DREAM

德林 INTERNATIONAL LIMITED
國際有限公司

(incorporated in Hong Kong with limited liability)
(於香港註冊成立之有限公司)

Stock Code 股份代號:1126

ANNUAL REPORT 2006 年報

CONTENTS

Board of Directors

Executive Directors

Mr. Kyoo Yoon CHOI *(Chairman and Executive Director)*
Mrs. Shin Hee CHA *(President) (appointed on 24 January 2006)*
Mr. Tae Sub CHOI *(Vice-president and Chief Operation Officer)*
Mr. Young M. LEE *(Executive Managing Director and Chief Financial Officer)*
Mr. James WANG

Independent Non-executive Directors

Mr. Valiant, Kin Piu CHEUNG
Professor Cheong Heon YI
Dr. Chan YOO

Audit Committee

Professor Cheong Heon YI *(Chairman)*
Mr. Valiant, Kin Piu CHEUNG
Dr. Chan YOO

Remuneration Committee

Dr. Chan YOO *(Chairman)*
Mr. Valiant, Kin Piu CHEUNG
Professor Cheung Heon YI
Mr. Young M. LEE

Registered Office and Principal Place of Business

8th Floor
Tower 5, China HK City
33 Canton Road
Tsimshatsui Kowloon
Hong Kong

Company Secretary

Mr. Wilson, Wai Sing WONG,
FCCA, FCPA, FCS(PE), FCIS, MPA

Auditor

PricewaterhouseCoopers
Certified Public Accountants
33/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

Authorised Representatives

Mr. Young M. LEE
Mr. Wilson, Wai Sing WONG

Principal Bankers

The Hongkong and Shanghai Banking Corporation Limited
Citibank, N.A.
Shinhan Finance Limited

Share Registrar

Abacus Share Registrars Limited
26/F., Tesbury Centre
28 Queens Road East
Hong Kong

Financial Relations Consultant

Strategic Financial Relations Limited
Unit A, 29/F., Admiralty Centre I
18 Harcourt Road, Hong Kong

Website Address

www.dream-i.com.hk

Stock Code

Stock Exchange, Hong Kong 1126
Access to Reuters 1126.HK
Access to Bloomberg 1126:HK

Mr. Kyoo Yoon Choi
Chairman

Dear Shareholders,

Presented with an adverse macroeconomic environment, toy manufacturers in the PRC, including Dream International Limited (the "Company") and its subsidiaries (collectively the "Group"), had another challenging year in 2006. The Group had to cope with high raw material costs and rising labour costs in the coastal cities in the PRC, while appreciation of the Renminbi added further cost pressure. All these factors together affected the profitability of our business and that of the industry at large.

In fact, we saw signs of these challenges emerging two years ago and started then to reinforce, reorganize and restructure our business to brace our business for the worst times. To ensure effective control over costs, we streamlined the management team and rationalized our workforces. We also reallocated resources among our different plants and moved production facilities to inland China where labour costs were lower. For higher production efficiency, we pursued automation of production and reviewed the workflows at different plants. We focused on higher margin customers who placed volume orders to enhance profitability. These strategies have improved our cost-effectiveness with benefits starting to materialize in the second half of 2006 in terms of profit contributions.

At the same time as we strived to reinforce our business foundation, we also kept a close watch on the business environment for the opportunities that would allow us to apply our core competence and bring about strong returns. Seeing educational products for pre-school children gaining popularity in the market, we launched a series of interactive plush toys incorporating educational elements in a US chain store during the year. Our debut move into the electronic toy segment has proven to be a success. The new product has received positive feedback from the market. Thus, we are going to invest more resources in R&D to develop new products that cater to market demand and also enrich our product portfolio.

We made a strategic move in 2005 to set up a joint venture to expand our steel and plastic toy business. The joint venture has made advancements and brought in encouraging contributions. It has expanded our product portfolio to include such as scooters, inline skates and skateboards, which are popular among youngsters in the US and Europe. To support sales of these products, the joint venture also strengthened its sales network in these two markets. Moreover, carrying the acquired "Great" and "Far Great" brands, our steel and plastic products made inroads into the PRC market and generated revenue in Renminbi for the Group. In early 2007, we obtained a license directly from an existing plush stuffed toy customer, a renowned character owner, and will cross-sell to it our steel and plastic products in the PRC. We believe the strong market demands for these products in the PRC will fuel growth of the business segment in the future.

Although we can see some of the challenges in the market prevailing in the near future, with hopes that raw material prices will stabilize and our business strategies starting to deliver the desired effects as reflected in the progress we achieved in the second half of 2006, we are cautiously optimistic about our business in the coming year. We expect to see gradual improvement in our business riding on our leadership and rich experience in the toy industry.

On behalf of the Board, I would like to express my appreciation to the management team and staff for their dedication and contribution to the Group. I would also like to thank all our shareholders, business partners and customers for their support during this testing period for the Group.

Kyoo Yoon Choi
Chairman
Hong Kong,
18 April 2007

FINANCIAL REVIEW

Plush toy manufacturers including the Group continued to face challenges in 2006. However, supported by a sizeable operation and strong reputation as an industry leader, the Group managed to attain a mild increase in turnover to HK$1,084.4 million (2005: HK$1,040.4 million) for the year ended 31 December 2006, thanks to the rapid growth of the steel and plastic toy business. Gross profit decreased to HK$160.0 million (2005: HK$186.9 million), mainly because of rising labour costs in the coastal areas in the PRC. Moreover, appreciation of the Renminbi and high raw material costs also created additional burden on costs of sales.

Loss attributable to equity holders was HK$129.7 million (2005: HK$36.3 million), including the impairment losses of goodwill of HK$100.2 million that arose from the purchase of Dream INKO Co., Ltd. in 2003. Excluding this non-recurring loss, loss attributable to equity holders improved to HK$29.5 million when compared with last year. The Group has been restructuring its business since 2005 and started to see the fruits of its efforts in the second half of 2006. It indeed reported net profit (excluding the one-off goodwill impairment losses) of HK$7.1 million for the second half of the year, a marked improvement from net loss of HK$36.6 million for the first half of the year.

The Group was in a healthy financial position with cash and bank deposits (excluding long-term structured deposits) of HK$82.8 million (31 December 2005: HK$103.1 million) as at 31 December 2006.

BUSINESS REVIEW

To maintain its leading position in the toy industry, the Group focused on larger orders and strived to expand its client base and enrich its product portfolio during the year. It also implemented various measures to address market challenges and other pressure on its operation. The Group continued to move its production facilities to inland China where labour costs are lower. To increase revenue denominated in Renminbi, the Group endeavoured to exploit the huge potential of the PRC market with the steel and plastic toy business. The Group also continued to restructure its business, such as streamlining the workforce and reallocating resources among its offices, to enhance operational efficiency and cost-effectiveness.

Product Analysis

During the year under review, revenue from plush stuffed toys amounted to HK$903.9 million, representing 83.4% of the Group's total turnover. As the Group focused on volume orders and higher margin customers, the proportion of Original Equipment Manufacturing ("OEM") business to the revenue from the plush stuffed toy segment decreased to 77.8%, yet it remained as the Group's core business. While maintaining close relationship with renowned character owners and licensors, the Group also secured new orders for promotional toys from a famous international fast food chain store. Leveraging its leading position in the plush stuffed toy industry, the Group continued to explore cross-selling opportunities for its steel and plastic products with existing OEM customers.

The Group's Original Design Manufacturing ("ODM") business recorded revenue of HK$199.8 million, and its proportion increased significantly to 22.2% of the plush stuffed toy segment's turnover. During the year, the Group launched a new series of interactive educational electronic plush toys for pre-school children that was well received in the market. In addition to shifting its focus to higher margin customers, the Group also allocated more resources to R&D to ensure it has the ability to match changing market trends and tailor products to meet unique customer requirements.

