MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS

For the financial year ended 31 December 2006, the Group recorded turnover of approximately HK$96.6 million (2005: HK$67.5 million), representing an increase of approximately 43% as compared with the preceding year. The Group's profit attributable to shareholders for the year was approximately HK$1.1 million (2005: net loss of HK$41,000). Basic earnings per share for the year was HK0.0382 cent (2005: loss per share of HK0.0015 cent (restated)).

DIVIDEND

The board of directors recommends the payment of a final dividend of HK0.01 cent (2005: nil) per ordinary share in respect of the year, to the shareholders on the register of members as at 25 May 2007.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from 18 May 2007 to 25 May 2007, both days inclusive, during which no transfer of shares will be registered. In order to qualify for the attendance at the annual general meeting of the Company to be held on 25 May 2007 and to qualify for the final dividend, all transfer of shares accompanied by the relevant share certificates must be lodged with the Company's Hong Kong branch share registrar and transfer office, Tengis Limited, at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong for registration not later than 4:00 p.m. on 17 May 2007.

BUSINESS AND OPERATIONAL REVIEW

During the year under review, the Group continues to engage in the design, manufacture and sale of toys as well as decorative gift items on an OEM and ODM basis and under the Group's own brandnames KCARE and KITECH. In 2006, revenue from toys and decorative gift items was approximately HK$49.1 million (2005: HK$31.8 million) and HK$47.5 million (2005: HK$35.7 million), respectively, accounting for approximately 51% and 49% respectively of the Group's total turnover. The North American market remained to be the most important market segment and accounted for approximately 73% (2005: 72%) of the Group's turnover. The increase in distribution costs by approximately 39% from approximately HK$6.6 million in 2005 to approximately HK$9.2 million for the year was consistent with the increase in the Group's turnover over the preceding year. The administrative expenses of the Group increased by approximately 44% from approximately HK$17.7 million in 2005 to approximately HK$25.5 million in 2006. Apart from the overall increase in administrative expenses as a result of the expansion of our Group's operations, the amortisation of share option costs of approximately HK$4.6 million recognised in 2006 in relation to share options being granted to our staff during the year also contributed to such increase. Such recognition of share option costs was made in accordance with the relevant Hong Kong Financial Reporting Standards and did not have any impact on the cash flow of the Group for the year.

The toys and gifts market for the year of 2006 remained competitive. Nevertheless, the Group was able to increase its sales by approximately 43% as we have intensified our marketing campaign in order to broaden our sales channel in North America and Europe. During the year, new orders have been received from a number of renowned customers. Gross profit margin has also improved from approximately 33.8% in 2005 to approximately

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36.8% in 2006 as the management has rectified its operational management and improved its production efficiency. In addition, the management has developed new products with value-added features to enhance product profitability. With the increase in turnover and improvement in profit margin, the Group managed to turnaround and became profitable for the year.

During the year, we commenced the distribution of decorative flags and garden products through the "Toland" brand name with an aim to increase our product variety and to improve our competitiveness in the decorative flags and garden products market. In order to strengthen the sales and marketing activities and to facilitate the research and development functions, we have also established a jointly controlled entity in the United States which is responsible for the marketing and development of our decorative flags and garden products for the North American market.

In 2006, the Group has become a licensed supplier for the mascot toy products of the Beijing 2008 Olympic. We have obtained the license to manufacture different toys categories including plush toys, plastic toys, inflatable toys and electronic toys. In addition, we are the sole manufacturer who is able to produce nano-technology plush toys by applying the licensed Swedish Texcote Technology. With environmental friendly features of water repellence, stain resistance and anti-bacteria, our nano-technology mascot toys have received encouraging response in the PRC market.

