



Playmates Toys Limited

彩星玩具有限公司*

Incorporated in Bermuda with limited liability

(Stock Code: 869)

Listing by
Introduction

Sponsor

WAG WORLDSEC CORPORATE FINANCE LIMITED

IMPORTANT

If you are in any doubt about this document, you should obtain independent professional advice from your stockbroker, bank manager, solicitor, professional accountant or other professional advisor.



PLAYMATES TOYS LIMITED

彩星玩具有限公司*

(Incorporated in Bermuda with limited liability)

INTRODUCTION OF THE ENTIRE ISSUED SHARE CAPITAL OF THE COMPANY ON THE MAIN BOARD OF THE STOCK EXCHANGE OF HONG KONG LIMITED

Nominal Value : HK\$0.01 each

Stock code : 869

Sponsor

WAG WORLDSEC CORPORATE FINANCE LIMITED

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This document is published in connection with the Introduction on the Hong Kong Stock Exchange of the Shares presently in issue and contains particulars given in compliance with the Securities and Futures (Stock Market Listing) Rules (Chapter 571V of the Laws of Hong Kong) and the Listing Rules solely for the purpose of giving information with regard to the Company and its subsidiaries.

This document does not constitute an offer of, nor is it calculated to invite offers for, shares or other securities of the Company, nor have any such shares or other securities been allotted with a view to any of them being offered for sale to or subscription by the public. No new shares in the share capital of the Company will be allotted and issued in connection with, or pursuant to, this document.

Information regarding the proposed arrangements for the listing of, and dealings and settlement of dealings in, the ordinary Shares following the Introduction is set out in the section entitled "Information about this Listing Document and the Introduction" in this document.

* *for identification purpose only*

31 December 2007

EXPECTED TIMETABLE

| | |
|--|--|
| Last day of dealings in PHL Shares on a cum entitlement basis | Friday, 18 January 2008 |
| First day of dealings in PHL Shares on an ex entitlement basis | Monday, 21 January 2008 |
| Latest time for lodging transfers of the PHL Shares cum entitlement to the Shares pursuant to the Distribution | 4:30 p.m. on Tuesday, 22 January 2008 |
| Register of members of PHL closes from | Wednesday, 23 January 2008 |
| PHL SGM | 9:00 a.m. on Friday, 25 January 2008 |
| Distribution Record Date | Friday, 25 January 2008 |
| Declaration of the distribution of a special interim dividend by PHL to be satisfied by way of distribution in specie of Shares to Qualifying PHL Shareholders | Friday, 25 January 2008 |
| Announcement of PHL SGM results | Monday, 28 January 2008 |
| Register of members of PHL opens on | Monday, 28 January 2008 |
| Shares certificates to be dispatched on | Wednesday, 30 January 2008 |
| Dealings in Shares on the Hong Kong Stock Exchange expected to commence on | 9:30 a.m. on Friday, 1 February 2008 |

Note:

1. All times refer to Hong Kong local time.
2. If the conditions referred to in the section headed “INFORMATION ABOUT THIS LISTING DOCUMENT AND THE INTRODUCTION – 9. CONDITIONS OF THE INTRODUCTION” are not fulfilled, the Introduction will lapse and the Stock Exchange will be notified immediately. We will cause notice of the lapse of the Introduction to be published by us in the South China Morning Post (in English) and the Hong Kong Economic Journal (in Chinese) on the next day following such lapse. In addition, if there is any revision to the above timetable, a separate announcement will be made by the Company.

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The Company has not authorised anyone to provide you with information that is different from what is contained in this document. Any information or representations not made in this document must not be relied upon by you as having been authorised by the Company, the Sponsor, any of their respective directors or any other person or party involved in the Introduction.

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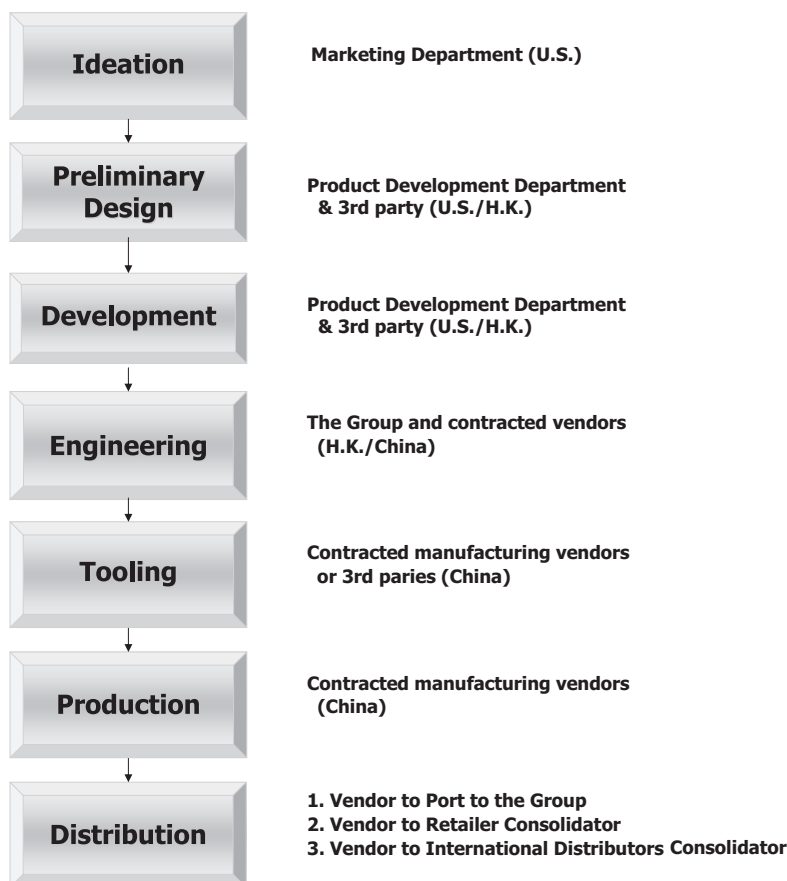
SUMMARY

This summary aims to give you an overview of the information contained in this document. As this is a summary, it does not contain all the information that may be important to you. You should read the entire document.

1. OVERVIEW

We design, develop, market and distribute a diverse portfolio of innovative branded toys. We market and distribute our products in over 50 countries worldwide. Our current product categories consist of action figures, vehicles, dolls, feature plush, role play toys and interactive electronic toys. We develop a wide range of products in these categories by acquiring rights in entertainment properties (including brands) from third parties and by developing brands internally. We also acquire rights in patented technologies and inventions through Inventor Licenses for use in our products. Our products can be categorised generally into licensed brands and proprietary brands – licensed brands are products that are principally based on entertainment properties held by third parties which we acquired the rights to use through Entertainment Licenses; while proprietary brands are brands we develop internally. Our key licensed brands include the *Teenage Mutant Ninja Turtles* range of toys, the *Disney Princess* brand dolls and the *Strawberry Shortcake* dolls. Our proprietary brands include *Amazing Dolls*, *WOW Pals*, *Struts* and *Playmates Electronics*. Design activities undertaken by us are set out in the sections headed “BUSINESS – PRODUCT DEVELOPMENT” and “BUSINESS – SOURCING AND PRODUCTION”.

The chart below summarises our product development work flow.



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Our product development involves in-house as well as external parties. Once in-house and external parties determine the design and specific requirements for our products, our Hong Kong and Shenzhen operations oversee their sourcing and production. These teams review the design and engineering of products for manufacturability and select contracted vendors or third parties with matching technical capabilities for production requirements and quality assurance. Finished goods are packaged and are shipped to our U.S. distribution centre or the point of delivery in the PRC or Hong Kong.

We also intend to expand our product offerings into targeted growth categories such as arts and crafts, preschool and youth electronics. We believe our ability to build long-term brand franchises and to quickly bring innovative new products from concept to retail shelves is recognized by the trade community which we operate in, including licensors, retailers and distributors.

We focus on building long-term brand franchises and creating innovative products. Our current major products include *Teenage Mutant Ninja Turtles* action figures, accessories and role play toys, *Disney Princess* brand large dolls and accessories and the *Amazing* brand interactive dolls. As an example of our long-term brand building ability, we have been developing and selling *Turtles* products since 1988. We seek to regularly expand our brand portfolio and product offerings, and have introduced the first *Amazing* doll in 1998, dolls and accessories based on *Disney Princess* characters in 2001, American Greetings' *Strawberry Shortcake* in spring 2006, fashion dolls and playsets based on *Disney Fairies* characters in fall 2006, and a line of preschool toys featuring characters from Universal Studios' *Land Before Time* in fall 2007.

We maintain close working relationships with major entertainment licensors and the toy invention and design community worldwide. These relationships help us gain access to licensed rights in new entertainment properties, new technologies and inventions. We currently hold master toy licenses and product category-specific licenses from American Greetings, DIC Entertainment, 4Kids Entertainment, Disney, Microsoft, Mirage Studios, Nickelodeon, Sesame Workshop, Universal Studios and others, which allow us to design, develop and market products branded with popular franchises such as *Blue's Clues*, *Care Bears*, *Disney Princess*, *Disney Fairies*, *Land Before Time*, *Popples*, *Sesame Street*, *Strawberry Shortcake* and *Teenage Mutant Ninja Turtles* brands. Master toy licenses generally grant us broad rights to create, market and distribute toys in a broad range of categories, as opposed to product category-specific licenses which grant us rights only in respect of a specific product categories, eg. baby dolls, accessories. Creating, developing and marketing toys based on these popular children's entertainment properties enable us to enhance the uniqueness and appeal of our products and benefit from the extensive entertainment production, marketing and promotional efforts of our licensing partners.

SUMMARY

As at the Latest Practicable Date, we had a total of 36 active licenses which are currently used in production, of which 13 are Entertainment Licenses and 23 are Inventor Licenses. Set out below is a summary of our major licensed brands:

| Product | Licensor | Scope |
|--------------------------------|--------------------|-------------------------|
| TMNT | Mirage Studios | Master Toy License |
| Strawberry Shortcake | American Greetings | Master Toy License |
| Sesame Street | Sesame Workshop | Baby Dolls |
| Care Bears | American Greetings | Baby Dolls |
| Disney Princess brand products | Disney | Large Dolls/Accessories |
| Disney Fairies brand products | Disney | Toy License |
| Land Before Time | Universal Studios | Master Toy License |
| Popples | American Greetings | Master Toy License |

The terms of the above licenses are currently scheduled to expire between 2007 and 2011. Discussions for license renewals of some of the licenses are in process. Of the licenses without renewals option that are expiring in 2007 and 2008, apart from one of these licenses that we may not intend to renew for commercial reasons, we had long term business relationship with the licensors of all these licenses and we had always been successful in renewing the relevant licenses with these licensors. However, as will be discussed in the section headed "RISK FACTORS", we cannot give assurance that we will be able to successfully renew the licenses. Many of our licenses are either valid as long as the products using the licensed rights are being sold by our Company or renewable.

Under most of our licenses, we are typically granted the right to use the intellectual properties licensed in the manufacturing, sale, advertisement, promotion and distribution of relevant products. Our responsibility is typically limited to royalty payments, however under some licenses, we also need to fulfill a minimum annual marketing requirement, based on a percentage of annual sales.

Our licenses require us to either pay a one-off payment or royalties. The calculation of royalty varies in different licenses, from a fixed or variable percentage of the net invoiced billings or net wholesale price to a fixed monetary amount per unit manufactured and shipped, with or without a minimum royalty payments guarantee or advanced royalties. Royalty terms are typically heavily negotiated and the royalty terms of our major licenses range from approximately 1% to 15% of the net wholesale selling price or net sales of the products.

Advanced royalties represent prepayments made to licensors of intellectual properties under licensing agreements which are recoupable against future royalties. Advanced royalties are amortised at the contractual royalty rate based on actual product sales. Management evaluates the future realisation

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of advanced royalties periodically and charges to expense any amounts that management deems unlikely to be recoupable at the contractual royalty rate through product sales. All advanced royalties are amortised within the term of the license agreement and are written off upon the abandonment of the product or upon the determination that there is significant doubt as to the success of the product.

The royalty expenses paid were HK\$145,874,000, HK\$125,965,000, HK\$102,488,000, HK\$33,549,000 for each of the years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007 respectively.

We maintain relationships with the worldwide toy invention and design community. We regularly license rights in new technologies and inventions from these inventors and designers and use these technologies and inventions to extend our product offerings in both our licensed brands and proprietary brands. Most of our Inventor Licenses grant us exclusive rights in these technologies and inventions and generally specifies terms of no fewer than three years. Recent examples of brands incorporating licensed technologies and inventions include *Turtles*, *Speedeez*, *Amazing Dolls* and *Waterbabies*.

Our ability to continue to have access to, and acquire Entertainment Licenses and Inventor Licenses is a key component of our long-term growth strategy.

Our key distribution channels in the U.S. include national mass merchandise retailers and national toy specialty chain stores, membership warehouse clubs, as well as supermarket, pharmacy and dollar store chains. We serve our U.S. customers through our in-house sales team that is complemented by a network of independent sales representatives who maintain close working relationships with our customers. Outside the U.S., we work with a network of independent toy distributors that manage the marketing and distribution of our products in over 50 countries around the world.

We sell our products to U.S. merchandise retailers, national toy specialty chain stores and independent toy distributors and receive payment for our products from these parties, as our products are not sold on a consignment basis to these parties. We therefore consider all these parties as our customers.

Recently, there have been widely publicized product recalls on safety grounds by toy companies in the U.S. Such incidents, among other things, caused consumer sentiments in the U.S. to appear to be increasingly negative towards products, in particular toys, manufactured in or sourced from the PRC. In light of these incidents, new regulations and legislations are being drafted in the U.S. and new requirements have been imposed in the PRC. Please see the section headed "BUSINESS – QUALITY CONTROL" for further details.

2. OUR STRENGTHS

Based on our reputation and credibility that we built over the last four decades or so, we attribute our success to date and our current opportunities to increase our sales, profit and market share to our following competitive strengths:

- Strong relationships with major entertainment licensors
- Brand management and marketing expertise

SUMMARY

- Design expertise and product innovation
- Efficient and scalable operating structure
- Multi-channel U.S. and international distribution network
- Seasoned management team

3. OUR GROWTH STRATEGIES

Key elements of our growth strategy include:

- Acquire rights in new Entertainment Licenses and inventions
- Expand product portfolio in targeted growth categories
- Broaden worldwide distribution

4. RISK FACTORS

There are certain risks involved in our operations. These risks can be categorized into (i) risks relating to our business; (ii) risks relating to the toy industry; (iii) risks relating to the Shares and the Introduction; and (iv) risks relating to conducting operations in the PRC. A detailed discussion of the risk factors is set forth in the section headed “RISK FACTORS” in this document. The following is a list of risk factors outlined in that section:

Risks relating to our business

- Potential changes to the U.S. federal tax and other laws could increase our effective tax rate or could have other adverse effects on our business.
- Recent widely publicized product recalls on safety grounds by toy companies in the U.S. toy industry could adversely affect our business, financial conditions and results of operations.
- We cannot ensure that raw materials used by our third party OEM and ODM vendors are of the same specification and standards required by us.
- We have been experiencing a downward trend in turnover and profit, and incurred relatively high fixed costs during the Track Record Period, and we had a history of loss making in the mid-to-late 1990s. Our operating results may continue to decline.
- Our business relies heavily on licenses from third parties, and on our ability to retain and renew existing licenses, and obtain licenses for new products and technology.
- Competition for licenses could increase our licensing costs and limit our ability to renew existing licenses, and to obtain and retain new Entertainment Licenses and Inventor Licenses.

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- We currently rely, and expect to continue to rely, on orders for our products from a small group of major customers.
- We currently generate a significant portion of our revenue from a few brands.
- We may fail to anticipate or respond to changes in consumer tastes and market trends in a timely manner.
- Our results of operations may fluctuate due to seasonality factors in the U.S. market.
- We outsource the production of all of our finished products and rely on a limited number of third party OEM or ODM vendors to produce all of our finished products.
- We may be subject to legal liability if any of our vendors breaches the code of conduct imposed by any of our customers that sells our product, or uses raw materials that are not of the same specifications and standards required by us, or if any of our products are recalled.
- We may be exposed to litigations which could adversely affect our reputation and business.
- We cannot ensure that the molds and tools provided by us for use by our third party OEM and ODM vendors are not used for purposes not authorised by us and not for the production of our products.
- We rely on third party logistics services for the timely delivery of our products in good condition.
- We rely on third party international toy distributors for all of our sales outside the U.S.
- Increases in the costs of raw materials and labor associated with the manufacturing of our products could increase our costs and reduce our gross margins and profits.
- We depend on key personnel, and we may not be able to retain, hire and integrate sufficient qualified personnel to maintain and expand our business.
- Fluctuations in the value of the Hong Kong dollar relative to the U.S. dollar could increase our expenses and adversely affect our financial condition.
- Appreciation in the value of the RMB against the Hong Kong dollar could cause increases in costs of our finished products.
- The widespread outbreak of any severe contagious disease or pandemic, if uncontrolled, could adversely affect our results of operations.

SUMMARY

Risks relating to the toy industry

- Sales volumes of toy products are highly seasonal.
- The toy industry is highly competitive.
- Toy companies may, in the usual course of their business, be exposed to claims from third parties that these toy companies may have infringed their intellectual property rights.
- The business and reputation of toy companies may be affected by product liability claims and adverse publicity arising from other claims, litigation, complaints and product recalls, relating to the use of their products.

Risks relating to the Shares and the Introduction

- There has been no prior public market for our Shares, and the liquidity and market price of our Shares may be volatile.
- The price of our Shares may fluctuate substantially and investments in our Shares may decline in value.
- A potential sale of our Shares by our existing Shareholders could have an adverse effect on our share price.
- We may not be able to pay any dividends on our Shares.
- The interests of our Controlling Shareholders may not necessarily be aligned with other Shareholders.
- We may become subject to taxes in Bermuda after 2016.

Risks relating to conducting operations in the PRC

- Changes in the PRC's political and economic policies could have an adverse effect on our business operations and results of operations.
- The PRC legal system is less developed than that in certain other jurisdictions and contains inherent uncertainties which could adversely affect our business and results of operations.

5. SUMMARY OF FINANCIAL INFORMATION

The following tables present summary financial information of the Group for the periods indicated. The combined income statements of the Group for the three years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2006 and 2007 and the combined balance sheets as at 31 December 2004, 2005 and 2006 and 30 June 2007 have been derived from, and should be read in conjunction with, the "APPENDIX I – ACCOUNTANTS' REPORT" in this document. Our financial information has been prepared in accordance with HKFRS.

SUMMARY

Combined income statements

| | Year ended 31 December | | | Six months ended 30 June | |
|--|------------------------|-----------------------|----------------------|-----------------------------|------------------------|
| | 2004 | 2005 | 2006 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| | | | | (Unaudited) | |
| Turnover | 1,282,662 | 1,277,607 | 1,127,997 | 317,579 | 347,579 |
| Cost of sales | <u>(584,035)</u> | <u>(637,264)</u> | <u>(586,826)</u> | <u>(173,510)</u> | <u>(183,254)</u> |
| Gross profit | 698,627 | 640,343 | 541,171 | 144,069 | 164,325 |
| Marketing expenses | (318,646) | (305,822) | (296,536) | (92,840) | (79,525) |
| Selling, distribution and administrative expenses | <u>(214,260)</u> | <u>(242,002)</u> | <u>(216,662)</u> | <u>(83,320)</u> | <u>(94,418)</u> |
| Operating profit/(loss) | 165,721 | 92,519 | 27,973 | (32,091) | (9,618) |
| Non-operating income/ (expenses) | | | | | |
| Interest expense and bank charges | (10,071) | (7,341) | (5,877) | (1,667) | (1,618) |
| Other revenue | 739 | 3,002 | 5,131 | 2,406 | 2,421 |
| Share of (loss)/profit of an associate | <u>(1,140)</u> | <u>1,149</u> | <u>2,930</u> | <u>(923)</u> | <u>(485)</u> |
| Profit/(loss) before taxation | 155,249 | 89,329 | 30,157 | (32,275) | (9,300) |
| Taxation credit/(charge) | <u>25,859</u> | <u>14,674</u> | <u>(4,033)</u> | <u>14,351</u> | <u>(5,337)</u> |
| Profit/(loss) for the year/period | <u><u>181,108</u></u> | <u><u>104,003</u></u> | <u><u>26,124</u></u> | <u><u>(17,924)</u></u> | <u><u>(14,637)</u></u> |
| Dividends | <u><u>–</u></u> | <u><u>–</u></u> | <u><u>–</u></u> | <u><u>–</u></u> | <u><u>36,660</u></u> |
| Earnings/(loss) per share | <i>HK cents</i> | <i>HK cents</i> | <i>HK cents</i> | <i>HK cents</i> | <i>HK cents</i> |
| Basic | <u><u>36.59</u></u> | <u><u>21.01</u></u> | <u><u>5.28</u></u> | <u><u>(3.62)</u></u> | <u><u>(2.96)</u></u> |

SUMMARY

Combined balance sheets

| | As at 31 December | | | As at 30 June |
|--|-------------------------|-------------------------|-------------------------|-------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| Non-current assets | | | | |
| Property, plant and equipment | 7,277 | 8,324 | 5,904 | 5,521 |
| Investment in an associate | 24,717 | 25,866 | 26,346 | 25,861 |
| Deferred tax assets | 68,391 | 85,728 | 80,077 | 75,096 |
| | <u>100,385</u> | <u>119,918</u> | <u>112,327</u> | <u>106,478</u> |
| Current assets | | | | |
| Inventories | 36,736 | 57,606 | 49,353 | 48,917 |
| Trade receivables | 336,433 | 371,370 | 353,212 | 121,593 |
| Other receivables, deposits and prepayments | 31,685 | 44,442 | 59,759 | 66,452 |
| Amount due from a fellow subsidiary | – | 130 | 244 | 29 |
| Amount due from intermediate holding companies | 2,450 | 2,543 | 4,993 | 4,993 |
| Taxation recoverable | – | – | 1,043 | 1,059 |
| Cash and bank balances | 39,391 | 80,057 | 90,541 | 97,103 |
| | <u>446,695</u> | <u>556,148</u> | <u>559,145</u> | <u>340,146</u> |
| Current liabilities | | | | |
| Bank loans | 19,500 | 19,000 | 66,500 | – |
| Trade payables | 61,643 | 90,777 | 91,041 | 47,517 |
| Other payables and accrued charges | 129,149 | 132,489 | 122,976 | 57,458 |
| Amount due to a fellow subsidiary | 1,500 | – | – | – |
| Amount due to the ultimate holding company | 6,884 | 14,245 | 19,942 | 8,355 |
| Provisions | 64,809 | 51,775 | 49,260 | 26,780 |
| Taxation payable | 72,998 | 72,817 | 755 | 1,183 |
| | <u>356,483</u> | <u>381,103</u> | <u>350,474</u> | <u>141,293</u> |
| Net current assets | <u>90,212</u> | <u>175,045</u> | <u>208,671</u> | <u>198,853</u> |
| Total assets less current liabilities | <u>190,597</u> | <u>294,963</u> | <u>320,998</u> | <u>305,331</u> |
| Non-current liabilities | | | | |
| Deferred tax liabilities | – | 270 | 181 | 181 |
| Net assets | <u>190,597</u> | <u>294,693</u> | <u>320,817</u> | <u>305,150</u> |
| Capital and reserves | | | | |
| Share capital | 2,420 | 93 | 93 | 93 |
| Reserves | 188,177 | 294,600 | 320,724 | 305,057 |
| Shareholders' funds | <u>190,597</u> | <u>294,693</u> | <u>320,817</u> | <u>305,150</u> |

SUMMARY

6. THE PHL GROUP

PHL is a company incorporated in Bermuda and was listed on the Main Board of the Stock Exchange on 6 January 1994. The principal business of the PHL Group, after the Reorganization and the Spin-off, will be in property investments, property management business, and securities and other investments.