Driven by strong market demand together with the full-year contribution from the joint venture set up in the second half of 2005, revenue from the steel and plastic toy business rose by over 200% to HK$180.4 million when compared with 2005. Backed by the joint venture, the Group expanded its product scope to cover scooters, inline skates and skateboards, which attracted direct orders from a US chain store as well as more businesses from customers in the US and Europe. Carrying the acquired "Great" and "Far Great" brands, the Group's steel and plastic toys including scooters, bicycles, tricycles and inline skates actually made inroads into the PRC market during the year.

Market Analysis

Driven by the growth in the steel and plastic toy business, North America remained as the most prominent market of the Group and accounted for 49.3% of its total turnover. Japan came second and contributed 25.0%, while Europe became another major market with a 17.3% share. China market, which is laden with potential, represented 2.6% of the Group's total turnover.

Operational Analysis

During the year, the Group operated ten plants in China and one plant in Vietnam at an average utilization rate of around 85%. The leased Vietnam plant as a temporary facility was closed in 2006 after the Group's own plant was ready for full operation. All the production in Vietnam was then centralized in one plant to achieve economies of scale and enhance operational efficiency. The plant manufactured plush stuffed toys and contributed HK$42.7 million to the turnover of the Group during the year.

To deal with rising labour costs in coastal areas in the PRC, the Group continued to move its production base inland and invested an additional US$1.3 million (approximate to HK$10.1 million) in the Chaohu and Mingguang plants, which commenced trial run in the second half of 2006. Including the plants in Shuyang and Beiliu that commenced full operation in the first half of 2006, the four plants in inland China will account for 28% of the Group's total production capacity when all of them are in full operation.

Prospects

The Group witnessed the unrelenting consolidation of the toy industry in last couple of years. Many small players were ousted leaving only the sizable and financially strong ones in the market. With fewer struggling small players in the cut-throat competition, the survived players will enjoy better margins and stronger bargaining power when negotiating with suppliers as well as customers.

Although, as a leading player, the Group stands to benefit in the consolidating market, it remains cautiously optimistic about the prospects of its business. The Group trusts that its comparative advantages in production capacity, quality control and design ability will inevitably make it a preferred choice to major multi-national buyers who have to comply with stringent legal and non-governmental requirements in their own countries and their products' end markets.

In addition, the Group will actively seek to capture business opportunities in the PRC market. It sees a strong ride for its steel and plastic products under the "Great" and "Far Great" brands as well as those produced on an OEM basis. In the first quarter of 2007, the Group leveraged its existing strong relationship with a renowned plush stuffed toy customer to secure orders for steel and plastic toys from the customer. These developments will not only boost the contributions from the steel and plastic toy business, but will also help reduce the pressure from appreciation of the Renminbi. Besides the PRC market, the Group will explore further business opportunities for its "Great" and "Far Great" products in other countries.

To thrive in the ever-changing market, the Group will sharpen its competitive edges and strive to sustain its leadership in the industry. Seeing the positive market response to its electronic plush toy first launched in 2006, the Group will look for and exploit more opportunities in electronic toys and other innovative toys. To achieve this, more resources will be invested in enhancing product development and production capabilities. Meanwhile, the Group will also explore new alliances with potential customers who are looking for quality and reliable manufacturing partners.

The Group's improved results (excluding the goodwill impairment loss of HK$100.2 million) in the second half of 2006 are evidence of its effective business strategies and cost control measures. These strategies and measures will be continued in the coming year to help the Group to sustain its position as the largest plush stuffed toy manufacturer in the world.

EXECUTIVE DIRECTORS

Mr. Kyoo Yoon Choi, aged 58, is the Chairman and Executive Director of the Company and the founder of the Group. He studied at Seoul National University in Korea between 1968 and 1972 and graduated with a bachelor's degree in engineering. Prior to setting up the Group in Korea in 1984, Mr. Choi had over eight years of experience in the plush toy business at Daewoo Corporation, which was one of the leading conglomerates in Korea at the time. Mr. Choi is responsible for the strategic planning and overall business development of the Group.

Mrs. Shin Hee Cha, aged 52, was appointed as an Executive Director of the Company on 24 January 2006 and has been acting as the Vice President of Dream INKO Co., Ltd. She joined C & H Co., Ltd. on 1 April 1984 and has been in charge of the sales and marketing function. Mrs. Cha graduated from the Inha University in South Korea, with a bachelor degree of social education in 1980. Prior to joining C & H Co., Ltd., Mrs. Cha was a general manager in Determined Productions, Inc. in South Korea for four years, which was engaged in toys trading business. She is the younger sister-in-law of Mr. Kyoo Yoon Choi.

Mr. Young M. Lee, aged 51, is the Executive Managing Director and the Chief Financial Officer of the Company. Mr. Lee has 20 years of working experience in US in the areas of accounting and finance such as public accounting, consulting to financial institutions, mergers and acquisitions, corporate controllership and investment banking. Prior to joining the Group in May 2001, Mr. Lee was the Managing Director of Kohap (Hong Kong) Ltd., which is the trading and financing arm of a Korean conglomerate, Kohap Ltd.. He is responsible for the overall financial management, strategic and business planning of the Group.

Mr. Tae Sub Choi, aged 52, was appointed as an Executive Director of the Company on 8 April 2003. He is also the Vice President and the Chief Operation Officer of the Company. Mr. Choi graduated from Seoul National University in Korea with a bachelor degree in German Language and Literature in 1979. Prior to joining the Group in Korea in 1994, Mr. Choi acquired 19 years of profound experience in the area of product development at Daewoo Corporation, which was one of the leading conglomerates in Korea at the time. He first joined the C & H Co., Ltd. in the sales department. Mr. Choi was subsequently promoted and was in-charge of J.Y. Toys Co., Limited in PRC for 2 years and C & H Lanka (PVT) Co., Ltd. in Sri Lanka for 6 years. He is currently the Vice-President and authorized representative of C & H Toys (Suzhou) Co., Ltd. and Jung Yoon Toys (Shanghai) Co., Limited in Suzhou and Shanghai region of PRC.

Mr. James Wang, aged 45, is the Managing Director of Dream International USA. He joined Dream International USA on 1 July 1991 and has been in charge of the Group's marketing function in the US. Mr. Wang graduated from the University of California, Los Angeles, with a bachelor degree in business administration in 1986. Prior to joining the Group, Mr. Wang had extensive experience in the fields of logistics and trading from his previous employments with Trans-union Line, KAL Trading Co. and Daewoo America Corp. He was appointed as an Executive Director on 1 April 2005.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Valiant, Kin Piu Cheung, aged 61, was a partner at KPMG, a leading international accounting firm in Hong Kong. Mr. Cheung has extensive experience in assurance and corporate finance work, particularly on trading and manufacturing corporations in Hong Kong and the PRC, and has assisted a number of companies in obtaining a listing on stock exchanges in Hong Kong, the PRC, Singapore and the US. In addition, he has provided financial advisory and due diligence services to foreign investors on investments in the PRC. Mr. Cheung is a fellow member of the Institute of Chartered Accountants in England and Wales and the Hong Kong Institute of Certified Public Accountants. He was appointed as the Company's Independent Non-executive Director on 22 October 2001.

Professor Cheong Heon Yi, aged 42, received his bachelor's degree and a master's degree in business administration from Seoul National University in Korea. Professor Yi was also awarded a philosophy of doctorate degree in accounting in 1997 from the University of California, Los Angeles. Professor Yi has taught at the University of California, Los Angeles for a year before joining the Hong Kong Polytechnic University in 1997. Professor Yi's research interests include financial reporting and corporate governance. His teaching focuses on financial accounting at the undergraduate level and financial reporting and corporate governance at the postgraduate level. He was appointed as the Company's Independent Non-Executive Director on 22 November, 2003.