MATERIAL ACQUISITIONS

On 2 September 2006, the Group entered into a capital contribution agreement to contribute RMB20 million to the registered capital in Beijing Mingrunfeng Trading Co., Ltd. (北京銘潤峰商貿有限公司, "Mingrunfeng") in return for a 51% equity interest in Mingrunfeng. On 22 September 2006, the Group entered into agreements to provide a revolving loan facility of not exceeding RMB40 million to Mingrunfeng and to provide guarantees for any future loan facility which may be secured by Mingrunfeng in proportion to the Group's equity interest in Mingrunfeng, subject to the terms and conditions of such agreements. Subsequent to the year end date on 16 January 2007, the Group further entered into various acquisition agreements with the original shareholders of Mingrunfeng to acquire all the remaining equity interest of Mingrunfeng at a consideration of approximately HK$119.5 million to be satisfied by the issue and allotment of 362,000,000 consideration shares at an issue price of HK$0.33 per share. Details of the agreements and the acquisitions were set out in the Company's announcements dated 26 September 2006 and 1 February 2007, and in the Company's circular dated 30 March 2007. The acquisitions of Mingrunfeng, the loan facility agreement and the guarantee agreement have all been approved by the shareholders of the Company at an extraordinary general meeting held on 16 April 2007. The Group is currently undergoing the related procedures to effect the acquisitions of the entire equity interest in Mingrunfeng and the acquisitions is expected to be completed in due course.

Mingrunfeng is the legal owner of the exploration right of a coal mine in Xilinguolemeng of the Inner Mongolia Autonomous Region of the People's Republic of China (the "PRC"). The coal mine has a site area of approximately 24.91 square kilometres and is located close to highways and railways (Figure 1). According to an independent technical assessment report issued by Steffen Robertson and Kirsten (Australasia) Pty Ltd. ("SRK Consulting"), the coal mine has estimated coal resource of 106 million tones and has an excellent potential to be developed

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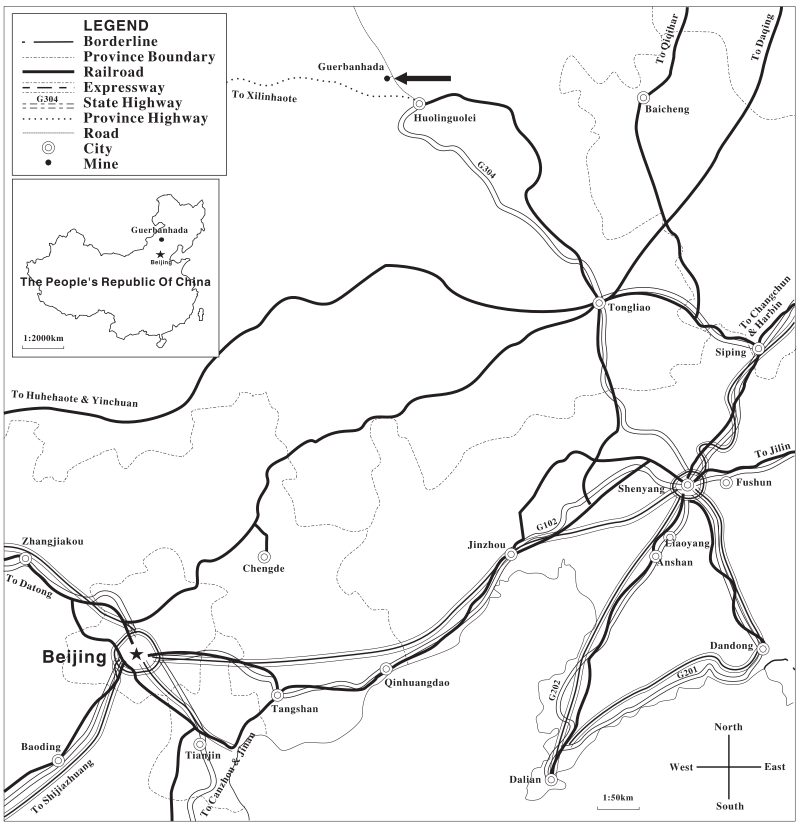
into an economic open cut coal mine servicing the domestic thermal market. In addition, SRK Consulting concluded that there appears to be no issues that may cause significant impact on the mining of the coal mine as it has no igneous intrusions and little or no structural features. The current on site market price for the coal of the coal mine is around Renminbi 160 Yuan per tonne.

Figure 1: Location of the Coal Project



LIQUIDITY AND FINANCIAL RESOURCES

The Group generally financed its operations with internally generated cash flow and facilities provided by its principal bankers in Hong Kong and in the PRC. During the year under review, positive cash flow was being generated across the Group, with approximately HK$10.6 million being generated from operating activities (2005: cash outflow of HK$5.1 million). The Group recorded a net cash inflow of approximately HK$36.3 million during the year (2005: cash outflow of HK$9.2 million), which increased the total cash and bank balances to approximately HK$85.2 million as at the balance sheet date. The Group's cash and bank balances are mostly held in Hong Kong dollars and Renminbi.

