I am pleased to present my review of the results and operations of the Herald Group (the "group") for the year ended 31 March 2006.

## RESULTS

The group achieved favourable results in the financial year under review amid a very challenging operating environment. The turnover of the group for the year ended 31 March 2006 was HK$1,326 million which was HK$117 million or 8% below the turnover of HK$1,443 million in the previous year. During the year under review, the Timepiece Division experienced a very sharp decrease in turnover while the businesses of the other divisions were relatively stable. The net profit attributable to the equity shareholders of the company in the year under review was HK$86.3 million, 10% down from the net profit of HK$96.1 million in the previous year. This year's net profit included a write-back of HK$9.3 million relating to impairment losses on property, plant and equipment which were charged to the profits in previous financial years. Excluding this write-back, the net profit of the group was HK$77 million, representing a decrease of 20% compared to the year-ago net profit.

## REVIEW OF OPERATIONS

### *Toy and Gift Division*

During the year under review, the Toy and Gift Division performed well amid very difficult market conditions. The division was able to maintain a relatively satisfactory result mainly due to the robust sales of the toys related to the "Star Wars" brands, particularly in the first half of the year. The turnover of the division increased modestly by 0.3% to HK$647 million from the turnover of HK$645 million a year earlier, while its operating profit increased by HK$1.2 million or 4.3% from HK$27.7 million to HK$28.9 million. The increase in operating profit was virtually due to provisions for impairment losses for bad and doubtful debts of HK$2.1 million and impairment losses of property, plant and equipment of HK$3.5 million written back to profit or loss in the reporting fiscal year. Excluding these write-backs, the division's operating profit decreased by HK$4.4 million. Like most of the toy factories in Guangdong, the division experienced very tough operating conditions. Firstly, the price pressure resulting from intense competition among toy factories has continued to erode the profit margins in the toy industry. Furthermore, labour shortages have become a much more serious problem for factories in the Pearl River Delta region. In March 2005, the minimum wage rate in the Dongguan area increased by as much as 27.6%. As labour is an important cost factor for the division, the steep wage increase had a negative impact on the results of the division.

### *Computer Head Division*

The Computer Head Division also performed well in the fiscal year 2006. Compared to last year, the division's turnover increased moderately by 2% from HK$155 million to HK$158 million, while the operating profit increased by 56% from HK$16.3 million to HK$25.5 million. During the year under review, the division achieved better production efficiency due to higher volumes, resulting in improved product yields and substantially lower reject rates. In 2005, the division completed the development of computer tape heads for the Linear Tape-Open Generation 4 tape drives. With an uncompressed capacity of 800 gigabytes, these heads are now the most advanced products in the market for computer data tape storage. The division has started delivery of these heads in April 2006. The division has always been concerned with environmental protection. In January 2006 the division acquired certification of ISO14001 relating to its environmental management system reflecting the division's strong commitment to environmentally friendly policies and procedures.

***Houseware Division***

The sales of the Houseware Division edged downwards by 1% to HK$240 million from last year. The operating profit of HK$12.4 million for the year was relatively flat compared to the operating profit in the earlier fiscal year. In the year ended 31 March 2005, the division had a product claim for which the division made a provision of HK$8.6 million. The claim was settled in the year under review and an excess provision of HK$1.5 million was written back as profit in fiscal 2006. Excluding the impact of this provision/write back, the operating profit for this year decreased by HK$10.1 million on a year-on-year comparison. The increases of prices of aluminum and stainless steel were the major factors that attributed to the decrease.

***Timepiece Division***

As mentioned in the interim report, the sales of the Timepiece Division were dampened by the general weakness of the retail sales in the UK and the closures of business of some of the division's customers. Furthermore, the business from a TV and internet retail group, which rapidly increased the sales of the division in the previous year, receded significantly. For the year ended 31 March 2006, the sales of the division decreased by 33% or HK$121 million to HK$249 million from HK$370 million in the prior year. Mainly due to lower turnover, the operating profit for the year under review declined to HK$21.4 million, representing merely 42% of last year's profit.