Dr. Chan Yoo, aged 42, graduated from Massachusetts Institute of Technology ("MIT"), Cambridge, MA, U.S. with a bachelor degree in Electrical Engineering and Computer Science in 1989. He obtained his master degree in Nuclear Engineering from MIT in 1991. He was conferred his PhD in Nuclear Engineering from MIT in 1995. Dr. Yoo gained over four years consulting experience from an international consultancy firm McKinsey & Company, Inc., Chicago office in U.S. and Seoul office in Korea. In the year 2000, Dr. Yoo set up McQs, incorporated in Seoul, Korea to provide business consulting services for Korean manufacturing companies to achieve world-class operational excellence and has been the Chief Executive Officer of the company since then. He was appointed as an independent non-executive director with effect from 30 September 2004.

SENIOR MANAGEMENT

Mr. Yong Kook Kim, aged 58, is the Vice-president of J.Y. Toys Co., Limited ("J Y Toys"). He joined the Group on 1 June 1987 and is in charge of the day-to-day operation and management of J Y Toys.

Mr. Man Jin Cho, aged 65, is the Executive Managing Director of C & H Suzhou. He has extensive experience in the field of acrylic knitted fabric manufacturing. He joined the Group on 1 May 1997 and helped the Group in establishing C & H Plush in the same year to expand into acrylic knitted fabric business. Mr. Cho is now responsible for the production operation of acrylic knitted fabric and developing materials for plush toys.

Mr. Dong Wook Cha, aged 46, is the Head of accounting and administration department of the Company. Mr. Cha has over seven years of experience in the field of accounting from his employments with Dongkook Trading Co. and Hyundai Heavy Industrial Co., Ltd. He joined C & H Korea on 1 February 1986 and has been working in the accounting and administration department of the Group since 1996.

COMPANY SECRETARY

Mr. Wilson W. S. Wong, aged 42, is a fellow member of the Hong Kong Institute of Chartered Secretaries, the Institute of Chartered Secretaries and Administrators, the Hong Kong Institute of Certified Public Accountants and the Association of Chartered Certified Accountants. Mr. Wong obtained his master degree in professional accountancy from the Polytechnic University of Hong Kong in 2002. He joined the Group on 20 September 2001.

The directors submit their report together with the audited financial statements for the year ended 31 December 2006.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

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 of the subsidiaries are set out in Note 9 to the financial statements.

An analysis of the Group's performance for the year by business and geographical segments is set out in Note 5 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidation income statement on page 28.

The directors do not recommend the payment of a dividend.

RESERVES

Movements in the reserves of the Group and of the Company during the year are set out in Note 16 of the financial statements.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and of the Company are set out in Note 7 to the financial statements.

DISTRIBUTABLE RESERVES

Distributable reserves of the Company at 31 December 2006, calculated under section 79B of the Hong Kong Companies Ordinance, amounted to HK$107,319,000 (2005: HK$210,411,000).

PURCHASE, SALE OF REDEMPTION OF SECURITIES

The Company has not redeemed any of its shares during the year. Nether the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

FIVE YEAR FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on pages 89 to 90.

SHARE OPTION SCHEME

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 Stock Exchange of Hong Kong Limited (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 may be exercised 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 the option. Such period will not exceed ten years from the date on which the option is granted.

The maximum number of shares which may be issued upon the exercise of all outstanding options and yet to be exercised under the share option scheme shall not exceed 30% of the issued share capital of the Company from time to time. Subject always to the above overall limit, the directors may grant options under the share option scheme, generally and without further authority, in respect of such number of shares which may be issued upon exercise of all options to be granted under the share option scheme not exceeding 10% of the issued share capital of the Company as at 7 February 2002, being the date on which the Company's shares were listed on the SEHK. For the purpose of calculating the above, options lapsed in accordance with the share option scheme shall not be counted.

The total number of securities available for issue under the share option scheme as at 31 December 2006 was 46,471,000 shares (including options for 17,231,000 shares that have been granted but not yet lapsed or exercised) which represented 6.95% of the issued share capital of the Company at 31 December 2006. In respect of the maximum entitlement of each participant under the scheme, the number of securities issued and to be issued upon exercise of the options granted to each participant in any 12-month period is limited to 1% of the Company's ordinary shares in Issue.

As at 31 December 2006, the directors individually and other employees in aggregate of the Company had the following interests in options to subscribe for shares of the Company granted at nominal consideration under the share option scheme of the Company. The options are unlisted. Each option gives the holder the right to subscribe for one ordinary share of the Company of par value US$0.01 each.

				Number of options		
	Date granted	Period during which options exercisable (Note 1)	Exercise price per share	Balance at 1 January 2006	Lapsed during the year (Note 2)	Balance at 31 December 2006
Directors:						
Shin Hee Cha (appointed on 24 January 2006)	2 January 2004	2 January 2005 to 2 January 2014	HK$1.87	3,500,000	–	3,500,000
Young M. Lee	7 February 2002	7 February 2003 to 7 February 2012	HK$1.18	1,360,000	–	1,360,000
Tae Sub Choi	15 April 2003	15 April 2004 to 15 April 2013	HK$1.43	1,365,000	–	1,365,000
James Wang	7 February 2002	7 February 2003 to 7 February 2012	HK$1.18	520,000	–	520,000
Employees in aggregate:	7 February 2002	7 February 2003 to 7 February 2012	HK$1.18	4,681,000	–	4,681,000
	15 April 2003	15 April 2004 to 15 April 2013	HK$1.43	455,000	–	455,000
	2 January 2004	2 January 2005 to 2 January 2014	HK$1.87	8,150,000	2,800,000 (Note 3)	5,350,000
Others:	7 February 2002	7 February 2003 to 7 February 2012	HK$1.18	2,600,000	2,600,000 (Note 4)	–
				22,631,000	5,400,000	17,231,000

Notes:

(1) The maximum percentage of the share options that may be exercised is determined in stages as follows:

	Percentage of share options granted
On or after 1st year anniversary of the date of grant	30%
On or after 2nd year anniversary of the date of grant	another 30%
On or after 3rd year anniversary of the date of grant	another 40%

(2) Pursuant to the condition of the share option scheme, any unexercised number of options granted to any employee will lapse three months after the employee ceases employment relationship with the Company.

(3) This 2,800,000 share options related to various employees who left the Group on or before 30 September 2006. These outstanding share options were lapsed by 31 December 2006.

(4) This 2,600,000 share options related to Mr. Chul Hong Min who resigned as director of the Company on 31 December 2005. These outstanding share options were lapsed by 1 April 2006.

(5) The options granted to the directors are registered under the names of the directors who are also the beneficial owners.

The life of the above granted share options is ten years commencing on the date on which an option is granted in accordance with the scheme.

DIRECTORS' INTERESTS IN CONTRACTS

Apart from the related party transactions as disclosed in Note 32 to the financial statements, no other contracts of significance in relation to the Group's business to which the Company, any of its fellow subsidiaries or its holding company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical details of directors and senior management are set out on page 8 to 9.

DIRECTORS

The directors during the year were:

Chairman and executive director

Kyoo Yoon Choi

Executive directors

Shin Hee Cha *(appointed on 24 January 2006)*
Tae Sub Choi
Young M. Lee
James Wang

Independent non-executive directors

Valiant, Kin Piu Cheung
Cheong Heon Yi
Chan Yoo

Kyoo Yoon Choi, Tae Sub Choi and Chan Yoo will retire at the forthcoming annual general meeting in accordance with articles 101 and 92 respectively of the Company's articles of association and, being eligible, offer themselves for re-election.

DIRECTORS' SERVICE CONTRACTS

The service contract of Valiant, Kin Piu Cheung, the independent non-executive director, was renewed by the board of directors on 22 October 2005 for a term of 2 years commencing on 22 October 2005.

The service contract of Cheong Heon Yi, the independent non-executive director, was renewed by the board of directors on 22 November 2005 for a term of 2 years commencing on 22 November 2005.