PHL's principal property investments includes The Toy House at 100 Canton Road, Tsimshatsui and Playmates Factory Building at 1 Tin Hau Road, Tuen Mun, and a number of properties at 21-23A MacDonnell Road, Hong Kong. PHL's property investment also includes certain residential properties in Hong Kong.

The property management function of the PHL Group is operated through Prestige Property Management Limited (*Prestige*), an indirect wholly owned subsidiary of PHL. Prestige's property management function includes managing The Toy House, Playmates Factory Building and 21-23A MacDonnell Road, and providing a full range of services including collecting rental and management fees, attending to repair and maintenance requirements, providing security control and preparing budgets and accounts.

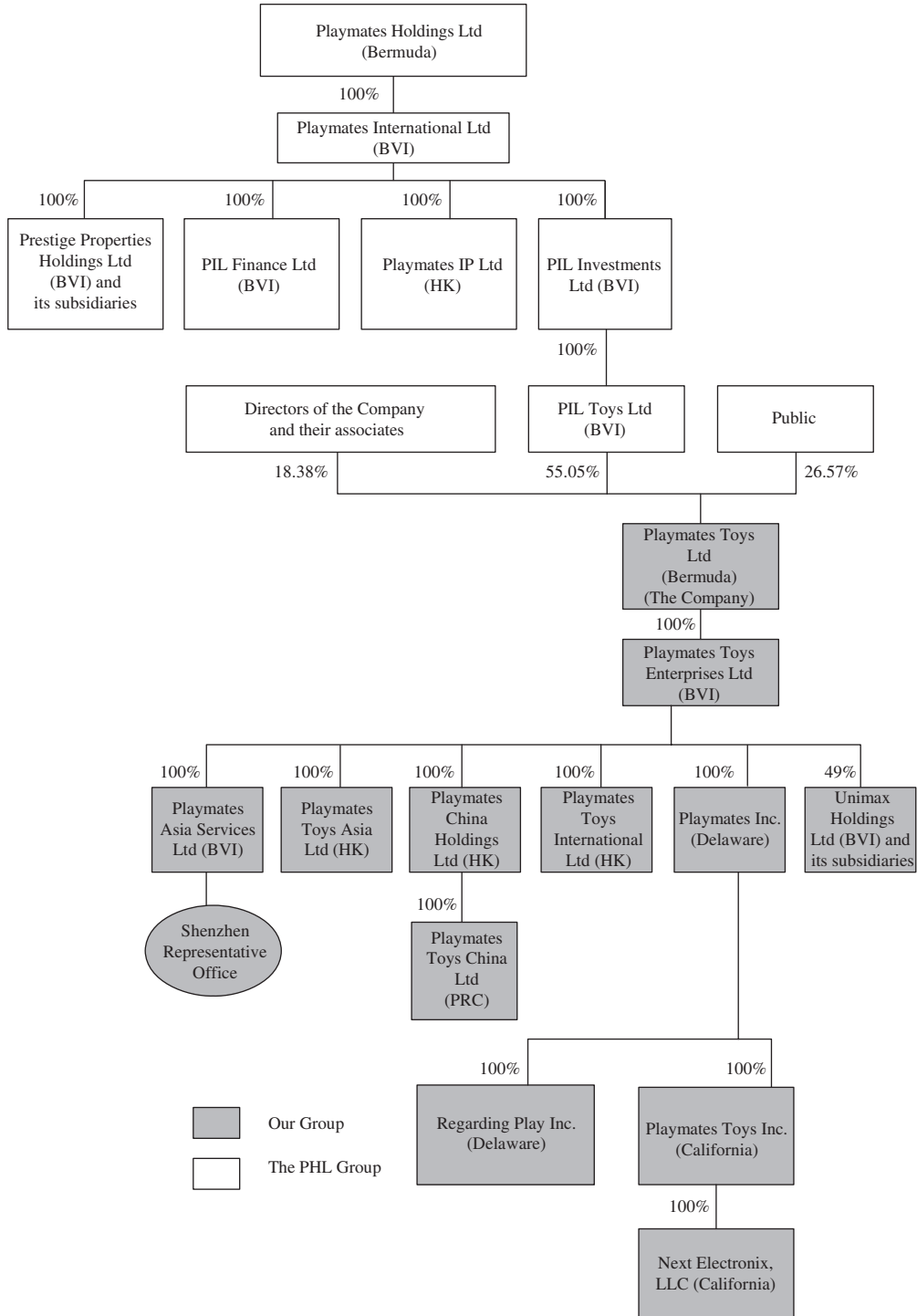
The operating profits on such property investments and management business for each of the financial years ended 31 December 2004, 2005 and 2006 was HK\$79,142,000, HK\$94,293,000 and HK\$260,718,000 respectively.

Securities investments are part of the treasury activities of the PHL Group. Investment decisions on securities are typically taken following consultation with external advisers qualified in the field of securities management. The net gain on such securities investments recorded by the PHL Group in each of the financial years ended 31 December 2004, 2005 and 2006 was HK\$3,845,000, HK\$14,466,000 and HK\$37,118,000 respectively.

For details of PHL Group results disregarding the toy business, please refer to the annual reports of PHL for each of the financial years ended 31 December 2004, 2005 and 2006.

SUMMARY

The following group structure chart summarises the corporate structure of the Group and shows the relationship between the Group and the key entities of the PHL Group after the Reorganization, Spin-Off and Distribution:



SUMMARY

7. OUR REORGANIZATION

We underwent the Reorganization in May 2007 to effectively consolidate under our Company the toy business of the Playmates Group. Prior to the Reorganization, the Playmates Group, through PIL, directly and indirectly owned our toy business. The Reorganization, was also effected to facilitate the Spin-off. The benefits of the Spin-off and Introduction to the Company are summarised in this section under the heading “9. REASONS FOR THE INTRODUCTION” and further detailed in this document under the section headed “REASONS FOR THE INTRODUCTION”.

Following the Reorganization, the Playmates Group’s ownership of the toy business was transferred to us. The principal steps of the Reorganization involved (i) the transfer to us of the U.S.-based toy business from the Playmates Group, (ii) the transfer to us of the Hong Kong and PRC-based toy business from the Playmates Group; and (iii) the incorporation of Playmates Toys Enterprises Limited as an immediate holding company of each of our Hong Kong, U.S. and PRC-based toy business operating companies. The Reorganization will be completed before the Introduction. Details of the steps involved in the Reorganization are set out in Appendix IV to this document under the heading “1.5 Reorganization”.

8. THE DISTRIBUTION

In connection with the Spin-off, the board of directors of PHL has on 17 December 2007 conditionally declared a special dividend by PHL to Qualifying PHL Shareholders. Upon the passing of the resolution to approve the Distribution at the PHL SGM, the PHL’s shareholders will vote to approve the proposed PHL Capital Reorganisation comprising of the PHL Capital Reduction under which the nominal value of every PHL Share in issue will be reduced from HK\$0.10 to HK\$0.01 and the PHL Share Consolidation under which every ten issued PHL shares of HK\$0.01 each resulting from the PHL Capital Reduction will be consolidated into one Consolidated PHL Share of HK\$0.10 each. Upon the approval of the PHL Capital Reorganisation, the Distribution will be wholly satisfied by way of distribution in specie to Qualifying PHL Shareholders of an aggregate of not less than approximately 222,523,256 Shares, constituting approximately 45% of the issued share capital of our Company as at the Distribution Record Date. Qualifying PHL Shareholders will receive one Share of our Company for every one Consolidated PHL Share held as at the Distribution Record Date. PHL will effect the Distribution after (i) PIL Toys distributes approximately 222,523,256 Shares to PIL Investments Limited, (ii) PIL Investments Limited distributes approximately 222,523,256 Shares to PIL, (iii) PIL distributes approximately 222,523,256 Shares to PHL and (iv) the PHL Capital Reorganisation. For further details of how the Distribution is effected, please refer to “APPENDIX IV – STATUTORY AND GENERAL INFORMATION – 1.3 Changes in the Share Capital of the Company”.

The Distribution is conditional upon:

- (i) the granting by the Listing Committee of the Stock Exchange of listing of, and permission to deal in, the Shares in issue and any Shares which may be issued pursuant to the exercise of the options which may be granted under the Share Option Scheme; and
- (ii) the passing at the PHL SGM of the necessary resolutions to approve the Distribution,

on or before the earlier of the Listing Date and 31 March 2008.

SUMMARY

Overseas Shareholders (excluding the Excepted Overseas Shareholders), if any, would be entitled to the Distribution but would not receive the Shares; instead, they would receive a cash amount equal to the net proceeds of the sale of their Shares by PHL on their behalf after dealing commences at the prevailing market price. The proceeds of such sale, net of expenses, will be paid to the relevant Overseas Shareholder (excluding the Excepted Overseas Shareholders) in Hong Kong dollars, unless the net proceeds falling to be distributed to the relevant Overseas Shareholder (excluding the Excepted Overseas Shareholders) is less than HK\$100, in which case such proceeds will be retained by and for the benefit of PHL.

We will despatch share certificates to Qualifying PHL Shareholders on 30 January 2008.

As at the Latest Practicable Date, there were a total of 2,225,232,569 PHL Shares allotted and issued to PHL's shareholders. Immediately after completion of the proposed PHL Capital Reorganisation, there will be a total of approximately 222,523,256 Consolidated PHL Shares allotted and issued to PHL's shareholders.

9. REASONS FOR THE INTRODUCTION

We believe a listing on the Stock Exchange may benefit the Company in the following ways:

- Enhancing our business profile
- Improving our profile with major customers
- Securing major licences
- Providing new sources of capital opportunity
- Incentivizing executives and staff
- Increasing management focus and motivation
- Creating our own investor base
- Clarity of credit profile

As there is no current funding requirement for the Group, no raising funds is arranged as part of this Introduction.

10. DIVIDEND POLICY

We may distribute dividends by way of cash or by other means that we consider appropriate. A decision to distribute any dividends would require the approval of our Board and will be at their discretion, subject to any requirements in our Bye-laws. In addition, any final dividend for a financial year will be subject to Shareholders' approval.

SUMMARY

A decision to declare or to pay any dividends in the future, and the amount of any dividends, depend on a number of factors, including our results of operations, working capital requirements, financial condition, statutory and regulatory restrictions on the payment of dividends, taxation considerations, future prospects and other factors that our Directors may consider important.

There can be no assurance that we will declare or distribute any dividend. There has been no historical dividend distribution (other than a distribution solely for the purposes of effecting the Reorganisation) and we currently do not have a definitive dividend payout plan or policy and tentative dividend payout ratio. The dividend distribution record of PHL in the past may not be used as a reference or basis to determine the level of dividends that may be declared or paid by us in the future.

DEFINITIONS

1. DEFINITIONS

In this document, unless the context otherwise requires, the following terms shall have the meanings set out below.

| | |
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| “Board” | the board of Directors |
| “Business Day” | a day that is not a Saturday, Sunday or public holiday in Hong Kong |
| “Bye-laws” | the bye-laws of the Company from time to time |
| “C-TPAT” | Customs Trade Partnership Against Terrorism |
| “CBP” | U.S. Customs and Border Protection |
| “CCASS” | the Central Clearing and Settlement System established and operated by HKSCC |
| “China”, “PRC” and “Mainland China” | the People’s Republic of China, excluding, for the purposes of this document only, Hong Kong, the Macau Special Administrative Region of the PRC and Taiwan |
| “Code” | Hong Kong Code on Takeovers and Mergers |
| “Companies Act” | the Companies Act 1981 of Bermuda |
| “Companies Ordinance” | the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) |
| “Consolidated PHL Share(s)” | new PHL Share(s) of HK\$0.10 each in the share capital of PHL upon the PHL Share Reorganisation being effective |
| “Controlling Shareholder(s)” | has the meaning ascribed to it under the Listing Rules and means anyone who will be entitled to exercise, or control the exercise of, 30% or more of the voting rights in general meetings of the Company immediately after the Introduction. In the context of the Company and for the purposes of this document means Mr. Chan Chun Hoo, Thomas, Angers Investments Limited, PHL, PIL, PIL Investments Limited and PIL Toys |
| “CPSC” | U.S. Consumer Product Safety Commission |

DEFINITIONS

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|----------------------------------|---|
| “Director(s)” | the director(s) of the Company |
| “Distribution” | the distribution of a conditional special dividend by PHL to be satisfied by way of distribution in specie of an aggregate of not less than approximately 222,523,256 Shares to Qualifying PHL Shareholders whose names appeared on the register of members of PHL at 4:00 p.m. on the Distribution Record Date, subject to the satisfaction of certain conditions as described in the section in this document entitled “HISTORY AND REORGANIZATION” |
| “Distribution Record Date” | 25 January 2008, being the record date for ascertaining entitlement to the Distribution |
| “Entertainment Licenses” | licenses on entertainment properties granted by third party owner of the related intellectual property rights |
| “Excepted Overseas Shareholders” | Overseas Shareholders whose addresses, as shown on the register of member of PHL at 4:00 p.m. on the Distribution Record Date, are in the United Kingdom, Malaysia, Singapore, Macau and the United States |
| “FTASC” | The Foreign Trade Association of Southern California |
| “Group” or “Company” | Playmates Toys Limited and its subsidiaries |
| “HKFRS” | Hong Kong Financial Reporting Standards |
| “HKSCC” | Hong Kong Securities Clearing Company Limited |
| “Hong Kong” or “HK” | the Hong Kong Special Administrative Region of the PRC |
| “Hong Kong dollar(s)” or “HK\$” | Hong Kong dollars, the lawful currency of Hong Kong |
| “Hong Kong GAAP” | generally accepted accounting principles of Hong Kong |
| “Illektron” | Illektron LLC, a limited liability company incorporated in California, U.S., an independent third party |
| “Indemnifiers” | PHL, PIL, PIL Investments Limited and PIL Toys |

DEFINITIONS

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| “Inventor Licenses” | licenses granted by third party owners of technologies and inventions |
| “Listing Rules” | the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange |
| “Hong Kong Stock Exchange” or “Stock Exchange” | The Stock Exchange of Hong Kong Limited |
| “Introduction” | the listing of the Shares on the Main Board of the Stock Exchange by way of an introduction pursuant to the Listing Rules |
| “Latest Practicable Date” | 28 December 2007, which is the latest practicable date prior to the printing of this document, for the purposes of ascertaining certain information for inclusion in this document |
| “Listing Date” | 1 February 2008, on which the Shares are first listed and from which dealings therein are permitted to take place on the Stock Exchange |
| “Memorandum of Association” | memorandum of association of the Company |
| “ODM” | original design manufacturer |
| “OEM” | original equipment manufacturer |
| “Overseas Shareholders” | registered holders of PHL Shares whose addresses on PHL’s register of members were outside Hong Kong at 4:00 p.m. on the Distribution Record Date and in relation to whom the applicable laws, rules or regulations require additional registrations or compliance with other procedures before the Distribution may be effected in relation to such registered shareholders of PHL, which PHL determines to be unduly burdensome or onerous on PHL, or in relation to whom PHL determines, in its sole discretion, that there are other difficulties in effecting the Distribution |
| “PAS” | Playmates Asia Services Limited, a company incorporated in the British Virgin Islands on 5 January 1999, an indirect wholly-owned subsidiary of the Company |

DEFINITIONS

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|------------------------------|--|
| “PCH” | Playmates China Holdings Limited, a company incorporated in Hong Kong on 25 May 2007, an indirect wholly-owned subsidiary of the Company |
| “PHL” | Playmates Holdings Limited, a company incorporated in Bermuda with limited liability on 10 October 1991, the shares of which are listed on the Stock Exchange (with stock code 635) and which is the ultimate holding company of the Company |
| “PHL Capital Reorganisation” | collectively, the PHL Capital Reduction and the PHL Share Consolidation |
| “PHL Group” | PHL and its subsidiaries, excluding the Group |
| “PHL SGM” | the special general meeting of PHL to be held at 9:00 a.m. on Friday, 25 January 2008 |
| “PHL Share(s)” | ordinary share(s) of nominal value of HK\$0.10 each in the share capital of PHL |
| “PHL Share Consolidation” | the consolidation of every ten issued and paid up PHL shares each resulting from the PHL Capital Reduction into one Consolidated PHL Share |
| “PHL Capital Reduction” | the capital reduction which involves the nominal value of each issued PHL Share being reduced from HK\$0.10 to HK\$0.01 by cancelling paid-up capital to the extent of HK\$0.09 on each issued PHL Share |
| “PIHL” | Playmates International Holdings Limited, now known as Y.T. Realty Group Limited (stock code: 75), a company incorporated in Bermuda on 19 February 1990, an independent third party |
| “PIL” | Playmates International Limited, a company incorporated in the British Virgin Islands on 13 June 2000, a direct wholly-owned subsidiary of PHL |
| “PIL Toys” | PIL Toys Limited, a company incorporated in the British Virgin Islands on 17 May 2007, an indirect wholly-owned subsidiary of PHL |
| “Playmates Group” | PHL and its subsidiaries |

DEFINITIONS

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| “Playmates Trademark Assignment Agreement” | trade mark assignment agreement dated 27 December 2007 entered into between Playmates IP Limited and our Company |
| “Property Licence Agreement” | property licence agreement and a supplemental licence agreement entered into between PAS and Bagnols Limited dated 27 February 2007 and 30 August 2007 respectively |
| “PTA” | Playmates Toys Asia Limited (formerly known as Playmates Asia Trading Limited), a company incorporated in Hong Kong on 25 May 2007, an indirect wholly-owned subsidiary of the Company |
| “PTE” | Playmates Toys Enterprises Limited, a company incorporated in the British Virgin Islands on 17 May 2007, a direct wholly-owned subsidiary of the Company |
| “PTI” | Playmates Toys Inc., a company incorporated in California, U.S. on 29 November 1982, an indirect wholly-owned subsidiary of the Company |
| “PTIL” | Playmates Toys International Limited, a company incorporated in Hong Kong on 22 December 2004, an indirect wholly-owned subsidiary of the Company |
| “Qualifying PHL Shareholder(s)” | registered holder(s) of PHL Shares, whose names appear on PHL’s register of members at 4:00 p.m. on the Distribution Record Date, other than Overseas Shareholders but including the Excepted Overseas Shareholders |
| “Renminbi” or “RMB” | Renminbi, the lawful currency of the PRC |
| “Reorganization” | the corporate reorganization of the Playmates Group, details of which are set out in the section headed “HISTORY AND REORGANIZATION” in this document |
| “SFC” | the Securities and Futures Commission of Hong Kong |
| “SFO” | the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) |
| “Share(s)” | ordinary share(s) of nominal value of HK\$0.01 each in the share capital of the Company |

DEFINITIONS

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|---------------------------|--|
| “Shareholder(s)” | registered holder(s) of the Share(s) |
| “Share Option Scheme” | the share option scheme conditionally adopted by the Company pursuant to a shareholder’s resolution passed on 17 December 2007, and to be approved by the shareholders of PHL on Friday, 25 January 2008 |
| “Spin-off” | the spin-off of the Group from the Playmates Group by way of a distribution in specie of not less than approximately 222,523,256 Shares, and the Introduction |
| “Sponsor” | WAG Worldsec Corporate Finance Limited |
| “Tenancy Agreement” | the tenancy agreement and a supplemental tenancy agreement entered into between PAS and Bagnols Limited dated 27 February 2007 and 30 August 2007 respectively |
| “TIA” | Toy Industry Association, Inc. as further described in the section headed “INDUSTRY OVERVIEW – MAJOR TRADE ASSOCIATIONS – Toy Industry Association, Inc.” in this document |
| “TMNT” or “Turtles” | Teenage Mutant Ninja Turtles |
| “TOYSA” | Toys Shippers Association, Inc |
| “Track Record Period” | the period comprising of the three years ended 31 December 2006 and the six months ended 30 June 2007 |
| “United States” or “U.S.” | the United States of America, its territories, its possessions and all areas subject to its jurisdiction |
| “US\$” or “U.S. dollars” | United States dollars, the lawful currency of the United States |

2. TERMS

In this document:

- the terms “Company”, “we”, “us”, “our”, “our Company” refer to Playmates Toys Limited, a company incorporated on 11 April 2005 under the laws of Bermuda; and
- the terms “associate”, “connected person”, “connected transaction”, “subsidiary” and “substantial shareholder” shall have the meanings given to such terms in the Listing Rules, unless the context otherwise requires.

FORWARD-LOOKING STATEMENTS

This document contains certain statements that are forward-looking and uses forward-looking terminology such as “anticipate”, “believe”, “could”, “estimate”, “going forward”, “intend”, “plan”, “seek”, “expect”, “may”, “ought to”, “should”, “will”, “would” and similar expressions. Such statements reflect the current views of our management with respect to future events and are subject to certain uncertainties, assumptions and risks, including the risk factors identified in this document. Reliance on any forward-looking statement involves risks and uncertainties as any or all of those assumptions could prove to be inaccurate and forward-looking statements based on those assumptions could also be incorrect. Accordingly, forward-looking statements included in this document should not be regarded as representations by us that our plans and objectives will be achieved.

RISK FACTORS

You should consider carefully the risks described below in respect of our business and the industry in which we operate, together with the other information contained in this document. Our business, financial condition and results of operations could be materially and adversely affected by any of these risks.

1. RISKS RELATING TO OUR BUSINESS

Potential changes to the U.S. federal tax and other laws could increase our effective tax rate or could have other adverse effects on our business.

Legislation has been introduced in the U.S. Congress intended to eliminate tax advantages for companies that have legal domiciles outside the U.S. but have certain U.S. connections. The legislation includes provisions that would permit the U.S. Internal Revenue Services to re-allocate or re-characterize certain items or provide additional limits on the deductibility of interest by foreign-owned U.S. companies. There is no assurance whether this or other restrictive legislation may be enacted or, if enacted, what the specific provisions or effective date of any such legislation would be, or what effect it might have on us.

Additionally, U.S. federal income tax laws and interpretations with respect to a number of issues potentially important to us and our subsidiaries – including such matters as the rules for determining whether a company is engaged in a trade or business within the U.S. and whether and in what manner will the rules relating to controlled foreign corporations apply – are uncertain in many respects and are subject to change, possibly on a retroactive basis. We cannot be certain if, when or in what form future regulations or other pronouncements may be provided or implemented and whether such guidance will have retroactive effect.