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The Group's bank and other borrowings are made in Hong Kong dollars and Renminbi, approximately 75% (2005: 75%) of such borrowings bear interest at fixed lending rates. At 31 December 2006, the Group's bank and other borrowings amounted to approximately HK$34.8 million (2005: HK$32.9 million), out of which approximately 95% (2005: 93%) is repayable within one year. The gearing ratio of the Group at 31 December 2006, calculated as a ratio of total bank and other borrowings to total assets, was approximately 17% (2005: 21%). Net current assets at 31 December 2006 were approximately HK$64.8 million (2005: HK$28.7 million) and current ratio was maintained at a healthy level of approximately 241% (2005: 160%). As the majority of the Group's transactions and borrowings were denominated in Hong Kong dollars, United States dollars and Renminbi, the Group's exposure to exchange rate fluctuation was relatively insignificant and the Group had not used any financial instruments for hedging purposes during the year under review.

At 31 December 2006, certain of the Group's buildings and leasehold land and buildings with carrying values of approximately HK$10.2 million (2005: HK$10.2 million) and HK$9.9 million (2005: HK$9.3 million), respectively, were pledged to secure general banking facilities granted to the Group.

As at 31 December 2006, the Group had capital commitment of RMB5 million, being the remaining balance of the capital contribution payable to Mingrunfeng. Further details of the Group's capital commitments are set out in note 36 to the financial statements.

The Group did not have any other material contingent liabilities as at 31 December 2006.

CAPITAL STRUCTURE AND USE OF PROCEEDS

As at 31 December 2006, the capital structure of the Company was constituted of 2,988,657,000 ordinary shares of HK$0.02 per share. Apart from ordinary shares in issue, the capital instruments in issue of the Company include options to subscribe for shares in the Company. During the year, 120,960,000 share options were granted under the share option scheme adopted by the Company with an exercise price of HK$0.1016 per share. No share option was exercised during the year and all 120,960,000 share options remained outstanding as at 31 December 2006. Subsequent to 31 December 2006 and up to the date of this report, 8,935,200 share options have been exercised by the option holders.

During the year under review, 774,837,000 new shares were issued by the Company as a result of the open offer of new shares on the basis of seven offer shares for every twenty existing shares held by the shareholders. The subscription price for each offer share was HK$0.05 and a net proceed of approximately HK$37 million was raised by the Company. The board of directors intends to apply the net proceeds as to (i) approximately HK$2 million towards upstream and downstream integration in the principal line of business of the Group to enhance its profitability, including but not limited to the distribution of fabrics or chemical products or the production of packaging materials; (ii) approximately HK$25 million towards possible diversified investments in the agricultural, energy and/or resources industries or other projects which the Board considers appropriate; and (iii) the remaining balance of approximately HK$10 million for general working capital of the Group. Further details of the open offer were set out in the Company's announcement and prospectus dated 6 July 2006 and 31 July 2006, respectively.

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As at 31 December 2006, HK$15 million of the net proceeds of the open offer was paid by the Group as deposit in relation to the capital contribution of Mingrunfeng.

Other than the foregoing, the proceeds from the Company's issue of new shares at the time of its listing on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 22 January 2001, after deduction of related expenses, amounted to approximately HK$43 million. The proceeds were applied in accordance with the proposed applications set out in the Company's prospectus dated 9 January 2001, as follows:

– approximately HK$5 million was used for developing new models and new products;

– approximately HK$5 million was used for the acquisition of new machinery and auxiliary equipment;

– approximately HK$10 million was used for establishing retail outlets and developing distribution channels in major cities in the PRC; and

– approximately HK$18 million was used as general working capital of the Group.

The Group has placed the unused balance of the net proceeds with licensed banks in Hong Kong and the People's Republic of China. These deposits have been receiving reasonable and steady interest income which preserves the best interests of the Group and the shareholders.

EMPLOYMENT, TRAINING AND DEVELOPMENT

At 31 December 2006, the Group had a total of 1,085 employees. The Group always maintains good working relations with its employees and has committed itself to staff training and development.

Remuneration packages are maintained at a competitive level and reviewed on a periodical basis. Bonus is awarded to employees according to the assessment of individual performance and industrial practice. The Company also maintains a share option scheme pursuant to which share options can be granted to provide incentive to the staff. During the year, 120,960,000 share options have been granted under the share option scheme adopted by the Company.