The service contract of Chan Yoo, the independent non-executive director, was renewed by the board of directors on 30 September 2006 for a term of 2 years commencing on 30 September 2006.

Their remuneration is determined by the board of directors on the renewal of their service contracts.

No director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ANY ASSOCIATED CORPORATION

At 31 December 2006, the interests and short positions of each director and chief executive in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of the Securities and Futures Ordinance (the "SFO")) as recorded in the register required to be kept by the Company under Section 352 of Part XV of the SFO or otherwise notified to the Company and the SEHK pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") were as follows:

(i) Long positions in ordinary shares of US$0.01 each

	Number of shares held				
	Personal interests (Note 1)	Family interests	Corporate interests	Total	Percentage of issued share capital of the Company
The Company					
– Kyoo Yoon Choi	–	–	455,000,000 (Note 2)	455,000,000	68.06%
– Tae Sub Choi	585,000	–	–	585,000	0.09%
– Young M. Lee	1,740,000	–	–	1,740,000	0.26%
C & H Co., Ltd					
– Kyoo Yoon Choi	189,917	124,073 (Note 3)	–	313,990	61.03%
– Shin Hee Cha	21,319	–	–	21,319	4.14%
– Tae Sub Choi	5,685	–	–	5,685	1.10%

Notes:

(1) The shares are registered under the names of the directors and chief executives of the Company who are the beneficial owners.

(2) Kyoo Yoon Choi in his own name holds approximately 36.91 % of the issued share capital of C & H Co., Ltd, and together with his wife, Woul Hee Cha, hold approximately 61.03% of the issued share capital of C & H Co., Ltd. which owned 382,850,000 shares in the Company. In addition, Kyoo Yoon Choi beneficially owns 100% of interest of Uni-Link Technology Limited which owned 72,150,000 shares of the Company.

(3) The wife of Kyoo Yoon Choi, Woul Hee Cha, holds approximately 24.12% of the issued share capital of C & H Co., Ltd.

(ii) Long positions in underlying shares of the Company

The directors and chief executives of the Company have been granted options under the Company's share option scheme, details of which are set out in the section "Share option scheme" above.

Save as disclosed above, at no time during the year, the directors and chief executives (including their spouses and children under 18 years of age) had any interests in, or had been granted, or exercised, any rights to subscribe for shares of the Company and its associated corporations required to be disclosed pursuant to the SFO or otherwise notified to the Company and the SEHK pursuant to the Model Code.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN THE SHARES AND UNDERLYING SHARES OF THE COMPANY

The register of substantial shareholders required to be kept under Section 336 of Part XV of the SFO shows that as at 31 December 2006, the Company had been notified of the following substantial shareholders' interest and short positions, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of directors and chief executives:

Name	Capacity in which shares held	Number of shares held	Percentage of the issued share capital of the Company
C & H Co., Ltd. (Note)	Beneficial owner	382,850,000	57.27%
Uni-Link Technology Limited (Note)	Beneficial owner	72,150,000	10.79%

Note:

Kyoo Yoon Choi, being a director of C & H Co., Ltd., together with his wife, Woul Hee Cha, hold approximately 61.03% of the issued share capital of C & H Co., Ltd. and Kyoo Yoon Choi beneficially owns 100% of the issued share capital of Uni-Link Technology Limited. Kyoo Yoon Choi is considered to have deemed interests in the 455,000,000 ordinary shares as to approximately 68.06% of the issued shares of the Company. James Wang, being a director of the Company, is also a director of Uni-Link Technology Limited.

Save as disclosed above, as at 31 December 2006, the Company is not aware of any other registered substantial shareholder who holds 5% or more of the issued share capital of the Company.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

MAJOR CUSTOMERS AND SUPPLIERS

The percentage of sales and purchases for the year attributable to the Group's major customers and suppliers are as follows:

Sales	
– The largest customer	44.2%
– Five largest customers in aggregate	71.0%
Purchases	
– The largest supplier	7.7%
– Five largest suppliers in aggregate	18.9%

None of the directors, their associates or any shareholder (which to the knowledge of the directors owns more than 5% of the Company's share capital) had an interest in the major customers or suppliers noted above.

CONTINUING CONNECTED TRANSACTIONS

During the year, the group entered into the following connected transactions with C & H Korea Group as defined in the Rules Governing the Listing of Securities on the Main Board of the SEHK ("the Listing Rules"):

(1) On 31 October 2006, the Group renewed its property lease agreement with C & H Co., Ltd. for Dream INKO Co., Ltd ("Dream INKO")'s principal place of business in Seoul, Korea. The property lease agreement is renewable upon its expiry in July 2007. The terms of the property lease agreement were agreed after arm's length negotiation by reference to enquiries made with other landlords, tenants and real estate agents in the proximity area.

During the year ended 31 December 2006, the rental paid amounted to HK$5,079,000 (2005: HK$7,038,000).

The directors, including the independent non-executive directors, of the Company confirmed that the aforesaid connected transactions were entered into:

(i) in the ordinary and usual course of business;

(ii) either on normal commercial terms or, on terms no less favourable to the Group than available to or from independent third parties; and

(iii) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

During the year ended 31 December 2006, the Company has fully complied with the Code on Corporate Governance Practice as set out in Appendix 14 of the Listing Rules on the SEHK.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the directors, it is confirmed that there is sufficient public float of more than 25% of the Company's issued shares at 18 April 2007.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

During the year ended 31 December 2006, C & H Co., Ltd. and its subsidiaries excluding the Group ("C & H Korea Group"), as set out below, are principally engaged in the business of properties investment in Seoul, leather the goods and accessories agency, fabric, textile manufacturing and investment holding in PRC, Vietnam and Sri Lanka through its wholly owned subsidiaries C&H Hitex Co., Ltd., Jung Yoon Textiles (Private) Limited, Vina Tarpaulin Inc. and C & H Lanka I (PVT) Ltd. Kyoo Yoon Choi, Shin Hee Cha and Tae Sub Choi are deemed to be interested in these businesses some of which may compete with the Group's businesses as they are shareholders of C & H Co., Ltd. and Kyoo Yoon Choi is also a director of C & H Co., Ltd.

Name of company	Nature of competing business	Remarks
C & H Lanka (PVT) Ltd. ("C & H Lanka")	C & H Lanka is a wholly owned subsidiary of C & H Korea. The directors of C & H Lanka are Kyoo Yoon Choi, Shin Hee Cha, and Young Dae Noh. C & H Lanka was engaged in the manufacturing of plush stuffed toys in Sri Lanka. C & H Lanka is undergoing winding-up procedure and the local court has appointed liquidators J. David & M.S. layawickrama of MS SMIS Associates as directors of the company.	Pursuant to the Deed of Undertaking*, C & H Lanka agreed not to engage or otherwise be involved in any business which competes or is likely to compete with the Group's business in any of the regions that the Group engages business in. Its business was limited to production of quota related plush stuffed toys and orders that could not be handled by the Group.
Jung Yoon Textiles (Private) Ltd. ("JY Textile")	JY Textile is a wholly owned subsidiary of C & H Korea. The directors of JY Textile are Kyoo Yoon Choi and Kyung Soon Song. JY Textile is engaged in the manufacturing and dyeing of fabrics.	JY Textile is engaged in manufacturing of fabrics and dyeing of fabrics for local customers in Sri Lanka.

* In relation to the listing of the company's shares on the Main Board of the SEHK, C & H Co., Ltd. has entered into the Deed of Undertaking in favour of the company to effect that for so long as C & H Co., Ltd. and its associates are beneficially interested, directly or indirectly, whether individually or taken together, in 30% or more of the issued capital of the company, C & H Co., Ltd. will not, and C & H Co., Ltd. will procure that none of its subsidiaries, other than the group, will engage or otherwise be involved in any business which competes or is likely to compete, either directly or indirectly, with any of the restricted business in any of the regions in which the group engages in and undertakes the restricted business (such regions include the People's Republic of China ("PRC"), Taiwan, Europe, the US and Japan). Such an undertaking shall extend to all subsidiaries of C & H Korea Group.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard set out in Appendix 10 of the Listing Rules regarding the Model Code. Based on the specific enquires of the Company's Directors, the Directors have complied with the required standard set out in the Model Code.

