounting period covered by the interim report.

AUDIT COMMITTEE

The Company has an audit committee in compliance with Rule 3.21 of the Listing Rules for the purpose of reviewing and providing supervision over the Group's financial reporting process including a review of the unaudited condensed interim financial statements for the six months ended 30 September 2008, this interim report and the Group's internal controls.

PUBLICATION OF RESULTS ANNOUNCEMENT

The results announcement is published on the website of Hong Kong Exchanges and Clearing Limited at www.hkex.com.hk under "Latest Listed Companies Information" and the website of the Company at www.e-lci.com under "Investor Relations".

On behalf of the Board of
Lung Cheong International Holdings Limited

Leung Lun
Chairman

12 December 2008