The U.S. federal tax rate is between 34% and 35%. We were only required to pay U.S. federal tax in 2004 and the amount was approximately HK\$3,068,000. We were the subject of two tax related examinations in the U.S., both of which have been resolved – please see the section headed “FINANCIAL INFORMATION – FACTORS AFFECTING OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION – Taxation” of this document for further information. The amount spent by us on appointing U.S. tax advisers and legal advisers were HK\$1,604,000, HK\$1,685,000, HK\$1,294,000 and HK\$1,193,000 for the years ended 31 December 2004, 31 December 2005 and 31 December 2006 and the six months ended 30 June 2007 respectively on these two tax cases. During the Track Record Period, as a result of these two tax cases, the Group made additional tax payments of HK\$69.1 million to the U.S. tax authorities in 2006.

Recent widely publicized product recalls on safety grounds by toy companies in the U.S. toy industry could adversely affect our business, financial conditions and results of operations.

Recently, there have been widely publicized product recalls on safety grounds by toy companies in the U.S. Such incidents, among other things, caused consumer sentiments in the U.S. to appear to be increasingly negative towards products, in particular toys, manufactured in or sourced from the PRC. Consumer preference may potentially turn away from products manufactured in the PRC, where our products are manufactured. There can be no assurance that the demand for the Group’s products will not be affected by the change in consumer preference and if this happens, our business, financial conditions and results of operations could be adversely affected. For measures taken by us in light of the product recalls, please see the section headed “BUSINESS – QUALITY CONTROL”.

RISK FACTORS

We cannot ensure that raw materials used by our third party OEM and ODM vendors are of the same specifications and standards required by us.

We have no ultimate control over whether our third party OEM and ODM vendors, to whom we outsource the production of all our finished products, follow our specifications and instructions as to raw materials to be used in the production of our products. Further, neither we nor our third party OEM and ODM vendors have ultimate control over whether the suppliers to such vendors follow our vendors' specifications and instructions as to raw materials. Therefore, we may not be able to ensure that the raw materials used in the production of our products meet the safety and quality standards specified by us.

We may therefore be exposed to the risk that our products are not manufactured with raw materials which comply with the safety and quality standards specified by us, including the risk that such raw materials may contain toxic or otherwise harmful ingredients, components or parts. There have recently been lead paint related and loose magnets related product recalls in the toy industry in the U.S. Although we have not encountered any product recalls during the Track Record Period, if our products are found to contain such ingredients, components or parts, we may be required to recall shipments of our products, and our operations and financial results may be thereby adversely affected.

In addition, although such products would have been manufactured by our OEM and ODM vendors, any adverse publicity or damage to reputation may be suffered by us as the toy designer.

New regulations, guidelines and standards in relation to toy safety may be promulgated by the U.S. and/or the PRC concerning the quality and safety of PRC exported toy products and we may be required to comply with such regulations, guidelines or standards. For measures taken by us in light of the product recalls, please see the section headed "BUSINESS – QUALITY CONTROL".

We have been experiencing a downward trend in turnover and profit, and incurred relatively high fixed costs during the Track Record Period, and we had a history of loss making in the mid-to-late 1990s. Our operating results may continue to decline.

Turnover for the three years ended 31 December 2004, 2005 and 2006 was HK\$1,282.7 million, HK\$1,277.6 million and HK\$1,128.0 million respectively. There was no significant change in turnover for 2005 but that was dropped by 11.7% in 2006. The decrease in turnover in 2006 was mainly due to overall industry-wide growth stagnation and the shrinkage of sales in action figures, which is one of our key toy categories.

Net profit for the three years ended 31 December 2004, 2005 and 2006 was HK\$181.1 million, HK\$104.0 million and HK\$26.1 million respectively. Net profit of the Group was materially affected by the following charging/crediting factors:

- (i) Recognition of previously unrecognized deferred tax assets (2004: a credit of HK\$133.9 million; 2005: a credit of HK\$38.6 million; 2006: Nil)
- (ii) Provisions for tax cases (2004: HK\$37.5 million; 2005: HK\$0.5 million; 2006: a credit of HK\$4.0 million)
- (iii) A non-recurring legal and professional expenses incurred for 2005 corporate reorganization (2004: Nil; 2005: HK\$17.9 million; 2006: Nil)

RISK FACTORS

The above factors were not the only causes for the decline of the Group's profitability during the Track Record Period. As the Group still incurred relatively high fixed costs (including product development costs, marketing and administrative expenses), even though turnover was dropped by 11.7%, net profit margin was comparatively lower for the year ended 31 December 2006.

Since the Group mainly engages in toy designing and marketing, one of its prime objectives is to enhance and extend the brand equity of its licensed brands and proprietary brands by introducing new product lines to enhance the appeal and to extend the life of these brands. Therefore, the Group has to commit considerable amounts of product development costs, marketing and promotional expenses in order to maintain a profitable business. At the same time, the Group incurs regular administrative expenses which are fixed or relatively fixed in nature, such as staff cost, rental expenses and legal and professional fees. As a result, the Group operated on a relatively high cost base in terms of its level of sales volume during the Track Record Period and we may make losses in the future if we are unable to achieve a higher level of sales volume that allows us to benefit considerably from an economy of scale.

As licenses proliferated in the toy industry in the mid-to-late 1990s, our profitability began to decline due to the unsatisfactory performance of a number of unproven licensing and entertainment initiatives such as *Monster Force* and *Blasters* lines. As at 1 January 2004, the commencement date of the Track Record Period, the accumulated losses brought forward by the Group was HK\$101.1 million, including HK\$103.3 million accumulated losses brought forward by the U.S. subsidiaries of the Group. In response to the declining profitability, we restructured our management team and operations and also implemented a more stringent process for evaluating license opportunities. We were able to maintain profitability since 2004 but there is no assurance that we will not incur additional losses in the future.

The Company will be implementing the growth strategy as described in the section headed "BUSINESS-OUR GROWTH STRATEGY" which we believe would be beneficial to the future business prospects and profit generating power of the Company.

Our operating results, in particular our net profit, may continue to decline if we are unable to reverse this trend through, among other things, our growth strategies.

If we fail to accurately identify and appropriately respond to changes in consumer preferences, tastes and market trends in toys and competing consumer products, the demand for our products may decrease and our business, financial condition and results of operations may be adversely affected.

Our business relies heavily on licenses from third parties, and on our ability to retain and renew existing licenses, and obtain licenses for new products and technology.

A substantial portion of our revenues are currently derived from the sale of products based on Entertainment Licenses, for example, products under the *Disney Fairies*, *Disney Princess*, *Strawberry Shortcake*, and *Teenage Mutant Ninja Turtles* brands. We also derive revenues from the sale of products under proprietary brands which incorporate technologies and inventions licensed from Investor Licenses, for example, the *Amazing* dolls and *WOW Pals*. For each of the years ended 31 December 2004, 2005 and 2006, and the six months ended 30 June 2007, we derived substantially all of our revenue from sales of product lines incorporating one or more of the Entertainment Licenses and/or Investor Licenses described above.

RISK FACTORS

Entertainment Licenses are typically granted for specific terms of between two to three years, in some cases with options to renew. Our current key Entertainment Licenses are currently scheduled to expire between 2008 to 2011. Inventor Licenses are typically granted for two to three years or longer, some with renewal options. Some Inventor Licenses remain effective for as long as we continue to manufacture and distribute products incorporating the respective design or technology. Our ability to sustain and grow our revenues depends on our ability to renew our existing licenses, and to acquire and retain new licenses. Licenses without renewal option that are expiring in 2007 and 2008 contributed approximately 20% to 30% of the Group's turnover during the Track Record Period. Of the licenses expiring in 2007 and 2008 without renewal options, apart from one of these licenses that we may not intend to renew for commercial reasons, we had long term business relationship with the licensors of all these licenses and we had always been successful in renewing the relevant licenses with these licensors.

While we intend to continue to leverage on the strength of our established relationships with licensors and the historic sales performance of our brands, we cannot give assurance that we will be able to successfully renew our Entertainment Licenses and Inventor Licenses, and do so on terms acceptable to us, or that we will be successful in our strategy to acquire new Entertainment Licenses and Inventor Licenses. If one or more of our Entertainment Licensors and Inventor Licensors were to terminate or fail to renew our licenses, or impose significantly more unfavorable terms in our licenses, or if our strategy to acquire new Entertainment Licenses and Inventor Licenses is unsuccessful, our business, financial condition and results of operations could be adversely affected.

Competition for licenses could increase our licensing costs and limit our ability to renew existing licenses, and to obtain and retain new Entertainment Licenses and Inventor Licenses.

Available licenses for proven entertainment franchises, in particular for popular television shows and movies, are increasingly limited in number and competition to secure and retain such licenses is increasingly intense. Increasing competition may require us to commit to higher minimum guarantees and to pay higher royalty advances and higher royalty rates in order to obtain and renew popular licenses. The calculation of royalty payable by a licensee for the use of a license differs under each license. It is usually determined by applying a royalty rate, which is a fixed or variable percentage on the proceeds from sales of products made under the particular license. A royalty advance is a sum that is paid to licensors upon signing of the license agreement and it is recoupable from the royalty earned over the term of the license as sales are generated. A minimum guarantee is the minimum amount of royalty payment that the licensee is obliged to pay under a license regardless of the amount of royalty earned over the term of the license.

We may in the future be required to pay an increased royalty or minimum guarantee when our existing licenses expire. If we have to commit significant financial resources in order to secure and retain licenses, our business, results of operations and financial condition could be adversely affected.

RISK FACTORS

We currently rely, and expect to continue to rely, on orders for our products from a small group of major customers.

The majority of our sales have historically concentrated in a few customers. Sales to our top five customers accounted in aggregate for approximately 75%, 78%, 67% and 58% of our total turnover for each of the years ended 31 December 2004, 2005 and 2006, and the six months ended 30 June 2007 respectively. Sales to our largest customer accounted for approximately 34%, 30%, 31% and 25% of our total turnover for each of the years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007 respectively. Three of our top five customers are retailers operating in the U.S. and our sales to them accounted in aggregate for approximately 66%, 63%, 60% and 52% of our total turnover for each of the years ended 31 December 2004, 2005 and 2006, and the six months ended 30 June 2007 respectively. The other two of our top five customers are our distributors for European countries including France, Germany, Italy, Spain and the United Kingdom.

We expect that we will continue to rely on a small number of major customers for a significant portion of our orders and revenue. The concentration of our customer base means that if any one of these customers changes its buying pattern and business volume to our detriment, for example, delays or reduces its orders from us, our business, revenues, results of operations and financial condition could be adversely affected. Changes in buying patterns and business volumes by our major customers could result from a number of factors outside our control, such as the financial condition of our major customers, and also, in the case of retail customers, reduction in the number of retail outlets and changes in business strategy. In addition, the concentration of our customer base amongst a limited number of major retailers in the U.S. means that our products must compete for a limited amount of shelf space at these retailers. The decisions by these retailers as to how much shelf space to allocate to our products depend on a number of factors outside our control, such as their retail strategies and the relative strengths of the competing products, and may adversely affect our sales and results of operations.

We currently generate a significant portion of our revenue from a few brands.

Sales of products in our *Amazing*, *Disney Fairies*, *Disney Princess*, *Teenage Mutant Ninja Turtles* and *Strawberry Shortcake* brands accounted in aggregate for 89% and 92% of our total revenue for the year ended 31 December 2006 and the six months ended 30 June 2007 respectively.

Since consumer tastes and preferences for toy products are constantly changing, lifecycles of brands vary in length and it is not possible to predict when the popularity of a certain brand will diminish. Accordingly, we cannot give assurance that going forward the amount of revenue generated from sales of products in these brands can be sustained. While we plan to introduce new brands regularly, we cannot give assurance that sales of products in any new brands will be sufficient to make up for any reduction in sales of our current brands. Any reduction in sales of the brands from which we currently generate a significant portion of our revenue could therefore adversely affect our revenues and results of operations.

We may fail to anticipate or respond to changes in consumer tastes and market trends in a timely manner.

We operate in an industry that is subject to rapid and unpredictable changes. Our business success depends on our ability to identify and respond to changes in consumer tastes and market trends in a timely manner, by redesigning, restyling and extending our established products and brands, and by developing and introducing new products and brands.

RISK FACTORS

Our direct and indirect competitors are constantly introducing new toys and entertainment products that fall outside the traditional toy categories, such as video games and other consumer electronics that compete with our products for consumer spending. The large number of new products constantly being introduced which compete with our products for consumer spending means that we have to satisfy constantly increasing consumer expectations for product appeal, quality, functionality and value.

We cannot give assurance that:

- we will be able, on an ongoing basis, to accurately identify and appropriately respond to changes in consumer preferences, tastes and market trends in toys and competing consumer products;
- any of our current products or brands will continue to be popular for any significant period of time; or
- we can redesign, restyle and extend our brands in ways that appeal to consumers.

Our results of operations may fluctuate due to seasonality factors in the U.S. market.

Our results of operations may fluctuate due to seasonality factors in the U.S. market. We achieve higher sales in the second half of a year when we sell products for the fall and holiday seasons. Furthermore, our sales are also affected by other seasonal spending patterns, such as holidays during Easter, Thanksgiving and Christmas. In addition, changes in consumer tastes and market trends may affect sales of our products timed for release during a particular season. For example, the relative success of an entertainment program or movie release may affect the sales of our products.

During 2004, 2005 and 2006, the sales generated in the first 6 months of the year accounted for 28.2% to 35.1% of the total annual worldwide sales, and the sales in second half of the year accounted for 64.9% to 71.8%. Although sales is relatively low in the first half year of the year, the Group still incurs regular costs in product development and marketing expenses as they planned in that year, and regular administrative expenses in this corresponding period. As a result, although the Group attained stable gross margin, it may make losses during the first half year of the year due to these seasonality factors. For the six months ended 30 June 2006 and 2007, the Group's net loss was HK\$17.9 million and HK\$14.6 million, respectively.

We outsource the production of all of our finished products and rely on a limited number of third party OEM or ODM vendors to produce all of our finished products.

We outsource the production of all of our finished products to third party OEM or ODM vendors and rely on our vendors to produce sufficient volumes of our finished products in a timely manner and at satisfactory quality and cost levels. If our vendors fail to so deliver, our reputation may suffer, and we may experience lost sales, increase in customer returns and associated costs, and warranty claims, all of which could adversely affect our business and results of operations.

Our five largest vendors supplied approximately 94%, 83%, 91% and 93% of our total purchases of finished products for each of the years ended 31 December 2004, 2005 and 2006, and the six months ended 30 June 2007 respectively. Our largest vendor supplied approximately 40%, 42%, 50% and 42% of our total purchases of finished products for each of the years ended 31 December

RISK FACTORS

2004, 2005 and 2006 and the six months ended 30 June 2007 respectively. We have over 15 years of relationship with this vendor. Our reliance on a limited number of vendors may expose us to the risk that we may be unable to fulfill orders from our customers in the event that any of our vendors experiences disruptions or other incidents, for example, labor strikes and natural disasters, that could significantly affect the production and supply of our products. Such events could adversely affect our business and results of operations.

In addition, a number of our major customers require our vendors to comply with codes with respect to employment standards and practices. We have no direct control over compliance by our vendors with such codes, and any failure by our vendors to comply with such codes could result in rejection of our products by our customers, which could cause damage to our reputation and could adversely affect our business and results of operations. We are not aware of any material non-compliance by our vendors with such codes with respect to employment standards and practices.

We may be subject to legal liability if any of our vendors breaches the code of conduct imposed by any of our customers that sells our products, or uses raw materials that are not of the same specifications and standards required by us, or if any of our products are recalled.

If any of our vendors breaches the code of conduct imposed by any of our customers or uses raw materials that are not of the same specifications and standards required by us, or if any of our products are recalled, depending on the specific circumstances surrounding the breach in each case, our customers may bring legal proceedings and/or make other claims against us. In the event that any legal actions or other claims brought by our customers are successful, we may be subject to legal liability which may require us to pay substantial monetary damages to compensate the loss suffered by our customers and/or to replace the products in question at our costs. As a consequence, we may also face termination of business relationship. Furthermore, even if we successfully defend ourselves against a claim, we could be forced to spend a substantial amount of money and time in defending such legal actions against us. Our operations and financial results may be thereby adversely affected. Although we may seek compensations from our vendors for breach of the manufacturing agreements between the vendors and us, there is no assurance that such compensations will be sufficient to cover our financial loss arising from such event. However, so far as we are aware, there has not been any material non-compliance by any of our vendors. Please see the section headed "BUSINESS – QUALITY CONTROL" for our measures taken to mitigate such risk.

We may be exposed to litigations which could adversely affect our reputation and business.

By nature of our operations, we may be exposed to litigations arising from, including but not limited to, product liability, alleged infringement of intellectual property rights, and any dispute in relation to the use of Entertainment Licenses and Inventor Licenses in our operations. Responding to and defending these proceedings may require substantial costs and diversion of resources, and the result of any such proceedings is uncertain and cannot be foreseen. Our reputation may also thereby be adversely affected. We maintain product liability insurance, but there can be no assurance that such coverage will continue to be available on terms acceptable to us or that such coverage will be adequate for liabilities actually incurred. If any successful product liability claim is not covered by or exceeds our insurance coverage, our financial condition could be harmed.

RISK FACTORS

We cannot ensure that the molds and tools provided by us for use by our third party OEM and ODM vendors are not used for purposes not authorized by us and not for the production of our products.

We have no ultimate control over the purposes for which our third party OEM and ODM vendors, to whom we outsource the production of all our finished products, use the molds and tools we provide to them for the production of our products.

We may therefore be exposed to the risk that our molds and tools may be used by such vendors for the production of copies of our products which are then sold at discounted prices throughout markets in which there is an active market for such discounted unauthorized copies. Depending on the specific circumstances surrounding any unauthorized use in each case, we may be subject to legal liability in the case of any unauthorized use of molds and tools by our third party OEM and ODM vendors. If consumers choose to purchase the cheaper, unauthorized products, our sales revenue may decrease, and our operations and financial results may be thereby adversely affected. However, so far as we are aware, we have not suffered from any unauthorized use of the molds and tools during the Track Record Period.

We rely on third party logistics services for the timely delivery of our products in good condition.

We rely on third party logistics services to ensure timely delivery of our products in good condition to our distribution center, or to the point of shipment, depending on the sales terms agreed with our customers. Delivery disruptions may occur for various reasons beyond our control, for example, poor handling by transport operators, transportation bottlenecks, labor strikes and natural disasters. If our products are not delivered according to the expected schedule, especially during the third and fourth quarters of the year when sales of our products have historically been relatively higher, our sales, reputation, business and results of operations could be adversely affected.

We rely on third party international toy distributors for all of our sales outside the U.S.

We rely on third party toy distributors for all of our sales outside the U.S., and derived approximately 22%, 26%, 25% and 35% of our turnover from markets outside the U.S. for each of the years ended 31 December 2004, 2005 and 2006, and the six months ended 30 June 2007 respectively. We cannot give assurance that our international distributors will operate their distribution channels and logistic capabilities in a timely and sufficient manner to benefit sales of our products. Our international distributors may also distribute other brands of toy products that compete with our products for consumer spending and we cannot give assurance that our distributors will prioritize their marketing and distribution resources to benefit sales of our products.

Increases in the costs of raw materials and labor associated with the manufacturing of our products could increase our costs and reduce our gross margins and profits.

The costs of production of our products, including costs of plastic resins, labor and other input costs may increase from time to time, and our vendors may pass on some or all of the increased costs to us. We cannot give assurance that we will be able to pass on such cost increases to our customers due to competitive market pressures on the retail pricing of toys. Any increase in the costs of raw materials, labor or other input costs associated with the production of our products could therefore increase our costs and reduce our gross margins and profits.

RISK FACTORS

We depend on key personnel, and we may not be able to retain, hire and integrate sufficient qualified personnel to maintain and expand our business.

Our business success depends on the contribution and performance of our key personnel, as well as our ability to continue to recruit, integrate and retain qualified and experienced personnel. Our key personnel currently consists of our executive directors, Mr. Chan Chun Hoo, Thomas (Chairman), Mr. Novak, Lou Robert (President of the Group) and Mr. Soong, Ronnie (President of Asian Operations), and other senior management staff, Mr. Ed Chanda (Senior Vice President of Operations), Ms. Lori Farbanish-Rotter (Vice-President of Design and Development of Girls Toys), Mr. Lou Gioia (Senior Vice President of Marketing and Product Development), Mr. Phil Jacobs (Senior Vice President of Sales), Ms. André Lake Mayer (Vice President of Strategic Alliances and Business Development) and Mr. Herb Mitschele (Vice President of International Sales and Marketing). Please see the section “DIRECTORS AND SENIOR MANAGEMENT” in this document for details of their areas of expertise.

The recruitment and retention of qualified and experienced personnel, especially those with the skills and experience to conceptualize, design, market and sell products based on licensed intellectual property, is highly competitive. We cannot give assurance that we will be able to continue to secure the services of sufficient qualified and experienced personnel in key positions, or to do so at reasonable costs. If we fail to secure the services of our existing key personnel, to fill or delay in filling key positions, or to recruit, integrate and retain new experienced personnel, this could disrupt our operations and adversely affect our results of operations.

Fluctuations in the value of the Hong Kong dollar relative to the U.S. dollar could increase our expenses and adversely affect our financial condition.

The official exchange rate for the Hong Kong dollar has been pegged to the U.S. dollar since 1983 and has remained generally stable since that time. However, there is no assurance that the Hong Kong dollar will continue to be pegged to the U.S. dollar or will remain stable in the future. While all of our revenue is denominated in U.S. dollars, substantially all of our purchases of finished products from our vendors are denominated in Hong Kong dollar. As a result, any material increase in the value of the Hong Kong dollar relative to the U.S. dollar would increase our expenses relative to our revenues, and could adversely affect our profitability. In addition, we use the Hong Kong dollar as our reporting currency in our financial statements. Future fluctuations of the Hong Kong dollar against the U.S. dollar may result in exchange losses or gains, and there is no assurance that such currency fluctuations will not have a material adverse effect on our financial condition in the future.

Appreciation in the value of the RMB against the Hong Kong dollar could cause increases in costs of our finished products.

Substantially all of our purchases of finished products from our vendors are settled in Hong Kong dollar. All of our vendors currently operate manufacturing facilities and produce our products in the PRC.

RISK FACTORS

The value of the RMB against other foreign currencies is subject to changes in PRC government policy and to international economic and political developments. Effective from 21 July 2005, the RMB was no longer referenced solely to the U.S. dollar (to which the Hong Kong dollar is pegged). Instead, a managed floating exchange system has been introduced by the PRC government which allows the RMB to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies. On the same day, the RMB was revalued against the U.S. dollar to approximately RMB8.11 to one U.S. dollar, representing an upward revaluation of 2.1% of the RMB against the U.S. dollar, as compared to the exchange rate of the previous day. On 18 May 2007, the Chinese government enlarged, effective on 21 May 2007, the floating band for the trading prices in the inter-bank spot exchange market of the RMB against the U.S. dollar from 0.3% to 0.5% around the central parity rate. This allows the RMB to fluctuate against the U.S. dollar by up to 0.5% above or below the central parity rate published by the Chinese government each day. The exchange rate may become volatile, the RMB may be revalued further against the U.S. dollar or other currencies or the RMB may be permitted to enter into a full or limited free float, which may result in an appreciation or depreciation in the value of the RMB against the U.S. dollar or other currencies.