AUDIT COMMITTEE

The audit committee has reviewed with the management and the Company's auditor, PricewaterhouseCoopers, the accounting principles and practices adopted by the Group and discussed internal control and financial reporting matters of the final results for year ended 31 December 2006. The Group's consolidated financial statements for the year ended 31 December 2005 were audited by KPMG.

AUDITOR

In August 2006, KPMG resigned as auditor of the Company and PwC have been appointed by the Board to fill the casual vacancy following the resignation of KPMG.

The financial statements have been audited by PwC who retire at the coming Annual General Meeting and, being eligible, offered themselves for re-appointment.

On behalf of the Board

Tae Sub Choi
Director

Hong Kong, 18 April 2007

CORPORATE GOVERNANCE PRACTICES

The board of directors of the Company (the "Board") believes that corporate governance is essential to the sustainable success of the Company and trust that all stakeholders of the Company can benefit from better transparency and accountability of a high standard of corporate governance.

In the opinion of the Board, the Company has applied the principles and complied with the code provisions contained in the Code on Corporate Governance Practices (the "CG Code") as set out in Appendix 14 of the Rules Governing the Listing of Securities (the "Listing Rules") of The Stock Exchange of Hong Kong Limited (the "SEHK") during the year ended 31 December 2006.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted the code of conduct regarding directors' securities transactions as set out in the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") of the Listing Rules. All the directors have confirmed that they have complied with the required standards as set out in the Model Code throughout the year.

BOARD OF DIRECTORS

As at 31 December 2006, the Board consisted of five executive directors, namely Mr. Kyoo Yoon Choi (Chairman), Mrs. Shin Hee Cha (Vice President), Mr. Tae Sub Choi (Vice President and Chief Operation Officer), Mr. Young M. Lee (Executive Managing Director and Chief Financial Officer) and Mr. James Wang, and three independent non-executive directors ("INEDs") (collectively the "Directors"), namely Mr. Valiant Kin Piu Cheung, Professor Cheong Heon Yi and Dr. Yoo Chan. There is no financial, business, family or other material relevant relationship between the Directors except that Mrs. Shin Hee Cha is Mr. Kyoo Yoon Choi's sister-in-law. The principal functions of the Board are to supervise the management of the business and affairs; to approve the strategic plans, investment and funding decision; and to review the Group's financial performance and operative initiatives. The role of INEDs is to bring an independent and objective view to the Board's deliberations and decisions. Mr. Valiant Cheung was a retired audit partner of KPMG and Professor Yi is currently teaching financial accounting and corporate governance in the Accountancy Faculty of the Hong Kong Polytechnic University. While Dr. Yoo is running his own management consultancy firm which has no business with the Group. The Board considers both of them have profound professional qualifications and expertise in accounting and financial management so that they are of sufficient caliber and number for their independent views to carry weight. The Company has received from each of the INEDs, an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the INEDs are independent.

The Company has arranged for appropriate liability insurance since 2002 to indemnify its Directors for their liabilities arising out of corporate activities. The insurance coverage is reviewed on an annual basis.

The Board will conduct meeting on a regular basis and on an ad hoc basis so far as the business required. The Board held a total of four board meetings during the year. The INEDs may take independent professional advice at the Company's expense in carrying out their functions. The Board is supplied with relevant information by the senior management pertaining to matters to be brought before the Board for decision as well as reports relating to operational and financial performance of the Group before each regular board meeting. At least 14 days notice of a regular board meeting is given to all directors to give them the opportunity to attend. Board papers are dispatched to the directors at least 3 days before the meeting to ensure that they have sufficient time to review the papers and be adequately prepared for the meeting.

Directors' attendance at the Board meetings held during the year:

Name of director	Number of attendance
Kyoo Yoon Choi *(Chairman)*	1/4
Shin Hee Cha *(appointed on 24 January 2006)*	1/4
Tae Sub Choi	4/4
Young M. Lee	4/4
James Wang	4/4
Valiant, Kin Piu Cheung	4/4
Cheong Heon Yi	4/4
Chan Yoo	4/4

DELEGATION BY THE BOARD

The Board is responsible for determining the overall strategy and approving the annual business plan of the Group, and ensuring the business operations are properly planned, authorised, undertaken and monitored. All policy matters of the Group, material transactions where there is conflict of interests, considered as being notifiable or connected transactions with meaning ascribed to by the Listing Rules from time to time should be reserved to the decision of the Board.

The Board has delegated functions that are necessary and incidence to carry out the decision of the Board or to facilitate the day-to-day operation of the Group in ordinary course of business to the executive management and divisional heads of different business units under the instruction or supervision of Chief Executive Officer, Chief Financial Officer and Chief Operation Officer. The Board and the management will also seek advice from the Audit Committee and Remuneration Committee. These committees are mainly composed of and chaired by INEDs. In case of urgency, executive management is empowered to make any decisions in prompt response to the any opportunities and threats that might arise from time to time. However, those emergency decisions or any other exceptional decisions made by management should be reported back to the Board for ratification as soon as practical.

The three independent non-executive directors are persons of high calibre, with academic and professional qualifications in the fields of finance, accounting, consulting and business management. With their experience gained from senior positions held in other companies, they provide valuable support towards the effective discharge of the duties and responsibilities of the Board. Each independent non-executive director gives an annual confirmation of his independence to the Company, and the Company considers these directors to be independent under Rule 3.13 of the Listing Rules. These three INEDs comprise the Audit and Remuneration Committees formed by the Board.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The post of Chairman and Chief Executive Officer ("CEO") are separate and are not held by the same individual to ensure their independence, accountability and responsibility. The Chairman of the Board, Mr. Kyoo Yoon Choi, is responsible formulating the strategic planning, business development, overall leadership and effective running of the Board, by ensuring that all key and appropriate issues are discussed by the Board in a timely and constructive manner.

The post of CEO, supported by other chief executives, is delegated with the authority and responsible for running the Group's business, and implementation of the Group's strategy in achieving the overall commercial objectives. Upon the resignation of Mr. Chul Hong Min on 31 December 2005, the current duties of the CEO is temporarily shared by other executive directors and key executives except the Chairman until a suitable successor is found by the Company.

NOMINATION, APPOINTMENT AND RE-ELECTION OF DIRECTORS

The Company does not have a Nomination Committee. The Board as a whole is responsible for the procedure of agreeing to the appointment of its members and for nominating appropriate person for election by shareholders at the general meeting, either to fill a casual vacancy or as an addition to the existing directors.

Those directors appointed by the Board during the year shall hold office only until the next following general meeting of the Company and shall then be eligible for re-election. The circular dispatched to the shareholders before the general meeting contains, inter alia, detailed information on election of directors including detailed biographies of all directors standing for election or re-election to ensure shareholders to make an informed decision on their election.

The Company has specified the term of two years appointment for independent non-executive directors ("INEDs") who are the only non-executive directors of the Company. None of the INEDs has entered into any service contracts with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation. Moreover, they are also subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the articles of association.

At the annual general meeting of the Company held on 26 May 2006, special resolution in respect of the amendments to the provision of the Articles of Association of the Company has been passed to conform with the CG Code so that (i) any director appointed to fill a casual vacancy shall be subject to re-election by Shareholders at the Company's next following general meeting after the appointment rather than the Company's next following annual general meeting after the appointment, (ii) every director shall be subject to retirement by rotation at least once every three years and directors holding office as the Chairman of the Board or the Managing Director shall also be subject to retirement by rotation and (iii) the Company may remove any Director by an ordinary resolution instead of special resolution.