## FINANCIAL POSITION

The group has maintained its sound financial position. At the end of the financial year, the group had a strong balance sheet with a healthy liquidity position. As at 31 March 2006, the group had total assets of HK$763 million (2005: HK$759 million) which were financed by current liabilities of HK$124 million (2005: HK$166 million), non-current liabilities of HK$4 million (2005: HK$4 million), minority interests of HK$33 million (2005: HK$28 million) and equity attributable to equity shareholders of HK$602 million (2005: HK$561 million).

At 31 March 2006, the group's cash balances aggregated to HK$239 million representing an increase of HK$15 million over the HK$224 million in last year's balance sheet. The group's current assets position as at 31 March 2006 was HK$574 million compared to HK$567 million as at 31 March 2005. The inventories decreased to HK$140 million from HK$168 million and the trade and other receivables decreased to HK$132 million from HK$174 million. The decreases were mainly due to the decline of the group's sales activities. During the year, the group acquired certain listed equity securities and unlisted equity linked notes which are held for trading. Together with other equity securities acquired in previous years and reclassified as trading securities during the year, the group's trading securities as at 31 March 2006 amounted to HK$60 million (2005: HK$Nil).

The group's current liabilities decreased from HK$166 million to HK$124 million primarily due to decrease in trade and other payables.

Like last year, the group had no bank borrowings at 31 March 2006. Furthermore, the group has no long-term borrowings. Trading securities of HK$37 million (2005: HK$Nil) are pledged to a bank to secure the banking facilities granted to a subsidiary of the company. As at 31 March 2006, the working capital ratio, an indicator of a company's liquidity represented by a ratio between the current assets over the current liabilities, was 4.64 compared to 3.41 last year. The quick ratio, another ratio that gauges the short-term liquidity of a company measured by trade debtors and cash at bank and in hand over the current liabilities, slightly increases to 2.76 from 2.21.

## CONTINGENT LIABILITIES

As at 31 March 2006 the group did not have any significant contingent liabilities.

## FOREIGN EXCHANGE EXPOSURE

During the year under review, approximately 30% of the group's turnover was denominated in sterling. From time to time, the group enters forward foreign exchange contracts to hedge its foreign exchange exposure.

## PROSPECTS AND GENERAL OUTLOOK

The new fiscal year will continue to be very challenging for the group. The problems of rising material costs and labour costs will continue to put pressure on the already tight profit margins of the group's businesses. Though relatively still higher than 2005, the management is pleased to see that metal prices have eased since mid June 2006. As at 7 July 2006, the LME aluminum closing price has come down to USD2,521 per metric ton from its peak of USD3,275 at 11 May 2006. The Shenzhen government has already raised the minimum wage rate in the Special Economic Zone by 17.4% with effect from 1 July 2006. It is believed that other areas in Guangdong will very soon have similar increases in the second half of 2006. Furthermore, up to the end of June 2006, the value of Renminbi has further increased by 1.4% against the U.S. dollar following an appreciation of 2% in July 2005. It is generally believed that the currency will further strengthen in the coming year. As the group's factories are all located in the PRC, an even stronger Renminbi will further lift the production costs of the group's products.

Despite the above-mentioned adverse market conditions, there are signs that retail sales in both the UK and the USA, which accounted for 37% and 48% of the group's sales respectively in the last fiscal year have both picked up in the first half of 2006. The management is confident that the group will weather the market difficulties and strive to achieve a solid result in the new fiscal year.

## DIVIDENDS

At the forthcoming Annual General Meeting to be held on 15 September 2006, the Directors will recommend a final dividend of HK4 cents per share (2005: HK4.5 cents). Together with the interim dividend of HK2.5 cents (2005: HK2 cents), the dividend for the year of HK6.5 cents (2005: HK6.5 cents) would represent an annual return of 8% on the company's average share price of HK80 cents in the year ended 31 March 2006.

The total final dividend will amount to HK$24,558,000 and is calculated based on the total number of shares in issue as at 13 July 2006 being the latest practicable date prior to the announcement of the results. Dividend will be payable on 29 September 2006 to shareholders registered in the Register of Members on 15 September 2006.

## APPRECIATION

On behalf of the Board of Directors and shareholders, I should like to extend my sincere thanks to all the group's employees for their efforts and hard work. Their commitment to the group, along with the support of customers and suppliers, has been crucial to the success of the group.

**George Bloch**
*Chairman*

Hong Kong, 14 July 2006