If there is any appreciation of the RMB against the Hong Kong dollar, our vendors may pass on some or all of their increased operating costs to us. We cannot give assurance that we will be able to pass on such cost increases to our customers due to competitive market pressures on retail pricing of toys. Appreciation in the value of the RMB against the Hong Kong dollar may therefore increase our costs and reduce our gross margins and profits.

The widespread outbreak of any severe contagious disease or pandemic, if uncontrolled, could adversely affect our results of operations.

The widespread outbreak of any severe contagious disease or pandemic, if uncontrolled, could affect the health of our employees and those of our suppliers and customers, and could lead to disruptions in production of our products by our vendors, shipment of our finished products, business of our customers and our operations in one or more locations. Any widespread uncontrolled outbreak of severe contagious disease or pandemic could therefore adversely affect our results of operations. We have not suffered from any material disruption in our supply chain for the three years ended 31 December 2006 and the six months ended 30 June 2007.

2. RISKS RELATING TO THE TOY INDUSTRY

Sales volumes of toy products are highly seasonal.

Sales volumes of toy products are highly seasonal. We typically experience higher sales during the second half of the year, especially during the period approaching the year end holiday season. Approximately 67%, 65% and 72% of our total revenue was generated during the second half of each of the years ended 31 December 2004, 2005 and 2006 respectively.

The seasonal sales pattern means that we have to make early and accurate forecasts of consumer demand for our products during the holiday season, and to commit significant working capital to carry inventory in anticipation of such demand. Failure to accurately forecast and respond appropriately to changes in consumer demand in a timely manner to meet seasonal fluctuations could adversely affect our business and results of operations.

RISK FACTORS

In addition, any disruption in the supply chain from the factories of our vendors to the retail shelves of our customers during the peak season in the second half of the year could materially and adversely affect our sales and results of operations for the relevant year.

The toy industry is highly competitive.

We operate in a highly competitive industry. We compete directly and globally with other toy companies, including large corporations such as Mattel, Hasbro, Bandai, Tomy-Takara, Jakks Pacific and MGA Entertainment, who are engaged in the design, manufacturing, marketing and sales of one or more categories of toy products we are engaged in, and whose products are sold by many of the same major customers who also carry our products. Many of our competitors have longer operating histories, greater brand recognition and stronger financial, technical, marketing and other resources than we have. In addition, we face indirect competition from producers of other categories of toys and entertainment products that may appeal to a similar demography as the consumers of our products.

There is no assurance that our strategies will be effective against our competitors, and that any of our products and brands will be successful in sales to our customers and ultimately to the consumers. Our strategies could be ineffective and our products or brands could fail to achieve their marketing and sales objectives, any of which may have a material adverse effect on our financial condition and results of operation.

Toy companies may, in the usual course of their business, be exposed to claims from third parties that these toy companies may have infringed their intellectual property rights.

Toy companies are exposed to claims from time to time from third parties that they may have infringed the intellectual property rights of such third parties. In the course of our business, we conduct regular patent and trademark searches with a view to identifying and avoiding any potential infringement of third party intellectual property rights. Nevertheless, exposure to such claims will remain a part of the usual course of our business as we increase the number and type of products we offer, as the number of products and competitors in our markets grow, as we enter new markets and as our products receive more publicity.

We have recently been party to two litigation claims. The first one is a dispute with J. Shackelford and Associates, the licensor of the toy concept we used in the *Amazing* brand of dolls concerning a variety of issues including royalty payments and terms of the license agreement. We have reached a settlement with the plaintiffs to this case in respect of which a settlement agreement was signed in December 2007. The second one is an alleged trademark infringement dispute with Illektron LLC concerning similarity in the design of one of our trademarks to one of theirs. We have also reached a settlement with the plaintiffs to this case, which is now fully settled and closed. Please see the section headed "BUSINESS – LEGAL MATTERS" for further information relating to these litigation claims.

Any disputes regarding intellectual property rights may divert the attention of our management and key personnel from our business operations, and may be costly and time consuming. In the event that we are not successful in defending these claims, or found to have infringed another party's intellectual property rights, we may be subject to significant monetary damages or court injunctions against the use of specific intellectual property rights in the development and sale of certain of our products, which may adversely affect our business and results of operations.

RISK FACTORS

The business and reputation of toy companies may be affected by product liability claims and adverse publicity arising from other claims, litigation, complaints and product recalls, relating to the use of their products.

In common with other companies in the toy industry, our products involve an inherent risk of personal injury to consumers, and we may be subject to product liability claims. If we are unsuccessful in defending these potential claims, we may be required to pay significant monetary compensation. Even if a product liability claim is unsuccessful or is not fully pursued, any negative publicity surrounding the claim could adversely affect our reputation and divert management's attention and resources away from our operations. We cannot give assurance that such potential claims will not exceed, or will not fall outside the scope of, our insurance coverage, and there is a risk that we may be unable to retain adequate product liability insurance in the future.

In the course of our business, products manufactured by our third party vendors may contain defects, or may fail to comply with stipulated safety standards in the countries we distribute those products, and could potentially expose us to regulatory or other legal action. We may voluntarily recall our products if we have concerns about potential negative publicity and product liability exposure relating to those products, and under certain circumstances, we may be compelled to recall our products by the relevant authorities and legislation. Any voluntary or compelled product recalls could harm our reputation, increase our customer service and support costs, and could adversely affect our business and results of operations.

In addition, in a number of our Entertainment Licenses, the relevant licensors have the rights to terminate such licenses if any products marketed under those licenses are subject to product liability claims, recalls or violations of product safety regulations. A termination of any such license could adversely affect our business and results of operations.

We have not suffered from any material product liability claims or termination of licences resulting from product liability claims during the three years ended 31 December 2006 and the six months ended 30 June 2007.

3. RISKS RELATING TO THE SHARES AND THE INTRODUCTION

There has been no prior public market for our Shares, and the liquidity and market price of our Shares may be volatile.

Prior to the listing of our Shares on the Stock Exchange, there has been no public market for our Shares. There is no assurance that the listing of our Shares on the Stock Exchange will result in the development of an active and liquid public trading market for our Shares. The market price, liquidity and trading volume of our Shares may be volatile. There is no assurance as to the ability of Shareholders to sell their Shares, or as to the price at which the Shares can be sold.

The price of our Shares may fluctuate substantially and investments in our Shares may decline in value.

The market price and trading volume of our Shares may fluctuate significantly and rapidly as a result of the following factors, amongst others, many of which are outside our control:

RISK FACTORS

- actual or anticipated fluctuations in our results of operations including as a result of seasonal variations in our sales-based revenues;
- variations in our financial performance from the expectations of market analysts;
- conditions and trends in the end markets we serve and changes in the estimate of the size and growth rate of these markets;
- announcements of significant contracts, acquisitions, strategic alliances or joint ventures by us or our competitors;
- changes in our pricing policies or the pricing policies of our competitors;
- changes in market valuation or earnings of our competitors;
- loss of one or more of our significant customers;
- addition or departure of key personnel;
- changes in legislation;
- fluctuations in stock market prices and trading volumes;
- the involvement of litigation; and
- general economic conditions.

In addition, the financial markets in Hong Kong have experienced significant price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies affected. These broad market and industry factors may adversely affect the market price of our Shares leading to a decline in the value of any investment in our Shares.

A potential sale of our Shares by our existing Shareholders could have an adverse effect on our share price.

Future sales of substantial amounts of our Shares by existing Shareholders following the Introduction, or the perception that such sales may occur, could negatively impact the market price of our Shares on the Stock Exchange and our ability to raise equity capital in the future at a time and price that we deem appropriate. Except as described in the section in this document entitled “RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS”, there are generally no restrictions imposed on our substantial shareholders to sell or otherwise dispose of their shareholdings. Any major disposal of our Shares by a substantial shareholder could cause the market price of our Shares to fall and negatively impact our ability to raise equity capital.

RISK FACTORS

We may not be able to pay any dividends on our Shares.

Our Company may in general meeting declare dividends. We may distribute dividends by way of cash or by other means that we consider appropriate. A decision to distribute any dividend would require the recommendation of our Board and will be at its discretion. In addition, any final dividend for a financial year will be subject to the approval of our shareholders. There can be no assurance that we will declare dividends at all in the future. A decision to declare or to pay any dividends in the future, and the amount of any dividends, will depend on a number of factors, including our results of operations, financial condition, payments by our subsidiaries of cash dividends to us, future prospects, applicable laws and regulations and other factors that our Directors may consider important.

The interests of our Controlling Shareholders may not necessarily be aligned with other Shareholders.

Our Controlling Shareholders will, subject to our Bye-Laws and applicable laws and regulations, be in a position to exert significant influence over the outcome of corporate actions requiring shareholders' approval, irrespective of how other shareholders may vote. The interests of our Controlling Shareholders may not necessarily be aligned with other shareholders.

We may become subject to taxes in Bermuda after 2016.

We have received an assurance from the Bermuda Minister of Finance, under Bermuda's Exempted Undertakings Tax Protection Act 1966, that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax will not be applicable to us or to any of our operations or our shares, debentures or other obligations before 28 March 2016. Accordingly, if our Bermuda tax exemption is not extended past 28 March 2016, we may be subject to any Bermuda tax that may be applicable to us after that date.

4. RISKS RELATING TO CONDUCTING OPERATIONS IN THE PRC

We currently rely on a limited number of third party manufacturers with manufacturing facilities in the PRC to produce all of our finished products. Our five largest vendors of finished products accounted for approximately 94%, 83%, 91% and 93% of our total purchases from our product manufacturers for each of the years ended 31 December 2004, 2005 and 2006, and the six months ended 30 June 2007 respectively. Our five largest vendors manufacture our products at facilities located in Guangdong province in the PRC. Accordingly, our results of operations, financial position and prospects are subject to the economic, political and legal developments in the PRC.

Changes in the PRC's political and economic policies could have an adverse effect on our business operations and results of operations.

The PRC economy differs from the economies of most developed countries in many respects, including:

- its structure;

RISK FACTORS

- the level of government involvement;
- the level of development;
- the growth rate;
- the control of capital investment;
- the control of foreign exchange; and
- the allocation of resources.

Since 1978, the PRC government has undertaken various reforms of its economic system and government structure. These reforms have resulted in significant economic growth and social progress for the PRC in the last two decades. As many of these reforms are unprecedented and experimental in nature, and are expected to be modified from time to time, there is no assurance that future economic reforms, and changes in the PRC's political, economic and social conditions, laws, regulations and policies will not have an adverse effect on our business, financial condition or results of operations. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us.

The PRC government also exercises significant control over the PRC's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. There is no assurance whether these actions and policies, and future actions and policies will have any material adverse effect on our current or future business, results of operations or financial condition.

The PRC legal system is less developed than that in certain other jurisdictions and contains inherent uncertainties which could adversely affect our business and results of operations.

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little value as precedents. In 1979, the PRC Government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. However, as these laws and regulations are relatively new and continue to evolve, interpretation and enforcement of these laws and regulations involve significant uncertainties. These uncertainties may limit the reliability of legal protections available to us in our operations in the PRC. Any litigation in the PRC may be protracted and may result in substantial costs and the diversion of resources and management attention. In addition, future developments in the PRC legal system, including the promulgation of new laws, changes to existing laws or the interpretation and enforcement thereof, could affect our operations. For example, we may be required in the future to procure additional permits, authorisations and approvals in order to continue engaging PRC-based manufacturers to manufacture our products. We cannot predict whether the uncertainties inherent in the PRC legal system or future developments in the PRC legal system will have any material adverse effect on our business and results of operations.

INFORMATION ABOUT THIS LISTING DOCUMENT AND THE INTRODUCTION

1. DIRECTORS' RESPONSIBILITY FOR THE CONTENTS OF THIS DOCUMENT

This document includes particulars given in compliance with the Securities and Futures (Stock Market Listing) Rules of Hong Kong and the Listing Rules for the purpose of giving information to the public with regard to our Group. Our Directors collectively and individually accept full responsibility for the accuracy of the information contained in this document, and confirm that having made all reasonable enquiries, to the best of their knowledge and belief there are no other facts, the omission of which would make any statement in this document misleading.

2. RESTRICTIONS ON THE USE OF THIS DOCUMENT

This document is published solely in connection with the Introduction. It may not be used for any other purpose and, in particular, no person is authorised to use or reproduce this document or any part thereof in connection with any offering of shares or other securities of the Company. Accordingly, there is no, and will not be any, offer of or solicitation, or an invitation by or on behalf of the Company and the Sponsor to subscribe for or purchase, any of the Shares. Neither this document nor any other document or information (or any part thereof) delivered or supplied under or in relation to the Introduction may be used for the purpose of, and the delivery, distribution and availability of this document or such other document or information (or any part thereof) does not constitute, any offer of or solicitation or an invitation by or on behalf of the Company and the Sponsor, to subscribe for or purchase any of the Shares.

3. NO CHANGE IN BUSINESS

No change in the business of the Company is contemplated following the Introduction.

4. PROFESSIONAL TAX ADVICE RECOMMENDED

Potential Shareholders should consult their professional advisors if they are in any doubt as to the taxation implications of holding and dealing in the Shares. It is emphasised that none of the Company, the Sponsor, any of their respective directors, agents or advisors or any other person involved in the Introduction accepts responsibility for any tax effects on, or liabilities of the Shareholders resulting from the holding or dealing in the Shares.

5. APPLICATION FOR LISTING ON THE STOCK EXCHANGE

Application has been made to the Listing Committee of the Stock Exchange for the granting of listing of, and permission to deal in, on the Main Board of the Stock Exchange, the Shares in issue and any Shares which may be issued pursuant to the exercise of the options granted under the Share Option Scheme. Dealings in our Shares on the Stock Exchange are expected to commence on 1 February 2008. The Introduction is subject to the Listing Committee of the Stock Exchange granting the listing of, and permission to deal in, the Shares.

INFORMATION ABOUT THIS LISTING DOCUMENT AND THE INTRODUCTION

Save as disclosed herein, none of the Shares are listed on or dealt in on any other stock exchange and no such listing or permission to list is being or is proposed to be sought in the near future.

6. STAMP DUTY

The Company's principal register of members will be maintained by its principal registrar, The Bank of Bermuda Limited, in Bermuda and the Company's branch register of members will be maintained by Tricor Abacus Limited, its branch registrar in Hong Kong.

Dealings in the Shares registered in our Company's Hong Kong branch register of members will be subject to Hong Kong stamp duty. The current rate of stamp duty in Hong Kong is HK\$2 for every HK\$1,000 (or part thereof) of the consideration or, if higher, the fair value of the Shares being sold or transferred.

7. ELIGIBILITY FOR CCASS

If the Stock Exchange grants the listing of, and permission to deal in, our Shares on the Stock Exchange and we comply with the stock admission requirements of HKSCC, our Shares will be accepted as eligible securities by HKSCC for deposit, clearance and settlement in CCASS with effect from the Listing Date or any other date as determined by HKSCC. Settlement of transactions between participants of the Stock Exchange is required to take place in CCASS on the second trading day after any trading day. You should seek the advice of your stockbroker or other professional advisor for details of those settlement arrangements as such arrangements will affect your rights and interests. All necessary arrangements have been made for the Shares to be admitted into CCASS. All activities under CCASS are subject to the general rules of CCASS and CCASS operational procedures in effect from time to time.

8. COMMENCEMENT OF DEALINGS IN THE SHARES

Dealings in the Shares on the Stock Exchange are expected to commence on 1 February 2008. Shares will be traded in board lots of 4,000 each.

INFORMATION ABOUT THIS LISTING DOCUMENT AND THE INTRODUCTION

9. CONDITIONS OF THE INTRODUCTION

The Introduction will be conditional upon:

- (i) the granting by the Listing Committee of the Stock Exchange of listing of, and permission to deal in, the Shares in issue and any Shares which may be issued pursuant to the exercise of the options which may be granted under the Share Option Scheme; and
- (ii) the passing at the PHL SGM of the necessary resolutions to approve the Distribution,

on or before the earlier of the Listing Date and 31 March 2008.

If the above conditions are not fulfilled prior to the time and date specified, the Introduction will lapse and the Stock Exchange will be notified immediately. We will cause notice of the lapse of the Introduction to be published by us in the South China Morning Post (in English) and the Hong Kong Economic Journal (in Chinese) on the next day following such lapse.

10. CURRENCY TRANSLATIONS

Unless otherwise specified, amounts denominated in U.S. dollars have been translated, for the purpose of illustration only, into Hong Kong dollars in this document at the following rate:

HK\$7.80: US\$1.00

No representation is made that any amounts in U.S. dollars, or Hong Kong dollars can be or could at the relevant dates have been converted at the above rate or any other rates or at all.

DIRECTORS AND PARTIES INVOLVED IN THE INTRODUCTION

1. THE DIRECTORS

| Name | Residential Address | Nationality |
|--|---|-------------|
| Chairman | | |
| CHAN, Chun Hoo Thomas | 8 Middle Gap Road, The Peak Hong Kong | Canadian |
| Executive Directors | | |
| NOVAK, Lou Robert | 886 Coast View Drive, Laguna Beach CA 92651, U.S. | American |
| SOONG, Ronnie | No. 6 Eastbourne Road, Block A2, 3/F Dragon Court, Beacon Hill, Kowloon Hong Kong | Chinese |
| Independent Non-Executive Directors | | |
| LEE Ching Kwok, Rin | Flat 5B, Wing On Towers, 7 Boyce Road Hong Kong | British |
| YANG, Victor | House 8, Cape Court, 6-16 Cape Drive Chung Hom Kok, Hong Kong | Canadian |
| CHOW Yu Chun, Alexander | Block 37, 17/F, Baguio Villa 550 Victoria Road, Hong Kong | Chinese |

DIRECTORS AND PARTIES INVOLVED IN THE INTRODUCTION

2. OTHER PARTIES

| | |
|---|---|
| Sponsor | WAG Worldsec Corporate Finance Limited 6th Floor, New Henry House 10 Ice House Street Central Hong Kong |
| Our Legal Advisers | <i>As to Hong Kong Law:</i> Freshfields Bruckhaus Deringer 11th Floor, Two Exchange Square Central Hong Kong <i>As to Bermuda Law:</i> Conyers Dill & Pearman 2901, One Exchange Square 8 Connaught Place Central Hong Kong |
| Legal Advisors to the Sponsor | <i>As to Hong Kong Law:</i> Deacons 5th Floor, Alexandra House 18 Chater Road Central Hong Kong |
| Auditors and reporting accountants | Moores Rowland <i>Chartered Accountants</i> <i>Certified Public Accountants</i> 701 Sunning Plaza 10 Hysan Avenue Causeway Bay Hong Kong |
| Property Valuer | Savills Valuation and Professional Services Limited 23rd Floor, Two Exchange Square Central Hong Kong |

CORPORATE INFORMATION

| | |
|--|---|
| Registered Office | Clarendon House 2 Church Street Hamilton HM 11 Bermuda |
| Principal place of business in Hong Kong | 21st Floor, The Toy House, 100 Canton Road Tsimshatsui, Kowloon, Hong Kong |
| Website of our Company | www.playmatestoys.com |
| Company Secretary | Ng Ka Yan <i>LLB, MBA</i> |
| Qualified accountant | Lee Tak Fai, Thomas <i>CPA, FCCA, MBA, MPA</i> |
| Authorized representatives | Chan Chun Hoo, Thomas 8 Middle Gap Road The Peak Hong Kong Soong, Ronnie No. 6 Eastbourne Road, Block A2, 3/F Dragon Court, Beacon Hill, Kowloon Hong Kong |
| Members of the Audit Committee | Chow Yu Chun, Alexander (<i>Chairman</i>) Lee Ching Kwok, Rin Yang, Victor |
| Members of the Compensation Committee | Yang, Victor (<i>Chairman</i>) Chow Yu Chun, Alexander Lee Ching Kwok, Rin |
| Bermuda principal share registrar and transfer office | The Bank of Bermuda Limited 6 Front Street Hamilton HM11 Bermuda |
| Hong Kong branch share registrar and transfer office | Tricor Abacus Limited 26/F Tesbury Centre 28 Queen's Road East Hong Kong |

CORPORATE INFORMATION

Principal bankers

The Hongkong and Shanghai Banking
Corporation Limited
HSBC Main Building
1 Queen's Road Central
Central
Hong Kong

Hang Seng Bank Limited
83 Des Voeux Road Central
Central
Hong Kong

Standard Chartered Bank (Hong Kong) Limited
4-4A Des Voeux Road Central
Central
Hong Kong

Compliance Adviser

WAG Worldsec Corporate Finance Limited
6th Floor, New Henry House
10 Ice House Street
Central
Hong Kong

INDUSTRY OVERVIEW

We have extracted and derived the information and statistics in the section below, in part, from various official government publications unless otherwise indicated. These information and statistics are not commissioned by us, the Sponsor or any of their respective affiliates or advisers. While reasonable care has been taken in the extraction, compilation and reproduction of such information and statistics, neither we nor the Sponsor nor any of our or their respective affiliates or advisers, nor any party involved in this Introduction have independently verified such information and statistics directly or indirectly derived from official government publications (or other sources where relevant) or make any representation as to their accuracy. The information and statistics may not be consistent with other information and statistics compiled within or outside China.

INDUSTRY OVERVIEW

INTRODUCTION

Play and the toys with which children play are fundamental in their lives as play is the primary way children learn about the world around them and develop skills for life. Play is an essential part of growing up. In reaching for a rattle, baby develops hand/eye co-ordination, strength, balance and agility. A baby's first toys are important in teaching about colour, shape, size, texture and weight. Activity centres, blocks, shape sorters and games help children learn important skills. Toys that are used with playmates encourage sharing, co-operation and communication. Blocks and models develop spatial play. Jigsaws, puzzles, board games and certain toys develop logical play. Some toys lend themselves more to physical play and promote dexterity and other physical skills as well as health; other toys are more suited for imaginary play stimulating children to play in a world of fantasy and imagination. In other words, toys are the tools that help foster the mental, physical, emotional and social development of boys and girls. Since children differ enormously in their rate of growth and development, there is a large variety of toys that cater for children's differing (and changing) needs and ability levels. All toys that are appropriate for a child's abilities stimulate that child to learn, to develop language, social and communication skills and/or to use imagination and creativity. Toys are an integral part of a child's development.

INDUSTRY CHARACTERISTICS

Market Size

The toys and games market is divided into two primary sectors: traditional toys and video games. Video games market covers all game consoles and PC games such as Sony's Playstation 3 and PSP, Nintendo's Wii and DS Lite, and Microsoft's X-Box 360, and the corresponding softwares. Traditional toys include different categories of products defined by play-pattern and targeted gender and age consumer demography, such as the boys-targeted categories of action figures, vehicles and activity toys, and the girls-targeted categories of dolls, plush, arts and crafts, etc.