REMUNERATION COMMITTEE

The Remuneration Committee of the Company comprises one executive director and three INEDs. The Remuneration Committee was formed in January 2005 and meetings shall be held at least once a year. Two meetings were held in 2006. The attendance of each member is set out as follows:

Directors' attendance at the Remuneration Committee meetings held during the year:

Name of director	Number of attendance
Chan Yoo *(Chairman)*	2/2
Valiant, Kin Piu Cheung	2/2
Cheong Heon Yi	2/2
Young M. Lee	2/2

At the meetings held during the year, the retirement compensation and incentive bonus for directors were reviewed and discussed. The Company has adopted a share option scheme on 22 January 2002, which serves as an incentive to attract, retain and motivate talented eligible staff, including the directors. Details of the share option scheme are set out in Note 15 to the financial statements. The emolument payable to directors will depend on their respective contractual terms and nature under employment contracts, if any, and as recommended by the Remuneration Committee. Details of the directors' remuneration are set out in Note 24 to the financial statements. The major roles and functions of the Group's Remuneration Committee are as follows:

1 To review annually and recommend to the Board the overall remuneration policy for the directors and key senior management officers;

2 To review annually the performance of the executive directors and key senior management officers and recommend to the Board specific adjustments and remuneration and/or reward payments;

3 To ensure that the level of remuneration for Non-executive Directors and INEDs are linked to their level of responsibilities undertaken and contribution to the effective functioning of the Board of the respective companies in the Group; and

4 To ensure that no director is involved in deciding his own remuneration.

The terms of reference of the Remuneration Committee are posted on the Company's website.

DIRECTORS' AND AUDITORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

The Management provides such explanation and information to the Board so as to enable the Board to make an informed assessment of the financial and other information put before the approval by the Board.

The Directors acknowledge their responsibility to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the Group and in presenting the interim and annual financial statements, and announcements to shareholders in a timely manner. In preparing the financial statements for the year ended 31 December 2006, the directors have selected suitable accounting policies and have applied them consistently, adopted appropriate Hong Kong Financial Reporting Standards ("HKFRS") which are pertinent to its operations and relevant to the financial statements, made judgements and estimates that are prudent and reasonable. The Board is not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Group's ability to continue as a going concern, the Board therefore continues to adopt the going concern approach in preparing the accounts.

The Board acknowledges its responsibility to present a balanced, clear and understandable assessment in the Company's annual and interim reports, other price-sensitive announcement and other financial disclosures required under the Listing Rules, and reports to the regulators.

The auditor's responsibilities are set out in the Independent Auditor's Report.

AUDIT COMMITTEE

The Audit Committee of the Company comprises three INEDs. The Audit Committee shall meet at least twice a year. Three meetings were held during the year. Brief report of the major findings raised in Audit Committee meeting are presented by the Chairman of the Audit Committee to the Board immediately in the subsequent Board meeting. The minutes of the Audit Committee meetings were circulated to the Board for information and for action by the Board where appropriate. Both the INEDs and external auditors clearly expressed that no meeting without the presence of the management was required. The executive director Mr. Young M. Lee was invited to attend the meetings as the chief financial officer. The attendance of each member is set out as follows:

Directors' attendance at the Audit Committee meetings held during the year:

Name of director	Number of attendance
Cheong Heon Yi *(Chairman)*	2/2
Valiant, Kin Piu Cheung	2/2
Chan Yoo	2/2
Young M. Lee	2/2

During the year ended 31 December 2006, the Audit Committee had performed the following work:

(i) reviewed the interim financial report for the six months ended 30 June 2006 and the annual financial report for the year ended 31 December 2006;

(ii) reviewed the major impact of the changes in accounting policies and practices and the Listing Rules on the accounting treatment and the financial reporting of the Company;

(iii) reviewed the effectiveness of internal control system;

(iv) discussed the nature and scope of the external audit and reporting obligations and reviewed the external auditors' statutory audit plan;

(v) reviewed the findings and recommendations of the management letter from the external auditors in relation to the interim review and audit of the Group;

(vi) reviewed and recommended for approval by the Board the 2006 audit scope, fee and supply of any non-audit services; and

(vii) reviewed the connected transactions entered into by the Group during the year.

The major roles and functions of the Audit Committee are as follows:

1 To consider the appointment of the external auditor, the audit fees, and any questions of resignation or dismissal of the external auditor of the Group.

2 To discuss with the internal and external auditors the nature and scope of the audit.

3 To review the interim and annual financial statements before submission to the Board.

4 To discuss problems and reservations arising from the interim review and final audit, and any matters the auditors may wish to discuss.

5 To review the external auditor's management letters and management's response.

6 To supervise the performance of the internal auditor's review on the Group companies' financial control, internal control and risk management systems.

7 To consider the major findings of internal investigations and management's response.

The terms of reference of the Audit Committee are posted on the Company's website.

AUDITORS' REMUNERATION

During the year under review, the remuneration paid to the Company's auditor, PricewaterhouseCoopers, is set out as follows:

Service rendered	Fees paid/ payable HK$'000
Audit services	3,000
Non-audit services	135
	3,135

INTERNAL CONTROLS

The Company set up an internal audit department in May 2006. The head of internal audit department was appointed by the Board to head the review of the effectiveness of the internal control system of the Group which cover all material controls, including financial, operational and compliance controls as well as risk management functions. The internal auditor has performed review of the internal control system of the Group for the year ended 31 December 2006 and the relevant review report has been submitted to the Audit Committee in April 2007 for consideration. The Board, through the reviews made by the internal auditor and the Audit Committee, considers that the Group's internal control system has implemented effectively.

COMMUNICATIONS WITH SHAREHOLDERS

The Board recognises the importance of good communications with all shareholders. The Company's annual general meeting is a valuable forum for the Board to communicate directly with the shareholders. The Chairman of the Board as well as Chairmen of the Audit and Remuneration Committees together with the external auditors are present to answer shareholders' questions. An annual general meeting circular is distributed to all shareholders at least 21 days before the annual general meeting. It sets out the procedures for demanding and conducting a poll and other relevant information of the proposed resolutions. Separate resolutions are proposed at general meetings on each substantially separate issue, including the election of individual Directors. The Chairman explains the procedures for demanding and conducting a poll again at the beginning of the annual general meeting and (except where a poll is demanded) reveals how many proxies for and against have been filed in respect of each resolution. The results of the poll, if any, will be published in the newspapers and on the Company's website.

A key element of effective communication with shareholders and investors is the prompt and timely dissemination of information in relation to the Group. The Company has announced all its price-sensitive information, announcements, interim and annual results in a timely manner in compliance with the Listing Rules.

VOTING BY POLL

The Company informs the shareholders (in its circulars convening a general meeting) the procedures for voting by poll and the rights of shareholders to demand a poll to ensure compliance with the requirements on the poll voting procedures. In accordance to provision 73 of Article of Association of the Company, at any general meeting a resolution put to the vote of the meeting shall be decided on a show of hands, unless a poll is (before or on the declaration of the result of the show of hands) demanded by:

i) the chairman; or

ii) at least three shareholders present in person or by a duly authorised corporate representative or by proxy for the time being entitled to vote at the meeting; or

iii) any shareholder or shareholders present in person or by a duly authorised corporate representative or by proxy and representing not less than one-tenth of the total voting rights of all shareholders having the rights to vote at the meeting; or

iv) a shareholder or shareholders present in person or by a duly authorised corporate representative or by proxy and holding shares in the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

The Company should count all proxy votes, and except where a poll is required, the chairman of a meeting should indicate to the meeting the level of proxies lodged on each resolution, and the balance for and against the resolution, after it has been dealt with on a show of hands. The issuer should ensure that votes cast are properly counted and recorded.

The chairman of a meeting should at the commencement of the meeting ensure that an explanation is provided of:

i) the procedure for demanding a poll by shareholders before putting a resolution to the vote on a show of hands; and

ii) the detailed procedures for conducting a poll and then answer any questions from shareholders whenever voting by way of a poll is required.

Independent Auditor's Report
To the shareholders of Dream International Limited
(incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Dream International Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 28 to 88, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's loss and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 18 April 2007

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2006

	Notes	2006 HK$'000	2005 HK$'000
Turnover	5	1,084,357	1,040,444
Cost of sales	23	(924,319)	(853,523)
Gross profit		160,038	186,921
Other income	22	6,867	8,322
Selling and distribution expenses	23	(38,310)	(45,602)
Administrative expenses	23	(137,218)	(160,079)
Goodwill impairment losses	8	(100,194)	–
Other losses – net	21	(6,073)	(19,929)
Operating loss		(114,890)	(30,367)
Finance costs	25	(7,684)	(3,339)
Share of (loss)/profit of associates		(237)	652
Loss before income tax		(122,811)	(33,054)
Income tax expense	26	(8,673)	(3,416)
Loss for the year		(131,484)	(36,470)
Attributable to:			
– Equity holders of the Company		(129,671)	(36,348)
– Minority interests		(1,813)	(122)
		(131,484)	(36,470)
Loss per share (expressed in HK$ per share)	28		
– Basic and diluted		(0.194)	(0.054)
Dividends	29	–	–

The notes on pages 34 to 88 are an integral part of these consolidated financial statements.

	Notes	2006 HK$'000	2005 HK$'000
ASSETS			
Non-current assets			
Leasehold land and land use rights	6	16,168	11,269
Property, plant and equipment	7	199,878	147,090
Intangible assets	8	17,268	112,659
Investments in associates	10	1,298	1,483
Deferred income tax assets	19	3,180	7,460
Other financial assets	11	71,054	71,670
		308,846	351,631
Current assets			
Inventories	12	166,123	160,482
Trade and other receivables	13	204,572	176,541
Cash and cash equivalents	14	82,798	103,128
		453,493	440,151
Total assets		762,339	791,782
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	15	52,019	52,019
Reserves	16	369,618	490,930
		421,637	542,949
Minority interests		20,474	14,998
Total equity		442,111	557,947

The notes on pages 34 to 88 are an integral part of these consolidated financial statements.

	Notes	2006 HK$'000	2005 HK$'000
LIABILITIES			
Non-current liabilities			
Borrowings	18	8,684	–
Deferred income tax liabilities	19	322	741
Retirement benefit obligations	20	10,703	10,820
		19,709	11,561
Current liabilities			
Trade and other payables	17	157,515	108,720
Bills payables		18,393	–
Current income tax liabilities		12,214	7,986
Borrowings	18	112,397	105,568
		300,519	222,274
Total liabilities		320,228	233,835
Total equity and liabilities		762,339	791,782
Net current assets		152,974	217,877
Total assets less current liabilities		461,820	569,508

Tae Sub CHOI
Director

Young M. LEE
Director

The notes on pages 34 to 88 are an integral part of these consolidated financial statements.

	Notes	2006 HK$'000	2005 HK$'000
ASSETS			
Non-current assets			
Property, plant and equipment	7	18,211	24,141
Intangible assets	8	308	–
Investments in subsidiaries	9	236,775	304,244
Investments in associates	10	1,248	1,248
Other financial assets	11	69,231	69,847
		325,773	399,480
Current assets			
Inventories	12	51,129	63,832
Trade and other receivables	13	145,559	115,968
Cash and cash equivalents	14	11,769	26,621
		208,457	206,421
Total assets		534,230	605,901
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	15	52,019	52,019
Reserves	16	291,041	393,273
Total equity		343,060	445,292
LIABILITIES			
Non-current liabilities			
Borrowings	18	4,800	–
Deferred income tax liabilities	19	322	741
Retirement benefit obligations	20	6,537	4,816
		11,659	5,557
Current liabilities			
Trade and other payables	17	127,309	88,822
Current income tax liabilities		7,877	7,877
Borrowings	18	44,325	58,353
		179,511	155,052
Total liabilities		191,170	160,609
Total equity and liabilities		534,230	605,901
Net current assets		28,946	51,369
Total assets less current liabilities		354,719	450,849

Tae Sub CHOI
Director

Young M. LEE
Director

The notes on pages 34 to 88 are an integral part of these consolidated financial statements.

	Attributable to equity holders of the Company				
	Share capital HK$'000	Reserves HK$'000	Total HK$'000	Minority interests HK$'000	Total equity HK$'000
Balance at 1 January 2005	51,942	561,642	613,584	–	613,584
Currency translation differences	–	2,752	2,752	–	2,752
Loss for the year	–	(36,348)	(36,348)	(122)	(36,470)
Shares issued under share option scheme	77	1,080	1,157	–	1,157
Equity settled share-based transactions	–	1,915	1,915	–	1,915
Capital contributions received from minority shareholders	–	–	–	15,120	15,120
Dividend relating to 2004	–	(40,111)	(40,111)	–	(40,111)
Balance at 31 December 2005	**52,019**	**490,930**	**542,949**	**14,998**	**557,947**
Balance at 1 January 2006	**52,019**	**490,930**	**542,949**	**14,998**	**557,947**
Currency translation differences	–	7,499	7,499	269	7,768
Loss for the year	–	(129,671)	(129,671)	(1,813)	(131,484)
Equity settled share-based transactions	–	860	860	–	860
Capital contributions received from minority shareholders	–	–	–	7,020	7,020
Balance at 31 December 2006	**52,019**	**369,618**	**421,637**	**20,474**	**442,111**

The notes on pages 34 to 88 are an integral part of these consolidated financial statements.

	Notes	2006 HK$'000	2005 HK$'000
Cash flows from operating activities			
Cash generated from/(used in) from operations	30	39,210	(8,464)
Income tax paid		(583)	(10,787)
Net cash generated from/(used in) operating activities		38,627	(19,251)
Cash flows from investing activities			
Purchase of property, plant and equipment	7	(75,366)	(57,107)
Proceeds from sale of property, plant and equipment	30	3,315	652
Purchase of club memberships and patents	8	(5,384)	–
Prepaid operating lease payments for leasehold land and land use right	6	(4,841)	(1,137)
Interest received		5,403	6,515
Maturity of time deposit		–	7,500
Net cash used in investing activities		(76,873)	(43,577)
Cash flows from financing activities			
Interest paid		(7,684)	(3,339)
Proceeds from exercised share options under share option scheme		–	1,157
Proceeds from borrowings		91,594	125,285
Repayments of borrowings		(76,312)	(80,573)
Dividends paid to Company's shareholders		–	(40,111)
Capital contributions from minority shareholders		7,020	15,120
Net cash generated from financing activities		14,618	17,539
Net decrease in cash, cash equivalents and bank overdrafts		(23,628)	(45,289)
Cash, cash equivalents and bank overdrafts at beginning of year		95,973	141,866
Exchange gains/(losses) on cash, cash equivalents and bank overdrafts		2,491	(604)
Cash, cash equivalents and bank overdrafts at end of the year	14	74,836	95,973

The notes on pages 34 to 88 are an integral part of these consolidated financial statements.

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.

2.16 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	2005	2006	2005	2006	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'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$'000	2005 HK$'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$'000	2005 HK$'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	Club memberships	Patents	Total
	HK$'000	HK$'000	HK$'000	HK$'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 HK$'000	Company Club memberships 2005 HK$'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	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'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:

	Assets	Liabilities	Equity	Revenues	Profit/(loss)
2006	HK$'000	HK$'000	HK$'000	HK$'000	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:

				Percentage of interest in ownership held	
Company name	Country/place of Incorporation/ establishment	Principal activities	Particulars of issued and paid up capital/register capital	by the Company	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	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'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	2005	2006	2005
	HK$'000	HK$'000	HK$'000	HK$'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 HK$'000	2005 HK$'000	2006 HK$'000	2005 HK$'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 HK$'000	2005 HK$'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)	Number of options 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 HK$'000	2005 HK$'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 HK$'000	2005 HK$'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.