Although estimates vary, the world market for toys and games is very large. Datamonitor, a leading business information company, estimates that the size of the world toys and games market in 2005 measured at retail selling prices was around US\$86 billion (or approximately HK\$670.8 billion); the United States accounted for over 37.5% of this total or around US\$32.3 billion (or approximately HK\$251.9 billion). The European market had an estimated 35.6% with a market value of approximately US\$30.7 billion (or approximately HK\$239.5 billion) in 2005. And that of the Asia-Pacific region was estimated to have 19.1% at a worth of US\$16.5 billion (or approximately HK\$128.7 billion) in 2005. The rest of the world accounted for the remaining 7.8% being approximately US\$6.5 billion (or approximately HK\$50.7 billion). The U.S. is the world's largest single toys and games market.

INDUSTRY OVERVIEW

According to Datamonitor, the United States toys and games market grew at a compound annual growth rate of 4.1% in the five year period from 2001 to 2005. By comparison, the European markets recorded average growth of 3.4% per year while the Asia-Pacific market contracted at an annual average rate of 5.4%. Datamonitor forecasts that the United States toys and games market will grow at an average rate of 5.3% in the five year period from 2005 to 2010 while the European and Asia-Pacific markets will record average growth of 3.9% and 4.7% per year respectively over the same period.

Sales of traditional toys proved to be the most significant for the U.S. market. As indicated in Table 1 below, in 2005 and 2006, sales of traditional toys generated total revenues of US\$22.2 billion (or approximately HK\$173.6 billion) and US\$22.3 billion (or approximately HK\$173.7 billion) respectively, which is relatively static over the last few years. As a result, the U.S. is a major base for product creation and design for many of the major toy companies in the world. Since many toys created for the U.S. market often appeal to consumers in other international markets, most U.S.-based toy companies also distribute products worldwide.

Shifts in Consumer Preferences

The toys industry is subject to constant and sometimes rapid and unpredictable changes in consumer preferences. Product life cycles are short. New toys are launched each season and successful existing lines need to be “refreshed” to sustain their appeal. New products can suddenly become “hot” hits. Successful new products gain market share at the expense of existing products within the same category and can even draw consumer purchasing power from other categories of toys.

Table 1: U.S. Traditional Toy Market by Segments

| Super-category (B: billion/M: million) | 2005 vs. 2006 state of the industry | | | | Change % |
|---|-------------------------------------|---------------|--------------------------------|---------------|-------------|
| | Annual 2005 (approximately) | | Annual 2006 (approximately) | | |
| | (US\$) | (HK\$) | (US\$) | (HK\$) | |
| Action Figures & Accessories | 1.4B | 10.9B | 1.3B | 10.1B | -9 |
| Arts & Crafts | 2.5B | 19.5B | 2.6B | 20.3B | 4 |
| Building Sets | 680.3M | 5.3B | 676.5M | 5.3B | -1 |
| Dolls | 2.7B | 21.1B | 2.7B | 21.1B | - |
| Games/Puzzles | 2.5B | 19.5B | 2.4B | 18.7B | -2 |
| Infant/Preschool | 3.2B | 25B | 3.3B | 25.7B | 2 |
| Youth Electronics | 871.0M | 6.8B | 1.1B | 8.6B | 22 |
| Outdoor & Sports toys | 2.9B | 22.6B | 2.8B | 21.8B | -2 |
| Plush | 1.4B | 10.9B | 1.3B | 10.1B | -4 |
| Vehicles | 2.0B | 15.6B | 2.1B | 16.4B | 5 |
| All Other Toys | 2.1B | 16.4B | 2.0B | 15.6B | -5 |
| Total Traditional Toy Industry | 22.3B | 173.6B | 22.3B | 173.7B | 0.3 |

(Source: The NPD Group/2005 vs. 2006 State of the Industry)

INDUSTRY OVERVIEW

The market for traditional toys is divided into a number of categories including action figures and accessories, arts and crafts, building sets, dolls, games/puzzles, infant/preschool, youth electronics, outdoor and sports toys, plush, vehicles and other miscellaneous toys. Table 1 above shows a breakdown of the U.S. market for traditional toys in 2005/2006 by category.

NPD Group, the industry analyst, reports that the strong performance of four super-categories helped the industry experience positive dollar sales growth over 2005. Sales in youth electronics increased 22% over 2005, the largest increase of all super-categories. Vehicles, arts and crafts, and infant/preschool were the other strong performers in 2006, showing respective dollars sales increases of 5%, 4% and 2% over 2005. Combined, these four super-categories comprised over US\$9 billion (or approximately HK\$70.2 billion) in retail sales.

Action figures, which performed strongly in 2005 due to the huge success of Star Wars products, experienced the largest decline in dollar sales in 2006, dropping by 9% and generating close to US\$1.25 billion (or approximately HK\$9.75 billion). The super-category that benefits from a hit movie depends upon the underlying nature of the property itself. According to the NPD Group, "With movie release such as Transformers, Spider-Man 3, and Fantastic Four: Rise of the Silver Surfer, the action figure super-category should realize gains in 2007". The sale of plush has also seen a decrease of 4% to US\$1.3 billion (or approximately HK\$10.1 billion) in 2006.

With increasing competition from video games, the traditional toys industry has responded by incorporating more technology into toys, from simple electric motors to sophisticated electronics and interactive technologies. Dolls have electronic components such as speech synthesizers sewn in to enable them to communicate with and respond to children. Some toy companies are incorporating educational features into their products and others are offering kid-size versions of adult consumer electronic products.

Typically, larger toy companies compete in more categories than smaller toy companies, and all toy companies, large or small, may enter into or exit from categories from time to time depending on their individual skill sets, choice of strategy, and prevailing market trends and consumer tastes. The largest public toy companies in the world (with reported annual revenue of over US\$1 billion (or approximately HK\$7.8 billion)), Mattel, Hasbro, Bandai and Tomy-Takara, compete in most, if not all, of the categories.

Seasonality

The toys market has pronounced seasonality. It is reported by Toys Retailers Association, regardless of the type of toy you choose - most types find the trading pattern around the same: around 15% per quarter until the pre-Christmas period when you take around 55% of your turnover. Such high seasonality has obvious implications for production planning, inventory and logistics. Suppliers have to make an early and accurate forecast of the likely demand and must commit working capital to manufacture and carry inventory in anticipation of such demand during the Christmas season. Retailers time their orders so that suppliers fill the orders as close to the time of purchase by consumers as possible in order to minimize inventories. Failure to forecast accurately such demand results in lost sales opportunities when demand is underestimated. Overestimation of demand results in unwanted excess inventories and this could lead to making customer concessions or write-offs relating to such excess inventories and/or price reductions to reduce excess inventories.

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Concentrated Competition

The industry is very competitive and has become highly concentrated as well. According to the NPD survey, in 2006, two toys companies (Mattel and Hasbro) and three retailers (Walmart, Toys “R” Us, and Target) dominate the U.S. market. In other countries, the toy industry has followed the U.S. trend of becoming corporate-dominated; the little cottage-industry nature of toys that remains is rapidly vanishing. Not only is the industry everywhere becoming more corporate-dominated, but Mattel and Hasbro feature prominently as these U.S. industry giants have expanded internationally.

According to the NPD survey, in 2006, the two industry giants (Mattel and Hasbro) account for about 30% of the U.S. market. Numerous smaller toy companies compete in the design and development of new toys, the procurement of character and product licenses, and the improvement and expansion of previously introduced products and product lines. In addition, the companies spend heavily on marketing and advertising campaigns to promote their products. Competitive pressure forces toy companies to differentiate themselves by focusing their efforts to compete in one or more selected product categories. The two industry giants compete in most, if not all, categories.

Most toy companies do not sell their products directly to the end consumers, although some do operate retail outlets or online stores. In the U.S., toy retailing has been consolidating over the last two decades and is now heavily concentrated in a handful of national mass merchandise retailers. The three big U.S. retail chains now account for about 58% of traditional toys sales in 2006. There is a plethora of retailers, some of which are tiny mum and pop stores, competing among themselves and with the three big retail chains but they continue to lose market share not just to the mass merchandisers but also to online/internet channels which have grown steadily in importance and now account for about 6.4% of retail sales in the U.S. market for 2006, according to the NPD survey.

We sell our products to U.S. merchandise retailers, national toy specialty chain stores and independent toy distributors and receive payment for our products from these parties, as our products are not sold on a consignment basis to these parties. We therefore consider all these parties as our customers.

Licensing in toy industry

As the retail trade consolidates, competition for shelf space at the top retailers becomes critical for toy companies and these retailers wield strong bargaining power. To increase their chances of getting shelf space, a strategy that some toy companies may choose to adopt is to offer products that are not only of good quality and play value and competitively priced, but are also unique in some way.

Uniqueness of a product is usually achieved by the use of exclusive and protected intellectual property in fictional or real character, design or technology. The entertainment industry, including the studios producing movies, television shows and comics, is an important source of such intellectual properties which are utilized under license. Licensing of a well known character is a quick way to get immediate recognition and if the launch of a licensed toy can be timed to coincide with the release of a film or television show to which the character is related, the product can benefit from the often significant promotion budget of the film or television show. The cost of licensing can be high and licensing is not without risks as films can flop at the box office and television shows are not always successful. Furthermore, toys sales do not always correlate well with box office receipts or television viewership figures. According to the NPD Group, “as a rule of thumb, licensed product will comprise approximately 25 percent of total toy sales in any given year”.

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We understand that the general industry practice regarding the duration of toy licenses is three years. We often try to negotiate three solid selling years and a two-to-three-year renewal. When a property is a franchise or is a newer opportunity that has longevity we will try to negotiate longer terms up front, typically 4 to 5 years but this is generally difficult to achieve. Some agreements allow for renewal based on performance benchmarks which can sometimes extend the term to five years.

Kids growing old younger

Video games have developed to attract younger and younger users and children have been deserting traditional toys at a younger and younger age. Another reason for this so-called kids growing older younger syndrome is the fact that kids today have more choices when deciding how to spend their free time, more places to go to, more things to see and do, more things to spend their pocket money on than toys.

TOY SAFETY

Toys sold in the United States are regulated by CPSC and must comply with Federal Regulations such as the Consumer Product Safety Act Regulations, Federal Hazardous Substances Act, and the Child Safety Protection Act. The United States government also relies on the toy industry to voluntarily regulate itself. There is a comprehensive voluntary safety standard for toys in the United States, referred to as ASTM F963, which contains additional requirements for safety. PTI is a member of TIA which, together with CPSC and TIA, is actively involved in reviewing and updating the standard.

The primary legislation for toys sold in Europe is the Toy Safety Directive (88/378/EEC) and the European standard for toys is EN-71. Additional requirements apply to electronic toys are contained in Safety of Electric Toys: EN50088. Toys containing Phthalates and certain kinds of toys are further regulated by other legislations such as the Restriction of Hazardous Substances in Electronic Equipment Directive and the Waste Electrical and Electronic Equipment Directive. Toys that conform to the Toy Safety Directive are marked to show European Conformity with the "CE" mark.

The safety and quality of products manufactured for us have always been of the utmost importance to us. We have a select group of vendors that produce our products. All toys manufactured for us are tested and certified by independent third party certified laboratories and are in full compliance with all US and European regulations. All toys must meet strict requirements for lead as well as other heavy metals. Ongoing factory monitoring is supported by random audits of products. These products are then forwarded to independent laboratories for testing.

Our vendors are certified to comply with the International Council of Toy Industries CARE Process to ensure that factories meet their standards for working conditions.

MAJOR TRADE ASSOCIATIONS

Toy Industry Association, Inc.

TIA, founded in 1916, is the national New York City-based trade association for U.S. producers and importers of toys, games and children entertainment products. It has more than 500 members who account for 85 percent of industry sales. Associate members include toy testing laboratories, design firms and professional inventors. TIA is recognized as the authoritative voice of the U.S. toy industry by the Government, the trade, the media and consumers.

INDUSTRY OVERVIEW

TIA has worked with the U.S. Government in the development of toy safety standards, including the creation in 1971 of a comprehensive voluntary safety standard for toys, ASTM F963. In the past six decades, TIA also affiliated with the following organization:

- National Safety Council
- National Bureau of Standards
- American National Standards Institute
- American Society for Testing and Materials
- European Committee for Standardization
- International Standardization Organization

TIA works with consumer organizations, such as the International Consumer Product Health and Safety Organization and most recently, the National Safe Kids Campaign, to communicate the importance of safe play throughout the U.S. and around the world. PTI has been a proud member of TIA for decades.

The Toys Shippers Association, Inc.

TOYSA is a not-for-profit association formed by TIA in 1990 to benefit companies importing toys and juvenile products.

Through the combined leverage of the members TOYSA negotiates freight contracts and partners with other logistics providers to lower supply chain costs and improve transit and visibility to products in the supply chain.

TOYSA negotiates competitive ocean freight contracts for companies importing toys and related commodities from the Far East to the U.S. and also offers a complete list of logistics services for members to reduce costs and control their logistics pipeline. PTI has been a member of TOYSA since its inception.

Customs Trade Partnership Against Terrorism

As we are an importer, we are regulated by U.S. laws, rules and regulations. In addition, PTI is a voluntarily certified partner of the C-TPAT (Customs-Trade Partnership Against Terrorism) program instituted and administered by U.S. Customs and Border Protection to develop, enhance, and maintain effective security processes for the supply chain of U.S. businesses. The C-TPAT Program was initiated by the CBP. It is a U.S. government agency set up after the 11 September 2001 terrorist attack in New York as a means to involve the U.S. business community in a defense strategy against terrorism.

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Under CBP's layered, defense-in-depth against terrorism, C-TPAT is the initiative that partners, on a voluntary basis, with members of the trade community. CBP and willing members of the national and international trade community collaborate to better secure the international supply chain to the United States in support of CBP's priority Homeland Security mission: security and facilitation of trade moving into the U.S. by relying on a multi-layered approach reinforced by a global collaboration, consisting of five goals to prevent terrorists and terrorist weapons from entering the United States.

Participants to the C-TPAT program supply CBP with information about the security of their supply chain and become certified once the information is verified and accepted by CBP. PTI has been a certified member of C-TPAT since 2003.

The Foreign Trade Association of Southern California

The FTASC is a prestigious and influential trade organization in California. Its membership is comprised of the leading international trade professionals in the area, coming from a wide range of companies and agencies that are actively involved in trade matters and enhanced international security measures.

FTASC's missions are to advocate free trade and oppose to trade barriers domestically and internationally, while also allow protection against international terrorism efforts by providing the members and the trade community with educational opportunities and informative programs. PTI has been a member of FTASC for over two decades.

THE BUSINESS OF TOYS

Children have played with toys throughout history and in all cultures. Today's children may have more than toys to entertain themselves with but they continue to play with toys. According to the NPD Group's "Kids Leisure Time Study", over 81% of children aged 5-12 play with toys every week. They spent over 9 hours per week on average playing with toys which was their top free time activity after watching television or movies. Thus toys will continue to be a big business.

RECENT DEVELOPMENT

Recently, there have been widely publicized product recalls on safety grounds by toy companies in the U.S. Such incidents, among other things, caused consumer sentiments in the U.S. to appear to be increasingly negative towards products, in particular toys, manufactured in or sourced from the PRC. In light of these incidents, new regulations and legislations are being drafted in the U.S. and new requirements have been imposed in the PRC. Please see the section headed "BUSINESS – QUALITY CONTROL" for further details.

HISTORY AND REORGANIZATION

OUR HISTORY

Our corporate history

In 1966, Mr. Chan Tai Ho, the father of our Chairman, Mr. Chan Chun Hoo, Thomas, founded a manufacturing business in Hong Kong which became the predecessor of our Group and the PHL Group. By the early 1980s, the business of this predecessor group had diversified and expanded to comprise a number of business entities. In 1984, all such business entities were restructured to be held under a predecessor holding company, whose shares were successfully offered to the public and listed on the then stock exchanges in Hong Kong in November 1984.

In 1990, PIHL (stock code: 75) replaced the predecessor holding company as the listed holding company of the group as a result of a re-domicile exercise.

By 1993, the toy and non-toy business segments, which include property investment and development and investment holding, of PIHL had each become significant business and in December 1993, the toy business was spun-off from PIHL via PHL (stock code: 635), and our business become directly and indirectly owned by PHL through PIL.

In September 2000, Chansam Investments Limited, a company directly and indirectly held by our Chairman, his father and their family, sold its controlling interests in PIHL to a wholly owned subsidiary of Yugang International Limited, which is an independent third party, and ceased to control PIHL.

In 2000, a non-toy operating subsidiary of PHL acquired a commercial building at 100 Canton Road. In the following years, it further acquired other properties and made other non-toy investments.

In May 2007, we underwent our Reorganization and following the Spin-off, we intend to focus on further developing the toy business by pursuing the growth strategies to acquire rights in new entertainment licenses and inventions, expand product portfolio in targeted growth categories and to broaden worldwide distribution. After the Spin-off, PHL intends to focus on property investments, property management business, and securities and other investments.

Our business history

Our business was founded in 1966 as an OEM doll manufacturing business in Hong Kong. We launched our first proprietary doll line in 1969 and our first licensed brands, with Disney characters, in 1982.

In 1978, we began to build our worldwide sales and distribution network when a sales office was set up in Massachusetts, U.S., followed shortly by the opening of a showroom in New York. Our California operations, where the majority of our management is currently based, were established in 1982.

With funding raised from the 1984 initial public offer, we took on the promotional toys business, and in 1986 launched our first TV-promoted product, an animatronic talking doll named *Cricket*. In 1987, we acquired exclusive worldwide master toy licenses in the *Teenage Mutant Ninja Turtles* franchise and launched our first series of *Turtles* products in 1988.

HISTORY AND REORGANIZATION

With the success of *Turtles* and other proprietary and licensed brands, we changed our business strategy from manufacturing-focused to marketing-focused. We experienced significant growth and evolved from a manufacturing-based business to a design, development and marketing enterprise. We disposed of our factories and related manufacturing assets in the early 1990s and thereafter, outsourced the production of all of our finished products to third party OEM or ODM vendors.

In 1998, we launched our proprietary *Amazing* brand. *Amazing Amanda* is a new generation of interactive dolls featuring voice recognition technology. In 2006 we also launched *Amazing Allysen* and in 2007, *Amazing McKayla* and *Amazing Lexie*. Our development and marketing focus enabled us to introduce innovative products such as the *Amazing* line of interactive dolls, which combined our experience in large dolls with sophisticated technologies. Our ability to incorporate technologies into the creation of innovative yet affordable toys enabled us to win a number of licenses that contributed to our portfolio of proprietary and licensed brands.

As licenses proliferated in the toy industry in the mid-to-late 1990s, our profitability began to decline due to the unsatisfactory performance of a number of unproven licensing and entertainment initiatives such as *Monster Force* and *Blasters* lines. In response to our declining financial results, we restructured our management team and operations. We built a strong team of experienced professionals in licensing, product development, marketing and sales. We also implemented a more stringent process for evaluating license opportunities. New personnel with extensive experience in the toy industry joined our senior management and we prioritized new license acquisitions and proprietary product development based upon our assessment of the long term growth potential of these opportunities. Since 2002, we have concentrated on offering a selective number of new brands and have focused on developing brands that we believe can generate long term value and revenues such as *Teenage Mutant Ninja Turtles*, *Disney Princess*, *Disney Fairies*, *Strawberry Shortcake*, *Sesame Street* and *Land Before Time*. We complement this approach by aligning strategically with licensors in the entertainment industry to extend their brand equity into toy and electronic products worldwide.

Pursuant to the above initiatives, in 2001, we launched our line of *Disney Princess* brand large dolls and in 2002, we worked with Disney to launch the first ever assortment of the classic *Disney Princesses* characters depicted as four to five year old girls which appealed to our major market.

In 2003, we have re-launched the *Turtles* based upon a brand new animated television series.

In 2005, we were granted a license by Disney Consumer Products for the *Disney Fairies* property.

In 2006, we launched a re-designed and contemporized line of *Strawberry Shortcake* products consisting of small dolls, playsets and vehicles, as well as soft dolls and large dolls.

OUR REORGANIZATION

We underwent the Reorganization in May 2007 to effectively consolidate under our Company the toy business of the Playmates Group. Prior to the Reorganization, the Playmates Group, through PIL, directly and indirectly owned our toy business. Following the Reorganization, the Playmates Group's

HISTORY AND REORGANIZATION

ownership of the toy business was transferred to us. The major steps of the Reorganization involved (i) the transfer to us of the U.S.-based toy business from the Playmates Group, (ii) the transfer to us of the Hong Kong and PRC-based toy business from the Playmates Group; and (iii) the incorporation of Playmates Toys Enterprises Limited as an immediate holding company of each of our Hong Kong, U.S. and PRC-based toy business operating companies. The Reorganization will be completed before the Introduction. Details of the steps involved in the Reorganization are set out in Appendix IV to this document under the heading “1.5 Reorganization”.

THE DISTRIBUTION

In connection with the Spin-off, the board of directors of PHL has on 17 December 2007 conditionally declared a special dividend by PHL to Qualifying PHL Shareholders. Upon the passing of the resolution to approve the Distribution at the PHL SGM, the PHL’s shareholders will vote to approve the proposed PHL Capital Reorganisation comprising of the PHL Capital Reduction under which the nominal value of every PHL Share in issue will be reduced from HK\$0.10 to HK\$0.01 and the PHL Share Consolidation under which every ten issued PHL shares of HK\$0.01 each resulting from the PHL Capital Reduction will be consolidated into one Consolidated PHL Share of HK\$0.10 each. Upon the approval of the PHL Capital Reorganisation, the Distribution will be wholly satisfied by way of distribution in specie to Qualifying PHL Shareholders of an aggregate of not less than approximately 222,523,256 Shares, constituting approximately 45% of the issued share capital of our Company as at the Distribution Record Date. Qualifying PHL Shareholders will receive one Share for every one Consolidated PHL Share held as at the Distribution Record Date. PHL will effect the Distribution after (i) PIL Toys distributes approximately 222,523,256 Shares to PIL Investments Limited, (ii) PIL Investments Limited distributes approximately 222,523,256 Shares to PIL, (iii) PIL distributes approximately 222,523,256 Shares to PHL and (iv) the PHL Capital Reorganisation. For further details of how the Distribution is effected, please refer to “APPENDIX IV – STATUTORY AND GENERAL INFORMATION – 1.3 Changes in Share Capital of the Company”.

The Distribution is conditional upon:

- (i) the granting by the Listing Committee of the Stock Exchange of listing of, and permission to deal in, the Shares in issue and any Shares which may be issued pursuant to the exercise of the options which may be granted under the Share Option Scheme; and
- (ii) the passing at the PHL SGM of the necessary resolutions to approve the Distribution,

on or before the earlier of the Listing Date and 31 March 2008.

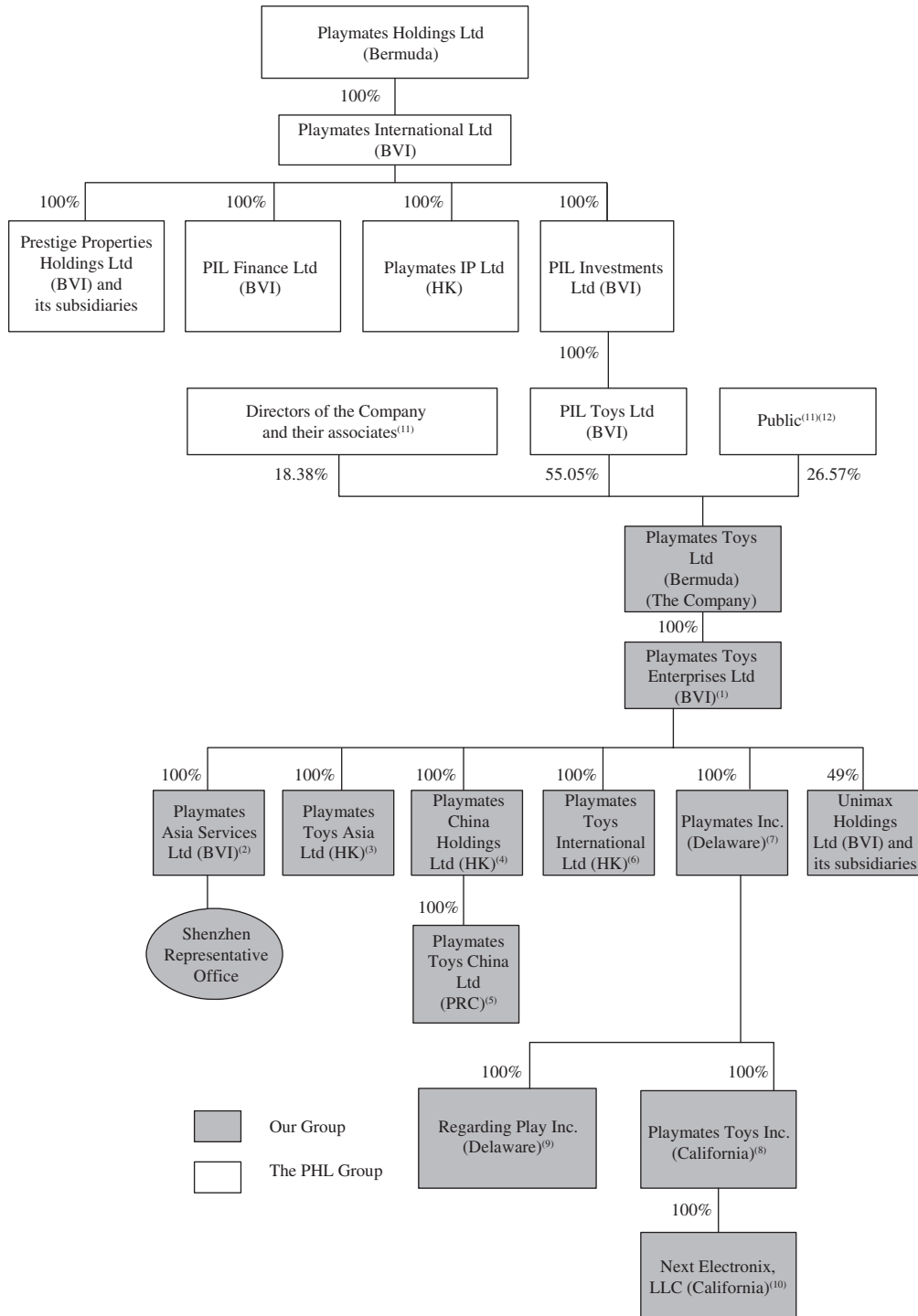
Overseas Shareholders (excluding the Excepted Overseas Shareholders), if any, would be entitled to the Distribution but would not receive the Shares; instead, they would receive a cash amount equal to the net proceeds of the sale of their Shares by PHL on their behalf after dealing commences at the prevailing market price. The proceeds of such sale, net of expenses, will be paid to the relevant Overseas Shareholder (excluding the Excepted Overseas Shareholders) in Hong Kong dollars, unless the net proceeds falling to be distributed to the relevant Overseas Shareholder (excluding the Excepted Overseas Shareholders) is less than HK\$100, in which case such proceeds will be retained by and for the benefit of PHL.

We will despatch share certificates to Qualifying PHL Shareholders on Wednesday, 30 January 2008.

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As at the Latest Practicable Date, there was a total of 2,225,232,569 PHL Shares allotted and issued to PHL's shareholders. Immediately after completion of the proposed PHL Capital Reorganisation, there will be a total of approximately 222,523,256 Consolidated PHL Shares allotted and issued to PHL's shareholders.

The following group structure chart summarises our Group's corporate structure and shows the relationship between the Group and the key entities of the PHL Group after the Reorganization, Spin-Off and the Distribution:



HISTORY AND REORGANIZATION

Notes:

- (1) Playmates Toys Enterprises Limited was incorporated on 17 May 2007 in the British Virgin Islands, and is principally engaged in the investment holding business.
- (2) Playmates Asia Services Limited was incorporated on 5 January 1999 in the British Virgin Islands, and is principally engaged in the provision of services business. Its Shenzhen Representative Office was established on 5 December 2002 and the approved residence period is from 5 December 2002 to 26 November 2010.
- (3) Playmates Toys Asia Limited was incorporated on 25 May 2007 in Hong Kong, and is principally engaged in the provision of services and trading business.
- (4) Playmates China Holdings Limited was incorporated on 25 May 2007 in Hong Kong, and is principally engaged in the investment holding business.
- (5) Playmates Toys China Limited was incorporated on 26 November 2007 in the PRC, and is principally engaged in the provision of services business.
- (6) Playmates Toys International Limited was incorporated on 22 December 2004 in Hong Kong, and is principally engaged in the business of toy distribution in non-U.S. markets.
- (7) Playmates Inc. was incorporated on 21 October 1996 in Delaware, U.S., and is principally engaged in the investment holding business. Playmates Inc., has long been an investment vehicle of the Group, was not included in PHL's list of principal subsidiaries in its annual report 2006 because its sole purpose was to hold Regarding Play Inc., Playmates Toys Inc. and Playmates Asia Services Limited. As such, Playmates Inc. has no business operation of its own.
- (8) Playmates Toys Inc. was incorporated on 29 November 1982 in California, U.S., and is principally engaged in the business of toy development, marketing and distribution in U.S. market.
- (9) Regarding Play Inc. was incorporated on 23 June 1999 in Delaware, U.S., and is an inactive company.
- (10) Next Electronix, LLC was incorporated on 1 September 2004 in California, U.S., and is an inactive company.
- (11) Public shareholders of the Company include certain connected persons of PHL, namely (i) directors of PHL (other than Mr. Chan Chun Hoo, Thomas, Mr. To Shu Sing, Sidney and Mr. Cheng Bing Kin, Alain, whose respective shareholdings are not counted in the public float of the Company as Mr. Chan is a director of the Company and Mr. To and Mr. Cheng were directors of the Group during the twelve months prior to the date of this Listing Document) who will also be shareholders of the Company, and (ii) Sansar Capital Management, LLC and Sansar Capital Master Fund, LP (the "Sansar Group"), a substantial shareholder (and holding approximately 11.03% of the issued share capital) of PHL. None of these directors (other than Mr. Chan Chun Hoo, Thomas) is also a director of the Company and they are therefore not connected persons of the Company, and their shareholding in the Company upon listing are therefore counted in the Company's public float. Further, Sansar Group's shareholding in the Company is expected to represent approximately only 4.96% of the issued share capital of the Company upon listing and its shareholding is therefore counted in the Company's public float. Sansar Group is an independent third party unrelated to the Company and PHL, and does not have any management or other function within the Company or PHL.
- (12) Shares indicated above as held by the public is expected to be held by over 1,600 separate shareholders, based on the shareholding profile of PHL as at the Latest Practicable Date.

Please see the sections headed "1.2 Incorporation of the Company" and "1.5 Reorganization" in Appendix IV of this document for further information in relation to the entities that comprise our Group and to our Reorganization.

BUSINESS

OUR CURRENT BUSINESS PROFILE

We design, develop, market and distribute a diverse portfolio of innovative branded toys. We market and distribute our products in over 50 countries worldwide. Our current product categories consist of action figures, vehicles, dolls, feature plush, role play toys and interactive electronic toys. We develop a wide range of products in these categories by acquiring rights in entertainment properties (including brands) from third parties and by developing brands internally. We also acquire rights in patented technologies and inventions through Inventor Licenses for use in our products. Our products can be categorised generally into licensed brands and proprietary brands – licensed brands are products that are principally based on entertainment properties held by third parties which we acquired the rights to use through Entertainment Licenses; while proprietary brands are brands we develop internally. Our key licensed brands include the *Teenage Mutant Ninja Turtles* range of toys, the *Disney Princess* brand dolls and the *Strawberry Shortcake* dolls. Our proprietary brands include *Amazing Dolls*, *WOW Pals*, *Struts* and *Playmates Electronics*. We also intend to expand our product offerings into targeted growth categories such as arts and crafts, preschool and youth electronics. We believe our ability to build long-term brand franchises and to quickly bring innovative new products from concept to retail shelves is recognized by the trade community that we operate in, including licensors, retailers and distributors.

We focus on building long-term brand franchises and creating innovative products. Our current major products include *Teenage Mutant Ninja Turtles* action figures, accessories and role play toys, *Disney Princess* brand large dolls and accessories and the *Amazing* brand of interactive dolls. As an example of our long-term brand building ability, we have been developing and selling *Turtles* products since 1988. We seek to regularly expand our brand portfolio and product offerings, and have introduced the first *Amazing* doll in 1998, dolls and accessories based on *Disney Princess* brand in 2001, American Greetings' *Strawberry Shortcake* in spring 2006, fashion dolls and playsets based on *Disney Fairies* characters in fall 2006, and a line of preschool toys featuring characters from Universal Studios' *Land Before Time* in fall 2007.

We maintain close working relationships with major entertainment licensors and the toy invention and design community worldwide. These relationships help us gain access to licensed rights in new entertainment properties, new technologies and inventions. We currently hold master toy licenses and product category-specific licenses from American Greetings, DIC Entertainment, 4Kids Entertainment, Disney, Microsoft, Mirage Studios, Nickelodeon, Sesame Workshop, Universal Studios and others which allow us to design, develop and market products branded with popular franchises such as *Blue's Clues*, *Care Bears*, *Disney Princess*, *Disney Fairies*, *Land Before Time*, *Popples*, *Sesame Street*, *Strawberry Shortcake* and *Teenage Mutant Ninja Turtles* brands. Master toy licenses generally grant us broad rights to create, market and distribute toys in a broad range of categories, as opposed to product category-specific licenses which grant us rights only in respect of a specific product categories, eg. baby dolls, accessories. Creating, developing and marketing toys based on these popular children's entertainment properties enable us to enhance the uniqueness and appeal of our products and benefit from the extensive entertainment production, marketing and promotional efforts of our licensors.

We also develop brands internally. Our major internally developed brands include *Amazing Dolls*, *WOW Pals*, *Struts* and *Playmates Electronics*.

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We summarise below a brief description of our internally developed brands, details of which can be found in the section headed “OUR PRODUCTS”:

Amazing Dolls – launched in 1998, it was ranked as one of the top selling large doll brands in the U.S. and generated sales of approximately US\$175 million (or approximately HK\$1.37 billion) between 1998 and 2006.

WOW Pals – created in 2007 to distinguish and focus our marketing efforts on the further development of this family of feature plush products.

Struts – expected to launch in spring 2008, it will feature all the traditional fashion doll play patterns involving accessories and playsets incorporated into a line of elegant ponies to capture girls’ affection of ponies.

Playmates Electronics – a range of new youth electronic toys to be introduced starting from fall 2008 ranging from handheld games to simulated mobile phones.

Our key distribution channels in the U.S. include national mass merchandise retailers and national toy specialty chain stores, membership warehouse clubs, as well as supermarket, pharmacy and dollar store chains. We serve our U.S. customers through our in-house sales team which is complemented by a network of independent sales representatives who maintain close working relationships with our customers. Outside the U.S., we work with a network of independent toy distributors who manage the marketing and distribution of our products in over 50 countries around the world. We sell our products to U.S. merchandise retailers, national toy specialty chain stores and independent toy distributors and receive payment for our products from these parties. As our products are not sold on a consignment basis to these parties, we therefore consider all these parties as our customers.

Our executive officers and key management personnel have an average of 20 years of collective toy, entertainment, consumer product and retail industry experience, and have served in a broad spectrum of management and operating functions in leading companies.

In the U.S., we have regularly received awards and recognitions from our customers and the trade. Some of such awards and recognitions we received in recent years include:

- 2002 Little Princesses winner of National Parenting Center’s Seal of Approval*
- 2002 Little Princesses awarded Family Fun Toy of the Year*
- 2002 My Interactive Princess winner of National Parenting Center’s Seal of Approval*
- 2003 Playmates Toys Inc. awarded Toys “R” Us’ Vendor of the Year*
- 2003 Turtles nominated for Toy Industry Association’s Toy of the Year*
- 2004 Playmates Toys Inc. awarded Target’s Partner Award of Excellence*
- 2004 Playmates Toys Inc. awarded Toys “R” Us’ Vendor of the Year*
- 2004 Turtles nominated for LIMA’s Character License of the Year*
- 2004 My Baby Princess winner of iParenting Media Award*
- 2004 Little Princess winner of iParenting Media Award*
- 2004 Speedeez awarded National Parenting Publications Honor*

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2004 Speedeez winner of National Parenting Center's Seal of Approval
2004 Waterbabies winner of National Parenting Publications Award
2004 Waterbabies winner of National Parenting Center's Seal of Approval
2005 Little Princess winner of iParenting Media Awards
2005 Waterbabies winner of iParenting Media Award
2006 Disney Fairies awarded Parents Magazine Best Toy of the Year
2006 Disney Fairies winner of iParenting Media Award
2006 Love'n Licks Puppy winner of Family Fun Toy of the Year
2007 Disney Fairies winner of iParenting Media Best Product Award

Our licensing heritage dates back to the 1980s and includes the following Entertainment Licenses:

| Licensor | Property |
|---------------------|--|
| American Greetings | Strawberry Shortcake, Care Bears, Popples |
| Disney | Classic and Standard Disney Characters, Disney Princess, Dick Tracy, Talespin, Darkwing Duck, Disney Fairies brands and properties |
| DreamWorks SKG | Antz, Chicken Run, Shrek |
| Mirage Studios | Teenage Mutant Ninja Turtles |
| Nickelodeon | Nick Characters, everGirl |
| Sesame Workshop | Sesame Street Characters |
| Sony Pictures | Jackie Chan Adventures |
| 20th Century Fox | The Simpsons |
| Universal Studios | ExoSquad, Monster Force, Earthworm Jim, How The Grinch Stole Christmas, King Kong, Land Before Time |
| Viacom | The Adams Family, Star Trek, Tomb Raider, Fairies of Cottingley Glen |
| Warner Bros Studios | Space Jam, Looney Tunes Characters |

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OUR COMPETITION

We consider our main and direct competitors to be toy marketing companies that principally target the U.S. toy consumers in our product categories. These include Mattel, Hasbro, Bandai, Jakks Pacific, MGA Entertainment, RC2 and Tomy-Takara. Indirectly, we also compete with producers of private label toys sold by many of our retail customers and with producers of other entertainment products that may be substitutes for our toys. In addition, we may face competition from the entry of new participants into our markets. In 2006, the top two toy companies in terms of sales volume, Mattel and Hasbro, commanded a market share in the U.S. of approximately 18% and 12% respectively. The rest of the market is highly fragmented which presents growth opportunities for smaller companies like us. Different toy companies have different sets of attributes in terms of operating histories, economies of scale, brand recognition, and financial, technical, and marketing capabilities which they can capitalize on to create their competitive advantages. We regard as most crucial for the success of our business the competition to acquire and retain licenses in entertainment franchises, patented technologies and inventions, as well as to secure shelf space with major U.S. retail customers.

OUR COMPETITIVE STRENGTHS

Based on our reputation and credibility that we built over the last four decades or so, we attribute our success to date and our current opportunities to increase our sales, profit and market share to our following competitive strengths:

- **Strong relationships with major entertainment licensors.** For over twenty years since the early 1980s, we have built a long history of licensing relationships with major players in the entertainment industry including American Greetings, DIC Entertainment, 4Kids Entertainment, Disney, DreamWorks SKG, the Joester Loria Group, Mirage Studios, Nickelodeon, Paramount Pictures, Sesame Workshop, Sony Pictures, Twentieth Century Fox, Warner Bros Studios and Universal Studios. We believe licensors choose to work with us due to our focused brand management approach, our ability to move rapidly from concept to finished product, our track record of designing innovative products, our commitment to building multi-year brands and our worldwide distribution capabilities.
- **Brand management and marketing expertise.** We are able to nurture and grow brands. We seek to maximise the commercial value of our brands through various brand management techniques including extensive market research using focus group testing, brand attribute and usage studies, evaluating the communication effectiveness of our TV commercials and analyzing retail sell-through for our products. We focus on extending our brands by introducing new product segments thereby increasing the brands' appeal and enhancing the brand equity. We do this by constantly looking for innovative ways to apply our license rights to a diverse range of products. For example, our *Disney Princess* brand product range includes the *Before Once Upon a Time*, *My Baby Princess*, *Soft & Sweet*, and *Enchanted Tales* series, each targeted to a different age bracket ranging from 18 months upwards, thereby ensuring that our products appeal to a wider age group. We also seek to extend the shelf-life and consumer appeal of our products through disciplined retail point-of-sale analyses, which enables us to monitor the flow of goods to our retailers

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and alter product mixes and marketing programs to capitalize on the current sales trends. We value and prioritize new license acquisitions and proprietary product development based upon our assessment of their multi-year growth potential. We support our major toy brands with multi-faceted marketing and promotional programs comprised of a brand-appropriate mix of television advertising, print advertising, consumer promotions, retail promotions and public relations and publicity campaigns.

- **Design expertise and product innovation.** We create and design high-quality, feature-rich toys through a creative and disciplined process that leverages our integrated design, development and marketing resources. Our ability to capture the likeness and spirit of licensed characters in products enables us to retain key brands and Entertainment Licenses and acquire new rights in character-rich intellectual properties, entertainment franchises and brands. We are able to extend the life of these brands with original design concepts, as well as innovative new features and functions. We regularly review the suitability and cost-effectiveness of new technologies for incorporation into proprietary and licensed brands that enhance and expand traditional play patterns. We believe that our track record of design expertise and ability to adapt technologies to create new and affordable toys will enable us to expand our product portfolio within our existing and targeted growth categories.
- **Efficient and scalable operating structure.** We believe that our current operating structure, which is designed to minimize fixed overhead costs, is efficient and can accommodate significant revenue growth without a proportionate increase in operating and administrative expenses, thereby permitting increased operating margins. Our integrated design and engineering teams in the U.S. and Hong Kong create the designs, functional specifications and packaging for our products. The designs and functions are then engineered for manufacturing by our China based suppliers under the supervision of our Hong Kong and Shenzhen based teams. We also contract with independent third parties for a portion of our design, development and engineering needs. All productions of our finished products are outsourced to independent OEM or ODM vendors with manufacturing facilities in China. Our selection criteria of vendors are not only based on technical capabilities and cost considerations, but also on their reliability and quality of finished products, and with whom we can build long-term relationships. Our long-standing vendor relationships give us reliable sources of supply, especially during peak seasons and other critical times. This operating structure, coupled with our own historical manufacturing experience, enables us to capitalize on U.S. and Hong Kong based creative resources and design expertise, and the cost advantages of China based manufacturing capabilities.
- **Multi-channel U.S. and international distribution network.** We continue to expand our U.S. distribution beyond mass merchandise retailers and national toy specialty chain stores into non-traditional channels including membership warehouse clubs, and supermarket, pharmacy and dollar store chains, and in some cases develop custom products for them. Internationally, we have strong relationships with independent distributors that have complementary brand management experience in the toy industry and we are broadening our distribution network for new brand introductions in over 50 countries around the world.

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- **Seasoned management team.** Our management team has extensive experience in the toy and consumer products industries with an average of over 20 years of experience in toy retailing, marketing, sales, finance and operations. Our management focuses on maintaining an efficient and dynamic operating structure, which we believe enables us to develop and market new product lines relatively quickly, and to realize profit at lower sales volume than is possible for many of our larger competitors. We believe the ability of our seasoned management team to develop, license, market and build long-term brands provides us with significant competitive advantages.

OUR GROWTH STRATEGY

Key elements of our growth strategy include:

- **Acquire rights in new Entertainment Licenses and inventions.** We intend to endeavor to retain existing key licenses in connection with our current portfolio of brands and major products and at the same time continue to aggressively and selectively acquire licensed rights in entertainment franchises with strong multi-year growth potential. We intend to align strategically with partners in the entertainment industry to extend their brand equity into toy and electronic products worldwide. Additionally, we intend to capitalize on our close working relationships with the toy invention and design community worldwide and leverage off these relationships to add unique and innovative products to our established brands and to build new proprietary businesses.
- **Expand product portfolio in targeted growth categories.** We intend to employ our design, product development, marketing and business management expertise in our current product categories to establish new market positions in targeted growth categories, which include preschool, youth electronics, feature plush, and arts and crafts. Expanding into new categories broadens the age demography of our consumer base. We believe we can also leverage our existing proprietary and licensed brands to develop complementary products in targeted growth categories. Additionally we intend to pursue opportunities as they arise in complementary acquisitions to build our product portfolio.
- **Broaden worldwide distribution.** We plan to increase the number and types of distribution channels we use in the U.S. and continue to seek to expand into non-traditional channels including electronics, book and entertainment product retailers, membership warehouse clubs, supermarket as well as pharmacy and dollar store chains to gain additional retail shelf space. We plan to capitalize on growth opportunities outside the U.S. by expanding our network of independent distributors.

OUR PRODUCTS

Our products are organized by brands. Each brand has a focused market position and is targeted at certain consumer demography. All of the products within a brand are usually classified under one industry category such as action figures, dolls, plush or youth electronics. The following are brief descriptions of our current key brands and planned product introductions.

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Teenage Mutant Ninja Turtles. In 1987, we acquired the worldwide exclusive master toy license from Mirage Licensing, Inc. for the Teenage Mutant Ninja Turtles franchise. The master toy license grants us broad rights to create, market and distribute toys in a broad range of categories (as opposed to being limited to specific product categories) based on characters and other elements depicted in the *Turtles* story. As it is a worldwide exclusive license, no other parties other than ourselves are and will be licensed to create, market and distribute toys based on TMNT intellectual property during the term of the license. Although the license is not perpetual, the current terms provide us with the exclusive rights through to at least 31 December 2014 and we have the option to further extend the term of the license for an unlimited number of consecutive renewal terms of 3 years each, subject to royalty performance criteria. We launched our first series of *Turtles* action figure products in 1988. In or about 1998, the brand reached the end of its first life-cycle and was temporarily retired from the market.

In 2003, we re-launched a new *Turtles* toy line based upon a brand new animated television series created and produced by Mirage and 4Kids Entertainment Inc. This animated series is broadcasted on the FOX network in the U.S. and by many children's broadcasters in major international markets worldwide. A total of 143 episodes have been produced or are in active production. We expect that this production commitment will provide new, first run *Turtles* episodes through 2007. In 2007, the *Turtle* franchise is being revitalized by the CGI animated feature film, TMNT, which premiered in March in the U.S. and will be showing in over 50 countries worldwide throughout the rest of the year.