Results	2002 HK$'000	2003 HK$'000	2004 HK$'000	2005 HK$'000	2006 HK$'000
Turnover	910,370	931,847	1,158,107	1,040,444	1,084,357
Operating profit/(loss)	124,671	135,410	62,869	(30,367)	(114,890)
Finance costs	(3)	(166)	(830)	(3,339)	(3,339)
Share of (loss)/profit of associates	(483)	(850)	(142)	652	(237)
Profit/(loss) before income tax	124,185	134,394	61,897	(33,054)	(122,811)
Income tax expense	(10,705)	(13,639)	(12,846)	(3,416)	(8,673)
Profit/(loss) for the year	113,480	120,755	49,051	(36,470)	(131,484)
Attributable to:					
Equity holders of the Company	113,480	120,755	49,051	(36,348)	(129,671)
Minority interests	–	–	–	(122)	(1,813)
	113,,480	120,755	49,051	(36,470)	(131,484)
Earnings/(loss) per share					
– Basic	HK$0.179	HK$0.185	HK$0.073	HK$(0.054)	HK$(0.194)
– Diluted	HK$0.178	HK$0.183	HK$0.073	HK$(0.054)	HK$(0.194)

Assets and liabilities	2002 *HK$'000*	2003 *HK$'000*	2004 *HK$'000*	2005 *HK$'000*	2006 *HK$'000*
Non-current assets					
Leasehold and land use rights and property, plant and equipment	90,200	99,411	120,442	158,359	216,046
Investments in associates	4,198	4,596	809	1,483	1,298
Intangible assets	(11,978)	107,609	102,739	112,659	17,268
Other financial assets	78,000	62,104	88,022	71,670*	71,054
Deferred income tax assets	4,743	4,750	5,122	7,460	3,180
Current assets	501,077	481,697	463,431	440,151	453,493
Current liabilities	107,719	153,654	135,287	222,274	300,519
Net current assets	393,358	328,043	328,144	217,877	152,974
Total assets less current liabilities	558,521	606,513	645,278	569,508	461,820
Deferred income tax liabilities	163	11	926	741	322
Other non-current liabilities	33,054	11,772	40,363	10,820	19,387
NET ASSETS	525,304	594,730	603,989	557,947	442,111

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

NOTICE IS HEREBY GIVEN that the Annual General Meeting of Dream International Limited will be held at Pacific Room III, Towers Wing, 9/F., The Royal Pacific Hotel and Towers Hong Kong, 33 Canton Road, China Hong Kong City, Tsimshatsui, Kowloon, Hong Kong on 25 May 2007 at 10:30 a.m. for the following purposes:

ORDINARY BUSINESS

1. To receive and adopt the Audited Accounts of the Company for the year ended 31 December 2006 and the reports of the Directors and Auditors thereon.

2. To re-elect Directors.

3. To approve the Directors' remuneration for the year ended 31 December 2006 and authorise Directors to fix the Directors' remuneration for the year ending 31 December 2007.

4. To re-appoint PricewaterhouseCoopers as Auditors and authorise the Directors to fix their remuneration.

SPECIAL BUSINESS

5. To consider and, if thought fit, pass the following resolutions as Ordinary Resolutions:-

   (1) "THAT:

   (i) subject to paragraph (iii) below, the exercise by the Directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to allot, issue or otherwise deal with any unissued shares in the capital of the Company and to make or grant offers, agreements, options and other rights or issue warrants which may require the exercise of such powers be and is hereby generally and unconditionally approved;

   (ii) the approval in paragraph (i) above shall authorise the Directors of the Company during the Relevant Period to make or grant offers, agreements and/or options which may require the exercise of the powers of the Company referred to in that paragraph at any time during or after the end of the Relevant Period;

   (iii) the aggregate nominal amount of unissued shares in the capital of the Company which may be allotted, issued or otherwise dealt with by the Directors of the Company during the Relevant Period pursuant to paragraph (i) above, otherwise than pursuant to a Rights Issue or the exercise of subscription rights attaching to any warrants issued by the Company, shall not exceed the aggregate of 10 per cent. of the aggregate nominal amount of shares in the capital of the Company in issue as at the date of passing this resolution;

(iv) for the purpose of this resolution:

(a) "Relevant Period" means the period from the passing of this resolution until whichever is the earlier of:

(1) the conclusion of the next annual general meeting of the Company;

(2) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or by law to be held; and

(3) the revocation or variation of the authority given under this resolution by an ordinary resolution of the shareholders of the Company in general meeting; and

(b) "Rights Issue" means an offer of shares in the capital of the Company, or an offer of warrants, options or other securities giving rights to subscribe for shares in the capital of the Company, open for a period fixed by the Directors of the Company, to holders of shares in the capital of the Company whose names appear on the Register of Members of the Company on a fixed record date in proportion to their holdings of shares (subject to such exclusions or other arrangements as the Directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of or the requirements of any recognised regulatory body or any stock exchange)."

(2) "THAT:

(i) subject to paragraphs (ii) and (iii) below, the exercise by the Directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to purchase Shares on The Stock Exchange of Hong Kong Limited be and is hereby generally and unconditionally approved;

(ii) the aggregate nominal amount of Shares which may be purchased pursuant to the approval in paragraph (i) above shall not exceed 10 per cent. of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution, and the said approval shall be limited accordingly;

(iii) for the purpose of this Resolution:

(a) "Relevant Period" means the period from the passing of this Resolution until whichever is the earlier of:

(1) the conclusion of the next annual general meeting of the Company;

(2) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or by law to be held;

(3) the revocation or variation of the authority given under this Resolution by an ordinary resolution of the shareholders in general meeting; and

(b) "Shares" means shares of all classes in the capital of the Company and warrants and other securities issued by the Company which carry a right to subscribe or purchase shares of the Company."

(3) "**THAT** the general mandate granted to the Directors of the Company to exercise the powers of the Company to allot, issue and otherwise deal with shares in the capital of the Company and to make or grant offers, agreements, options and/or warrants which might require the exercise of such powers pursuant to Resolution 5(1) above be and is hereby extended by the addition to the total nominal amount of share capital which may be allotted or agreed conditionally or unconditionally to be allotted by the Directors of the Company pursuant to such general mandate an amount representing the total nominal amount of shares in the capital of the Company purchased by the Company pursuant to the exercise by the Directors of the Company in accordance with Resolution 5(2) above of the powers of the Company to purchase such shares, provided that such amount shall not exceed 10 per cent. of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution." (Note i)

By order of the Board
Kyoo Yoon Choi
Chairman

Hong Kong, 26 April 2007

Notes:

(i) This resolution will be proposed to members for approval provided that resolutions 5(1) and 5(2) are passed by the members.

(ii) A member entitled to attend and vote at the above meeting shall be entitled to appoint more than one person as his proxy, to attend and vote for him in accordance with the Articles of Association of the Company. A proxy need not be a member.

(iii) In the case of joint holders of a share the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders and for this purpose seniority shall be determined by the order in which the names stand in the register in respect of the joint holding.

(iv) To be valid, a form of proxy and the power of attorney or other authority (if any) under which it is signed (or a notarially certified copy thereof) must be deposited at 8th Floor, Tower 5, China HK City, 33 Canton Road, Tsimshatsui, Kowloon, Hong Kong not less than 48 hours before the time appointed for the holding of the above meeting or any adjournment thereof.

(v) The Register of Members will be closed from 21 May 2007 to 25 May 2007, both dates inclusive, during which period no share transfers can be registered.


Dream International Limited