In addition to extensive marketing and promotional programs, we regularly introduce new *Turtles* characters and themes, and refresh package designs to drive continuing interests in *Turtles* and encourage multiple purchases among boys who are in our major target market for action figure toys. We believe that the lasting worldwide appeal of the *Turtles* story will enable us to continue to develop and market new *Turtles* characters, vehicles, role play toys, accessories and other products for the foreseeable future.

The Disney Princess. In 2001, we launched our line of *Disney Princess* brand large dolls. The *Disney Princess* brand line is inspired by the classic *Disney Princess* characters that include Cinderella, Belle, Ariel, Snow White and Sleeping Beauty. This license grants us rights to develop and market a wide variety of large dolls and accessories inspired by the classic *Disney Princess* characters and their timeless stories.

In early 2002, we worked with Disney to launch the first ever assortment of the classic *Princess* characters depicted as four to five years old children. These new *Little Princess* brand dolls appealed to our major market since the *Princess* brand dolls were now the same age as the little girls who play with them. Portrayed in a variety of themes and characters, and presented under the sub-branding of the *Little Princess* brand, they were among the best-selling large dolls in the U.S. in 2003 and 2004.

Based on the success of the *Little Princess* brand, we continued to create new ways to present the *Disney Princess* brand to capitalize on their popularity. In 2004, we appealed to the classic nurturing play of little girls by introducing the first ever *Disney Princess Babies* brand which using the *Disney Princess* brand offered a new way to play. Supported by national print advertising campaign, the *Disney Princess Babies* brand expanded our portfolio of dolls with new key play patterns, themes and scales.

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Since 2005, we have continued to extend both the *Disney Little Princess* and *Disney Princess Babies* brands with new designs and special play features including *Sing Along Little Princesses* brand toys that sang, for the very first time, in their own character voices, twirling *Ballerina Little Princess* brand toys and *Princess Bathtime Babies* brand toys that floated around the bath in their own inflatables.

In 2005, we created with Disney Consumer Products, in its first cross-divisional support of the first DVD release of the Disney original classic, the “Platinum Edition” Cinderella film. In 2006, we expanded our *Disney Princess* brand large doll offering with new 15-inch large dolls and accessories in the classic *Disney Princess* brand styling. These dolls were fully posable with easy-to-change fashions and accessories that fit on both dolls and little girls that played with it. The first launch introduced the classic Cinderella character in her signature outfits. Since then, we added the character Ariel from *Disney’s The Little Mermaid* to the series. In fall 2007, we expect to launch the first ever assortment of classic *Disney Princess* brand characters who sing the title songs from their films in their original character voices as depicted in their films.

In fall 2007, we launched our first TV-promotional *Disney Little Princess* brand doll playset – *Tea Time with Me Belle* that offers little girls an interactive role play experience with Belle and her friends, Mrs. Potts and Chip. We plan to continue new product introductions and marketing support of the *Disney Princess* Franchise.

The ***Disney Fairies*** Brand. In 2005, we were granted a toy license by Disney Consumer Products for multiple categories for their latest, new girls brand initiative, the *Disney Fairies* brand. *Disney Fairies* brand centers around *Tinker Bell*, the beloved pixie made famous by Disney’s *Peter Pan* property. Introduced in a publishing launch in 2005, the *Disney Fairies* brand is a magical world where *Tinker Bell* invites girls to discover Pixie Hollow inhabited by her fairy friends. Additionally, our rights in multiple categories in this franchise will enable us to build our presence in strategic growth categories as we expect awareness of the *Disney Fairies* brand to continue to build through Disney’s various on-going promotions.

We launched our *Disney Fairies* brand line of products in fall 2006 with a broad line of small dolls, playsets and fashion dolls that brought the world of fairies to life. In 2007, it is anticipated that the *Disney Fairies* franchise will further expand across multiple platforms including the Disney Channel, sneak previews of the new “Tinker Bell” movie on Buena Vista Home Entertainment DVD releases, and a growing base of licensees. All of these elements build towards the anticipated animated release of the “Tinker Bell” movie in November 2008.

Strawberry Shortcake. In 2006, we launched a re-designed and contemporized line of *Strawberry Shortcake* products consisting of small dolls, playsets and vehicles, as well as soft dolls and large dolls. In 2007, we introduced new themes, play environments, vehicles and a Strawberry Baby Doll that giggles while she blows a strawberry scented kiss. New animated home video releases throughout the year by 20th Century Fox will continue to expand the franchise.

We believe that this brand offers us an opportunity to capitalize on the popularity of the proven heritage brand with multi-year potential.

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Amazing Dolls. We launched our proprietary *Amazing* brand in 1998 that incorporates the innovative use of licensed technology to enhance traditional play patterns with interactivity in dolls. Our *Amazing* brand was ranked as one of the top selling large doll brands in the U.S. and generated sales of approximately US\$175 million (or approximately HK\$1.37 billion) between 1998 and 2006. *Amazing Amanda*, launched in the U.S. market in fall 2005, is the first of a new generation of interactive dolls, and was a top selling doll in that year. *Amazing Amanda* features patented voice recognition technology that allows for a variety of play themes to offer realistic interactivity, making *Amanda* among one of the most technologically sophisticated and engaging dolls in the category. Distribution of *Amanda* has expanded to a number of international markets, and since fall 2007, *Amanda* is available in 10 language versions, namely English, French, Italian, Finnish, Norwegian, Swedish, Danish, Russian, Spanish and Portuguese.

Following the success of *Amanda*, we have introduced other interactive *Amazing* products, including *Amazing Allysen* in 2006, and two new products in 2007, *Amazing McKayla* and *Amazing Lexie*. We intend to continue to develop products utilizing new technologies to deliver interactive play to further exploit our established market position in the large doll category.

WOW Pals. Consistent with our growth strategy, we entered the feature plush category in 2005 with *Cold Nose Puppy*, a plush puppy that “wowed” kids with a cold nose feature. In 2006 and 2007 we further expanded our presence in this category with *Love’n Licks*, *Love’n Blush* and *Skate’n Tricks Puppies*. The *WOW Pals* brand was created in 2007 to distinguish and focus our marketing efforts on the further development of this family of feature plush products.

NEW BRANDS

We continually assess the market potential of a wide variety of toy inventions, new technologies and emerging entertainment properties. Some of these new brands we may launch in fall 2007 or 2008 include:

Land Before Time. A classic animation franchise targeting preschool age children from Universal Studios, *Land Before Time* has a heritage built over a decade with multi-million units of home video distributed worldwide. In 2007, the brand is being re-launched with new animated TV programming on Cartoon Network. We acquired the master toy license from Universal Studios in 2005, and in fall 2007 we are introducing in tandem with the TV programming a new line of preschool toys consisting of dinosaur characters, vehicles, playsets, and a plush line based on the show.

Popples. Popples were a line of feature plush in the mid 1980’s. In 2006, we were appointed the master toy licensee for the property by American Greetings. We reintroduced the Popples feature plush line in 2007 and experienced limited success. The toy business is a trend driven business and many new product lines are introduced every year. Some products may not enjoy broad consumer acceptance or meet retail expectations - such as Popples, which did not gain consumer acceptance as we have expected. As at the Latest Practice Date, all the finished goods had been sold in the U.S. market and there is no carried over inventory. As the brand was not planned to be a significant revenue contributor when first budgeted, we believe the limited success of Popples has no material impact on the future prospects and/or profitability of the Group.

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Struts. This is a proprietary girls brand brought to us by one of the leading inventors in the industry. Struts are fashion fillies (ponies) and are designed to capture girls' affection for ponies. The Struts line will feature all the traditional fashion doll play patterns involving accessories and playsets incorporated into a line of elegant ponies. This collection is expected to launch in spring 2008.

Eon Kid. A brand new CGI action series has been launched in fall 2007 on the KidsWB! TV Network, *Eon Kid* is produced by Manga Entertainment, a division of Starz Media. Starz Media productions also include *The Simpsons*, *King of the Hill*, *Wow! Wow! Wubbzy!* and *Eloise*. We will introduce a line of action figures, vehicles and role play toys in spring of 2008. It will be known as "Iron Kid" in international markets outside the U.S.

Playmates Electronics

In line with our growth strategy to expand into the youth electronics category, and mindful of the growing popularity of electronic games among children who are our ultimate target customers, we are aiming to introduce a range of new youth electronic toys marketed under our Playmates Electronics brand starting from fall 2008. These toys range from handheld games to simulated mobile phones and include:

Draw & Dream. The Draw & Dream Interactive Drawing and Activity Center is a platform that will leverage off licenses popularized by comic books, cartoons and movies to drive sales of both of the hardware and software. It is a proprietary experiential electronic drawing toy that uses a projector as its main component. It encourages and inspires a child's inner artist with exciting music, audio guidance and visual projections of their favorite characters and scenes. Children can learn to paint and draw in color, draw and color a character, make a story, make a scene, and become a fashion designer, a comic book artist, or a greeting card designer. The creations will be done on a standard piece of paper that can be projected onto a wall. It is compact and portable. We plan to introduce the platform with multiple Entertainment Licenses in fall 2008.

Plug and Play Digi Cam. This is a digital camera that uses a plug and play controller format as the basis of the camera. The pictures taken can then be easily customized on the TV screen in a variety of ways by applying onto the pictures various animations, video games and more. Modified images can be saved to memory, and moved from the camera to the computer and can even be printed in hardcopy or emailed to a friend. We expect to launch the Plug and Play Digi Cam in fall of 2008.

LICENSING

A significant portion of our sales are from products that are branded with exclusive Entertainment Licenses from third parties, including American Greetings, DIC Entertainment, Disney, Mirage Studios, Nickelodeon, Sesame Workshop and Universal Studios. Our current licensed brands include the *Disney Princess*, *Disney Fairies*, *Popples*, *Strawberry Shortcake* and *Teenage Mutant Ninja Turtles* brands, among others.

In line with our strategy to acquire and create profitable, multi-year licensed and proprietary brands respectively and to build a sustainable revenue base within a balanced product portfolio, we implement a stringent process for evaluating licensing opportunities. Currently, our key license acquisition strategies are as follows:

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- Invest in rights to franchise brands that can generate long-term value and revenue streams
- Align with strategic partners in entertainment to extend their brand equity into toy and electronic products worldwide
- Expand licensing focus to include new opportunities in pre-school, youth electronics, lifestyle and collector segments
- Expand age demography for our products through the acquisition of licenses and technologies that appeal to older children
- Discover undervalued license properties and develop their untapped value
- Acquire economically affordable and profitable Entertainment Licences and Inventor Licences that are distinguishable from existing products in the market

We believe leveraging the power of entertainment brands and popular characters in our products does not only garner customers' confidence but often also assures consumer demand. These partnerships encourage and allow for extensive and unique cross-promotional marketing efforts.

All of our Entertainment Licenses are either exclusive master toy licenses, which grant us rights to produce toys in a broad range of categories, or exclusive licenses for specific product categories. Licenses are generally granted for fixed periods of time, typically two to three years, and in some cases have renewal options or remain valid as long as the product using the licensed rights are being sold by our Company.

As at the Latest Practicable Date, we had a total of 36 active licenses which are currently used in production, of which 13 are Entertainment Licenses and 23 are Inventor Licenses. Set out below is a summary of our major licensed brands:

| Product | Licensor | Scope |
|--------------------------------|--------------------|-------------------------|
| TMNT | Mirage Studios | Master Toy License |
| Strawberry Shortcake | American Greetings | Master Toy License |
| Sesame Street | Sesame Workshop | Baby Dolls |
| Care Bears | American Greetings | Baby Dolls |
| Disney Princess brand products | Disney | Large Dolls/Accessories |
| Disney Fairies brand products | Disney | Toy License |
| Land Before Time | Universal Studios | Master Toy License |
| Popples | American Greetings | Master Toy License |

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The terms of the above licenses are currently scheduled to expire between 2007 and 2011. Discussions for license renewals of some of the licenses are in process. Many of our licenses are either valid as long as the products using the licensed rights are being sold by our Company or are renewable. Of all of our active licenses, 6, 4, 3 and 3 are expiring in 2008, 2009, 2010 and 2011 respectively. These licenses contributed substantially to our total turnover. Apart from a few licenses expiring in 2007 and 2008, we have options to renew all these expiring licenses. The licenses expiring in 2007 and 2008 without renewal options contributed approximately 23%, 20%, 33% and 22% of our turnover for each of the years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007 respectively. Of the licenses expiring in 2007 and 2008 without renewal options, apart from one of these licenses that we may not intend to renew for commercial reasons, we had long term business relationship with the licensors of all these licenses and we had always been successful in renewing the relevant licenses with these licensors. However, as discussed in the section headed "RISK FACTORS", we cannot give assurance that we will be able to successfully renew these licenses.

Under most of our licenses, we are typically granted the right to use the intellectual properties licensed in the manufacturing, sale, advertisement, promotion and distribution of relevant products in specific territory. The territory of our exclusive rights, whilst always includes U.S., varies among licenses and ranges from worldwide to specific countries. Our responsibility is typically limited to royalty payments, however under some licenses, we also need to fulfill a minimum annual marketing requirement, based on a percentage of annual sales.

Our licenses require us to either pay a one-off payment or royalties. The calculation of royalty varies in different licenses, from a fixed or variable percentage of the net invoiced billings or net wholesale price to a fixed monetary amount per unit manufactured and shipped, with or without a minimum royalty payments guarantee or advanced royalties. Royalty terms are typically heavily negotiated and the royalty terms of our major licenses range from approximately 1% to 15% of the net wholesale selling price or net sales of the products.

Advanced royalties represent prepayments made to licensors of intellectual properties under licensing agreements which are recoupable against future royalties. Advanced royalties are amortised at the contractual royalty rate based on actual product sales. Management evaluates the future realisation of advanced royalties periodically and charges any amounts that management deems unlikely to be recoupable at the contractual royalty rate through product sales to expense. All advanced royalties are amortised within the term of the license agreement and are written off upon the abandonment of the product or upon the determination that there is significant doubt as to the success of the product.

The royalty expenses paid were HK\$145,874,000, HK\$125,965,000, HK\$102,488,000, HK\$33,549,000 for each of the years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007 respectively.

We maintain relationships with the worldwide toy invention and design community. We regularly license rights in new technologies and inventions from these inventors and designers and use these technologies and inventions to extend our product offerings in both our licensed and proprietary brands. Most of our Inventor Licenses grant us exclusive rights in these technologies and inventions and generally specifies terms of no fewer than three years. Recent examples of brands incorporating licensed technologies and inventions include *Turtles*, *Speedeez*, *Amazing Dolls* and *Waterbabies*.

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Our ability to continue to have access to, and acquire Entertainment Licenses and Inventor Licenses is a key component of our long-term growth strategy.

SALES AND DISTRIBUTION

Our sales and distribution operations comprise of an in-house sales force, independent sales representatives (whom we pay commissions to) and a network of third party international distributors. Our products are available in retail stores in over 50 countries worldwide. We distribute our products through multiple channels in order to maximize the sales opportunities for our diverse product offerings. Our products are shipped from the manufacturing facilities of our vendors in the PRC either to our distribution center in California from where our U.S. customers typically take delivery of the goods, or directly to our customers' designated point of delivery in the PRC or Hong Kong.

In the U.S., we sell directly to a wide range of customers including national mass merchandise retailers and national toy specialty chain stores, membership warehouse clubs, supermarket, pharmacy and dollar store chains. Our three largest U.S. customers collectively accounted for approximately 66%, 63% and 60% of our worldwide turnover in 2004, 2005 and 2006 respectively.

Our U.S. sales and distribution effort is supported by a detailed inventory management process. We place regular inventory orders with our manufacturing vendors to meet the anticipated seasonal demands of our customers throughout the year. We attempt to strike a balance between maximizing sales and minimizing end-of-season inventory by analyzing point-of-sale data and adjusting the volume, assortment and product mix of our inventory orders as appropriate. We also regularly review our customers' replenishment orders for consistency with sales trends, and we regularly solicit orders to exploit positive sales trends and offer in-season price adjustments to reduce end-of-season inventory risk on slow-moving products.

Outside the U.S., we sell to over 50 countries, primarily in Europe, North America, Latin America, and Asia Pacific (including Australia). Our international sales and distribution efforts are managed through our network of independent toy distributors, including Vivid Imaginations in the United Kingdom, Giochi Preziosi in continental Europe, Spinmasters in Canada, Funtastic in Australia and Tomy-Takara in Japan. Most of our international distributors hold leading market share positions in their respective markets and are well-regarded for their abilities to manage promotional toy brands. Our sales in international markets were approximately 22%, 26%, 25%, and 35%, of our worldwide turnover in the years 2004, 2005 and 2006 and six months ended 30 June 2007 respectively. Our international distributors bear all marketing and promotion, inventory carrying, sales and distribution expenses in their respective markets.

We consider national mass merchandise retailers and national toy specialty chain stores in the U.S. and non-U.S. independent toy distributors as our customers because we sell our products to and receive the purchase price therefor from these customers irrespective of whether these products are thereafter sold to end customers. We are not a concessionaire at these customers, nor are they our distributors agents.

BUSINESS

OUR CUSTOMERS

Our five largest customers accounted for approximately 75%, 78%, 67% and 58% of our total sales for each of the three years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007, respectively, while our largest customer accounted for approximately 34%, 30%, 31% and 25% of our total turnover for those respective periods.

As at the Latest Practicable Date, none of our Directors, their respective associates, or existing shareholders of our Company who will be interested in more than 5%, of our Company's issued share capital immediately following commencement of listing of our Shares on the Stock Exchange had any interest in any of our five largest customers for each of the three financial years ended 31 December 2006 and the six months ended 30 June 2007 respectively.

MARKETING

In the U.S., we directly market our products to consumers in the target demography of each brand using a wide range of advertising and promotional programs. These programs include national television advertising, print and online advertising, consumer directed promotions and retail advertising and promotions. For licensed brands, we develop our marketing strategies in cooperation with each licensor with the objective of communicating the key characters and attributes of the entertainment while positioning our toys as extensions of the entertainment experience. For proprietary brands, we focus our marketing campaigns on communicating the unique play features and functions of the key products while reinforcing key brand attributes.

Our marketing strategies can be summarised as follows:

- Setting competitive prices in price-sensitive categories such as basic dolls, vehicles and action figures
- Be opportunistic in proprietary, defensible niches and acquire licenses to collectibles and technology led dolls
- Setting a target retail gross margin for each license of no less than 30%
- Boosting retailer gross margin and extend listing breadth in key categories by using retailer direct letter of credit pricing
- Giving competitive trade discounts in the U.S., including freight allowances and new store discounts

Television Advertising. We believe that television advertising is the most effective and cost efficient means of reaching our target consumers and is accordingly a key component of our marketing strategy. Television advertising expense accounts for a major portion of our marketing expenditures. We work with our advertising agency to produce television commercials and purchase commercial airtime from leading U.S. children's television networks. Our advertising campaigns are planned and executed to ensure that our marketing messages reach the targeted consumer demography effectively and cost efficiently.

BUSINESS

Print and Online Advertising. Print and online advertising campaigns are used to extend the reach of our television advertising or specifically target a demography that cannot be effectively reached with television advertising alone. For example, a print campaign advertising the launch of a new doll targeted at mothers with children in our core target market was placed in women's service magazines. We also advertise in trade publications to announce acquisitions of new licenses or launches of new brands.

Consumer Directed Promotion. The majority of our consumer directed promotions are designed to encourage purchase of our products through contest, offer of coupon, added value or sweepstakes incentives. Most of our consumer directed promotion activities are communicated on our product packages. Added value promotions are used to generate incremental sales for high volume products. For example, we may include a DVD with one episode of an animated television series in the key action figure assortment and offer the assortment for a limited time without increasing its price. The incremental volume that these limited time offers generate makes added value programs a cost effective way to grow our brands and attract new consumers. We also cooperate with licensors to cross-promote our toys in the products of non-toy licensees and offer reciprocal opportunities to those licensees in our toys.

Retail Advertising and Promotion. Building retail awareness and expanding the retail shelf presence for our brands can be accomplished by using a variety of cooperative advertising and promotion activities with individual retailers. Such activities include retailer sponsored print and television advertising, in-store events and participation in licensor sponsored retail promotions. We negotiate retailer-specific cooperative advertising programs and agree on the sharing of costs with individual customers. In addition, we can secure incremental product listings and shelf space commitments from retailers and generate incremental sales volume by offering retailer-specific exclusive products that complement a standard product line.

Our international distributors bear their respective in-country marketing expenses in their respective markets to advertise and promote the products they distribute on our behalf. We assist our international distributors in their efforts to localize our U.S. marketing strategies to local market dynamics and consumer tastes.

PRODUCT DEVELOPMENT

Our products are developed by an integrated team composed of our U.S. marketing, design and engineering team and our Hong Kong and Shenzhen based design and engineering team, as well as third-party designers, model-makers and ODM vendors. This strategy enables us to capitalize on our in-house design and development expertise and the cost advantages of outsourcing and utilizing Asia based manufacturing capabilities. From concept to finished product, members of our U.S. marketing team – the brand managers – oversee the development of all of our products. These brand managers work closely with all other team members to ensure that product costing and pricing, aesthetics, performance, quality, safety and packaging reflect the respective brand marketing strategies.

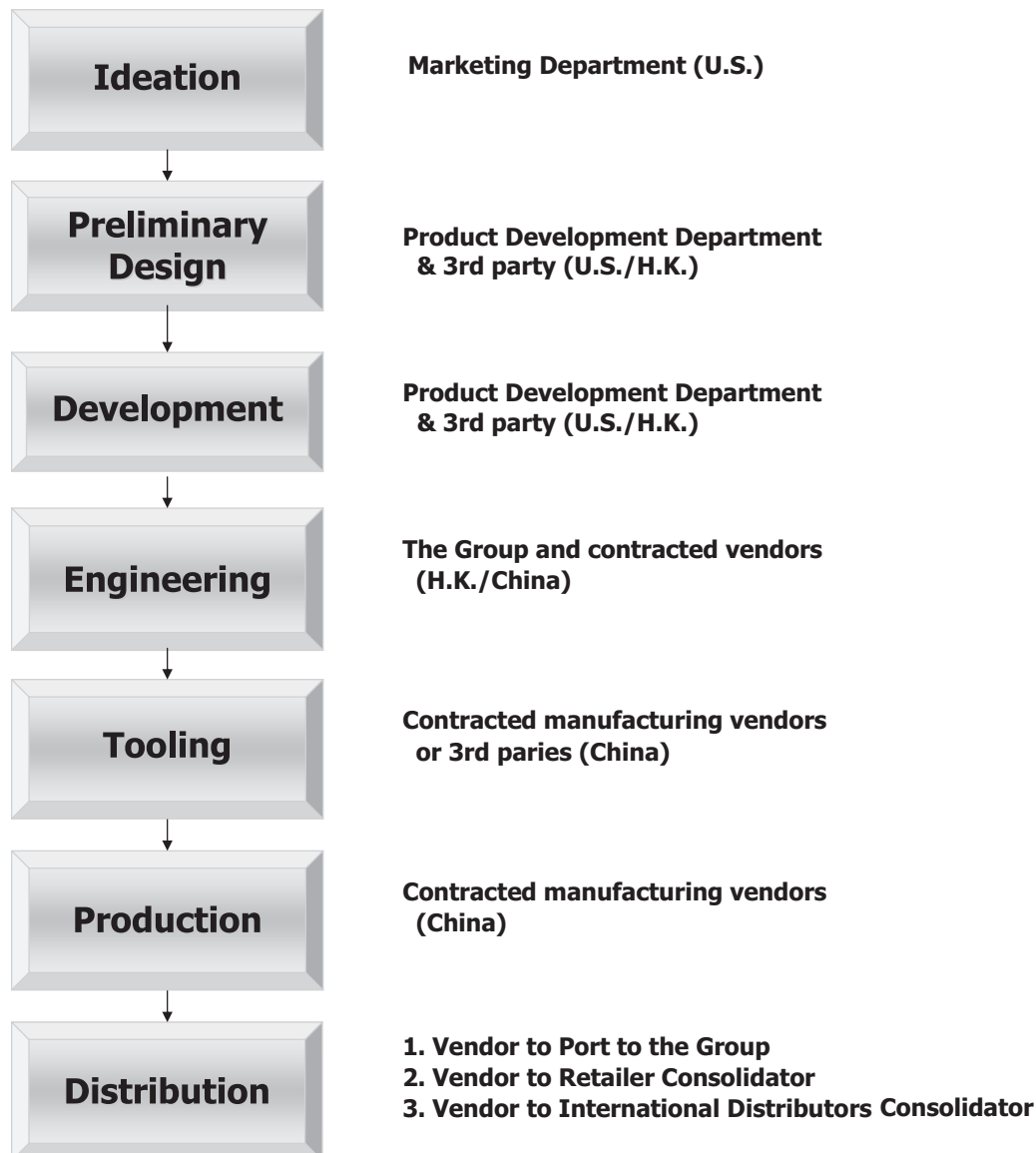
Our product development costs were HK\$15,728,000, HK\$21,847,000, HK\$22,073,000, HK\$14,759,000 and HK\$7,173,000, for the fiscal years ended 31 December 2004, 2005 and 2006 and for the six months ended 30 June 2006 and 2007 respectively. Approximately 50% of product design was outsourced to third party designers. All third-party contractors sign a non-disclosure agreement protecting our Company's intellectual property rights. Furthermore the terms of work with the third-party designers are on a work-for-hire basis where all work product belongs exclusively to us.

BUSINESS

New product development for a new brand is driven by our marketing team’s definition of the unique selling proposition of the new brand that will differentiate it from competitive products and capitalize on the attributes of the entertainment or invention. New product development in existing brands commences following assessment of the marketplace for competitive products, recent sales performance of similar brands, and determination of the strategic merits of adding new products in established categories and/or new categories.

Our U.S. based product development team oversees new product design. This team creates illustrations and models or contracts with third-party vendors to create these materials for review and approval by the marketing brand manager. By outsourcing our design needs, we are able to more efficiently control our fixed product development expenses and ensure the timely delivery of materials, thus maximizing our speed to market.

The chart below summarizes our product development work flow. This chart should be reviewed in conjunction with the section headed “SOURCING AND PRODUCTION”.



BUSINESS

SOURCING AND PRODUCTION

Once the design and specific requirements for our products are determined, our Hong Kong and Shenzhen operations oversee their sourcing and production. These teams review the design and engineering of products for manufacturability, select vendors with matching technical capabilities for the production requirements, engage vendors to fabricate prototype models and molds and tools, perform quality assurance and control by laboratory testing to ensure our products meet all applicable safety requirements, and monitor production quality control. Finished goods that successfully pass this monitoring and testing process are packaged, and our Hong Kong and Shenzhen operations arrange for shipment to our U.S. distribution center, or to the point of delivery in the PRC or Hong Kong designated by our customers.

All productions of our finished products are outsourced to independent OEM or ODM vendors with manufacturing facilities in China. These vendors own the manufacturing equipment and machinery, employ their own managerial staff and production workers, purchase raw and semi-finished materials according to their customers' production requirements, and manage the production processes. In addition, these vendors have agreed to comply with our vendor standards regarding work environment, employment practices and compliance with applicable codes, regulations and laws. For example, one of our major customers requires us to only appoint vendors who have obtained an International Council of Toy Industries ("ICTI") CARE Seal of Compliance. To obtain the ICTI CARE Seal of Compliance, a vendor must comply with the ICTI Code of Business Practice, which contains principles regarding work environment, fair labour treatment, as well as employee health and safety in the toy industry. In this regard, we also ask all our vendors to comply with our own Code of Business Conduct which contains similar principles.

We purchase finished goods from the vendors and authorize them to purchase custom-designed electronics and other proprietary components on our behalf, and use these components for the sole purposes of production of our products. Most of our vendors have been supplying us for more than five years. We issue individual purchase order for each batch of production and do not have long-term contracts with our vendors. We believe that alternative sources of supply of production resources are readily available, if necessary. We regularly review the pricing and quality of our vendors to ensure we engage the best suppliers for our needs.

The production of new products generally requires the development of new or the modification of existing molds and tools. We own all of our molds and tools and provide them to our vendors during production. All of our molds are clearly and conspicuously marked "PLAYMATES". Molds and tools are usually returned to us when the associated product is no longer in production and are stored for possible future use or destroyed as required under the relevant license agreement. Further, we enter into manufacturing agreements with each of our vendor which, inter alia, restricts the vendor from disclosing the molds or any information relating to the molds to any employees who are not properly engaged to execute the order from us, or to any third party.

BUSINESS

OUR SUPPLIERS

Our five largest suppliers accounted for approximately 94%, 83%, 91% and 93% of our total purchases for each of the three years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007, respectively, while our largest supplier accounted for approximately 40%, 42%, 50% and 42% of our total purchases for those respective periods.

As at the Latest Practicable Date, none of our Directors, their respective associates, or existing shareholders of our Company who will be interested in more than 5%, of our Company's issued share capital immediately following commencement of listing of our Shares on the Stock Exchange had any interest in any of our five largest suppliers for each of the three financial years ended 31 December 2006 and six months ended 30 June 2007, respectively.

QUALITY CONTROL

We believe that our commitment to quality control is one of the principal factors contributing to our success. We have established a strict quality control system and a set of quality standards for all our shipped products. Our policies on quality control of the production of our products are:

- We have in place a quality manual which documents the process and requirements for all toys supply to the Group
- The areas that are monitored include product safety, quality, laboratory testing, customers' requirement, specification, inspection, samples and vendor responsibility
- All process and requirement are revised from time to time to meet any new regulations of the countries to which the products are shipped
- Our vendors are required to fully understand our quality manual and let their key members know the requirements of the Group and our customers
- All products supplied to the Group must be tested and complied with applicable international standards and regulations with report issued from accredited laboratories before shipment to such effect
- All products are required to be re-tested every twelve months even the product design did not change
- Failure of our vendors to comply with our standards and procedures will result in the products being rejected or returned to the vendor

The quality assurance of products manufactured for and on our behalf has been of the utmost importance since our inception, over 40 years ago.

BUSINESS

All product concepts and designs are reviewed in the U.S. to assure adherence to worldwide quality standards. As some of our customers require all toys manufactured for them by our third party vendors to be tested and certified by independent, certified, third party laboratories and are in full compliance with or exceed all U.S. and international regulations and, in particular, strictly meet all requirements for lead, heavy metals and magnets. Certifications given by such third party laboratories are internationally recognised. Our monitoring and product testing ensure continued compliance with all U.S. and international regulatory requirements and industry standards for quality and safety.

Communications with our third party vendors on quality assurance procedures that include detailed requirements for compliance with all quality and safety regulations are documented, and our third party vendors are bound by and required to comply with such requirements pursuant to their respective manufacturing agreements. As part of our long standing quality assurance program, vendors have always adhered to the policies and procedures imposed by us.

Our vendors and independent third-party laboratories test the safety of our products and assure compliance to worldwide standards. Safety testing is designed to meet regulations imposed by relevant federal, state and international governmental authorities and by retailers. We sell to several retailers that require their vendors, and their vendors' manufacturers, to certify that they comply with the retailers' codes of conduct. Such a code of conduct may contain product safety standards which the retailers would require their vendors and manufacturers to comply with for all items supplied to such retailer. In addition to the quality control measures described above, to ensure that our vendors comply with the codes of conduct imposed by the relevant customers, and in turn mitigate the risk of potential liability, legal or otherwise, that we may be subject to, we enter into manufacturing agreements with each of our vendors under which our vendors agree that the goods supplied shall be so designed and constructed as to be safe and without risk to health and the vendor shall comply with, inter alia, any regulations or codes of practice made by our customers. We ensure that all our vendors receive and understand the code of conduct imposed by our relevant customers.

A retailer may also require each item supplied to it to pass relevant safety tests and obtain certification from the retailer's nominated laboratories at regular intervals. We in turn also have in place a quality manual which contains requirements that all products supplied to us must comply with all applicable standards, including the standards imposed by our customers and we require all our suppliers to fully understand and comply with our quality manual, and to ensure that their key members are aware of and comply with such requirements.

Furthermore, in cases where our customers have recognised vendors that they wish to use, we will only engage such recognized vendors in supplying toys to such customers. As far as possible, we limit the vendor that we engage to those vendors that we had previously engaged satisfactorily. We have long-term business relationships with most of our current vendors. Hence, so far as we are aware, there has not been any material non-compliance by any of our vendors.

In addition, for each product, comprehensive product specifications are always provided to the vendor and such vendor, under its obligations under the manufacturing agreement, is required to produce such product in strict compliance with the product specifications. Finished products will be sample-tested by third-party laboratories nominated by our customers in accordance to the relevant international standards as described in the section headed "INDUSTRY OVERVIEW – TOY SAFETY". Finished products will only be shipped to our customers if they pass such testing.

BUSINESS

We have complied with all standards imposed by our customers as are within our control during the Track Record Period and up to the Latest Practicable Date. We are not aware of any material non-compliance with applicable standards by our vendors.

In addition, U.S. retailers generally require their vendors to certify that they comply with Customs Trade Partnership Against Terrorism (C-TPAT). Our products are designed, manufactured, packaged and labelled to conform to safety, regulatory, industry-wide and product-specific standards and requirements. Prior to shipment, we confirm that our products meet or exceed these regulations. We carry product liability insurance coverage. We believe that our product liability insurance coverage is sufficient and appropriate taking into account relevant factors including our licensors' requirements, the size of our business and industry practice. We have not suffered from any material product liability claims or termination of licences resulting from product liability claims during the three years ended 31 December 2006 and the six months ended 30 June 2007.

Recently, there have been widely publicized product recalls on safety grounds by toy companies in the U.S. Such incidents, among other things, caused consumer sentiments in the U.S. to appear to be increasingly negative towards products, in particular toys, manufactured in or sourced from the PRC, where our products are manufactured. Although we have not encountered any product recalls during and subsequent to the Track Record Period, during the recent period involving recalls of other parties' products, we took additional action to augment our already stringent existing quality assurance program by taking the following specific actions:

- (i) implementing a random paint monitoring program;
- (ii) strengthening sub-contractor control guidelines and recommendations;
- (iii) implementing random audits of products produced by all vendors by randomly choosing products and forwarding them to independent laboratories for redundant testing;
- (iv) increasing the frequency of third party external laboratories testing for carry-over items; and
- (v) directed all active vendors to use only eight qualified paint suppliers specified by us.

Should any of our vendors fail to comply with our customers' codes of conduct, or use raw materials that are not of the same specifications and standards required by us, or should any of our products be recalled, we may be liable to compensate our customers and/or to replace the products in questions at our costs, which may adversely affect our operations and financial results. Although we may in turn seek compensations from our vendors for breach of the manufacturing agreements between the vendors and us, there is no assurance that such compensations from the vendors will be sufficient to cover our financial loss arising from such event.

Moreover, if we encounter any product recall, in addition to adverse effect on our operations and financial results, any adverse publicity and damage to reputation may be suffered by us as the toy designer rather than by our OEM and ODM vendors.

BUSINESS

Since the recent incidences of product recalls, the U.S. government is drafting new regulations and legislation aimed at reforming the Consumer Product Safety Commission Reform by providing more resources and authority for the agency. We are a member of the Toy Industry Association and Playmates Safety Specialist is a member of TIA's new Toy Safety Coordination Initiative.

Since August 2007, new requirements have been imposed by the Dongguan Entry-Exit Inspection and Quarantine Bureau of the PRC on all toys exporter in Dongguan, where some of our vendors are located. When presenting exported toys to the Bureau for inspection before export, such exporter must provide (i) a declaration that the exported toys comply with applicable standards and (ii) a test report that such exported toys conform to the safety requirements imposed by the laws and regulations in the country or area to be exported to. For this purpose, the test report is only valid for 1 year and such safety testing must take place before the mass production of the exported toys at a recognised laboratory. As far as we are aware, our vendors in Dongguan have been in compliance with such new requirements since their impositions.

TRADEMARKS AND COPYRIGHTS

We have registered a number of trademarks with the U.S. Patent and Trademark Office and with similar authorities in various countries. All of our products are produced and sold under trademarks owned by or licensed to us. We typically register our properties and seek protection under the trademark, copyright and patent laws of the U.S. and other countries where our products are produced or sold. We believe our trademarks hold significant value, and we plan to enhance such value through increased trade and consumer awareness of our trade names and trademarks.

Pursuant to the Playmates Trademark Assignment Agreement, Playmates IP Limited, an indirect subsidiary of PHL, will upon listing, assign the trademarks as specified in the section headed "4. INTELLECTUAL PROPERTY OF THE GROUP" in Appendix IV of this Listing Document to our Group for our use in connection with our toy business. We agree to pay Playmates IP Limited a nominal consideration for the assignment.

MANAGEMENT INFORMATION SYSTEMS AND TECHNOLOGY

Our IT infrastructure utilizes a combination of system based enterprise solution and personal computer based business application software, and hardware products from leading technology companies. Our management information systems support our customer transaction, marketing, financial, merchandising and inventory management processes and are configured for scalability to support foreseeable future growth. The systems are distributed and accessible over a company-wide network providing our employees with access to key business processes and applications. Our system is also connected via secure and dedicated electronic-data-interchange protocols to major U.S. customers, and through such connections, point-of-sale data is collected from those customers as available. The data is analyzed and used to support key decisions in areas including merchandising, allocation, and inventory management. We regularly evaluate the adequacy of our IT infrastructure and update our software and hardware platforms to improve the efficiency and security of our network. We maintain a state-of-the-art IT infrastructure that ensures security, reliability and adequacy in supporting our business objectives. Our websites are hosted both internally and offsite, which reduces costs and maximizes availability of service. Our IT staff is trained to quickly respond to and resolve technology emergencies that may affect our business operations.

BUSINESS

EMPLOYEES

As at 30 June 2007, we employed 126 full-time employees, of whom 55 are located in the U.S., 39 in Hong Kong and 32 in Shenzhen, China. As at 30 June 2007, the following tables show the breakdown of our full-time employees by division and function:

| Division | Number of Employees | | |
|-------------------------------|---------------------|-----------|-----------|
| | U.S. | Hong Kong | Shenzhen |
| Finance and Administration | 13 | 6 | 2 |
| Licensing | 1 | 0 | 0 |
| Management | 2 | 2 | 0 |
| Management Information System | 2 | 2 | 1 |
| Operations | 6 | 12 | 11 |
| Packaging | 6 | 3 | 0 |
| Product Development | 13 | 12 | 6 |
| Quality Control | 0 | 2 | 12 |
| Sales and Marketing | 12 | 0 | 0 |
| Total | 55 | 39 | 32 |

None of our employees are represented by a union.

LEASEHOLD PREMISES

Our principal executive offices occupy approximately 12,476 square feet of space in Costa Mesa, California under a lease expiring on 14 January 2008. In addition, we have a lease for our U.S. distribution center, expiring 28 February 2010, for approximately 103,108 square feet of space in Santa Fe Springs, California. We also have leased office space of approximately 6,165 square feet in Kowloon Tong, Hong Kong and 3,929 square feet in Shenzhen from third parties from which we manage our China based operations. In addition, we have leased two warehouses in Tuen Mun, which are approximately 2,250 square feet and 1,779 square feet in size respectively. We believe our facilities in the U.S., Hong Kong and Shenzhen are adequate for the foreseeable future.

BUSINESS

LEGAL MATTERS

We were a party to disputes and legal proceedings that arose in the ordinary course of our business. PTI was involved in two litigation claims.

Shackelford Case

In October 2006, Judy Shackelford, J. Shackelford and Associates, and J. Shackelford LLC (the “**Plaintiffs**”), filed a complaint against PTI but it was never served on PTI. On or about 13 November 2006 the Plaintiffs filed and served on PTI a first amended complaint arising out of a licensing agreement entered into by J. Shackelford & Associates and PTI in December 1997. The Plaintiffs have been our licensor for more than ten years. They are independent third parties to PTI. Under this agreement, PTI obtained the exclusive rights to use Shackelford’s toy concept, which was used in respect of *Amazing Dolls*. The Plaintiffs alleged a number of matters giving rise to claims in relation to the license agreement, including breach of contract, fraud and deceit, trademark infringement, breach of implied covenant of good faith and fair dealing, breach of confidence, unfair competition, accounting and constructive trust, specific performance and declaratory relief. The amount of general damages alleged is US\$20,000,000, or approximately HK\$156 million, plus exemplary and punitive damages and attorneys’ fee and costs. We believed we have valid defences to these allegations and claims and we intended to defend ourselves vigorously against these claims. On or about 12 December 2006, two of the three Plaintiffs filed a second related action for patent infringement against PTI. No specific amount of damages is alleged in this second action. PTI filed an answer to the complaint for patent infringement, denying the allegations and asserting various affirmative defenses. In May 2007, the parties agreed to arbitrate both actions. PTI has filed counterclaims against Shackelford relating to the same licensing agreement and to a consulting agreement between the parties.

We have reached a settlement with the Plaintiffs in respect of which a settlement agreement was signed in December 2007, upon the execution of which all of the claims in the above litigation were dismissed and all parties were released against all claims against each other. This dispute has not caused any material adverse impact on our business, results of operations or financial condition during the Track Record Period.

The legal and professional expenses incurred and paid is HK\$1,189,000 which was accounted for in the year ended 31 December 2006 and approximately HK\$3,704,000 which was accounted for in the six months ended 30 June 2007. Subsequent to 30 June 2007, the legal and professional expenses incurred and paid is approximately HK\$1.2 million which will be accounted for in the financial statements for the second half of 2007. Legal and professional expenses of HK\$3.7 million and HK\$1.2 million accounted for in the six months ended 30 June 2007 and subsequent to the Track Record Period respectively were not relevant to the year ended 31 December 2006. As we believed that this litigation will not have a material adverse impact on our business, results of operations or financial condition, we therefore had so far not made any provision therefor during the Track Record Period and up to the Latest Practicable Date.

BUSINESS

Upon the amicable settlement of this case, we will continue our business relationship with J. Shackelford and Associates by amending the existing license agreement.

Illektron Case

In June 2006, Illektron filed a trademark infringement action against PTI requesting a preliminary injunction regarding similarity in lettering in the logo for PTI's Battle Dice action figure game and Illektron's Battlez for a card game. Although Illektron was able to establish a valid, protectable trademark interest in the Battlez mark, the Court found in July 2006 that Illektron had failed to demonstrate a "likelihood of success" on its trademark infringement claim and therefore found in favour of PTI and denied Illektron's motion, a decision upheld on appeal. Subsequently, the case was set down for trial. However, on 1 October 2007 the parties have amicably resolved the matter which is now fully settled and closed. In light of our confidentiality obligation under the settlement agreement, we are unable to disclose the amount paid for the settlement. The legal and professional expenses incurred and paid is approximately HK\$988,000 which was accounted for in the year ended 31 December 2006 and approximately HK\$1,887,000 which was accounted for in the six months ended 30 June 2007. Subsequent to 30 June 2007, the legal and professional expenses incurred and paid is approximately HK\$0.5 million which will be accounted for in the financial statements for the second half of 2007. Legal and professional expenses of HK\$1.9 million and HK\$0.5 million accounted for in the six months ended 30 June 2007 and subsequent to the Track Record Period respectively were not relevant to the year ended 31 December 2006. We believe that this litigation does not have a material adverse impact on our business, results of operations or financial condition.

Except for the foregoing proceedings, as of the Latest Practicable Date, neither we nor any of our subsidiaries were involved in any litigation, arbitration or administrative proceedings that could have a material adverse effect on our financial condition, or results of operations, taken as a whole. So as far as we are aware, as of the Latest Practicable Date, no such material litigation, arbitration or administrative proceedings are threatened.

PROVISIONS

Provisions are recorded when there is a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. Expenditures for which a provision has been recognized are charged against the related provision in the year in which the expenditures are incurred. Provisions are reviewed as of each published balance sheet date and adjusted to reflect the current best estimate. All provisions are current in nature and therefore the effect of the time value of money is not material. Where we expect a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. Major provisions are described below:

BUSINESS

Consumer Returns

Our Group uses agreed customer allowances based on a percentage of sales and information on actual consumer returns of defective goods to estimate return percentages. The provision is calculated based on these factors and is adjusted for any fluctuations in the returns expected by our management as of each period end.

Cooperative Advertising

Our Group participates in customer advertising programmes and allows certain customers to take a percentage of sales deduction, which is negotiated on an individual basis. In addition, our Group contributes toward specific expenses of the customers for in-store sales promotions and advertising circulars. We provide a defined fixed percentage allowance to certain U.S. customers for their participation in various specific cooperative advertising (special) programs with their U.S. customers, (and, in some limited situations, their non-U.S. customers). The amounts of fixed percentage allowance are negotiated and documented in the terms of trade with each relevant customer. Special programs include catalogs, temporary price reductions, circular ads, palette programs and new store discounts. The program application, limits and amounts are offered on a case-by-case basis by our Senior Vice President of Sales. Some of the programs are set for defined periods of time or limited to a maximum number of units sold, and confirming data is provided by the retailer to finalise the actual program cost.

Claims for cooperative advertising may be received up to two years after the relevant balance sheet date and, in certain cases, later. Our management reviews the provisions periodically and any unutilised amount will be reversed at the year end.

Cancellation Charge

The provision represents the estimated amounts that would be payable to suppliers to settle the costs incurred by them for production order which have been or are likely to be cancelled.

We continually assess potential exposure to these customer and supplier claims and, where necessary establish provisions for any such exposures. We also make appropriate reserves for inventory write-downs and bad debt on a regular basis. Our management relies on available information to evaluate each potential exposure and exercises its best judgement to estimate the amount of provision necessary and sufficient for each potential exposure.

ENVIRONMENTAL, OCCUPATIONAL HEALTH AND SAFETY

We are not subject to any significant environmental, occupational health and safety issues as we do not engage in production or manufacturing activities.

BUSINESS

GOVERNMENT REGULATIONS

As far as we are aware there is no material non-compliance with the relevant laws and regulations of jurisdictions in which the Group operates (including that it has obtained all necessary permits and licenses in the jurisdictions where the Group has operations).

In addition, our business operations in the PRC are not subject to any specific licence requirements other than those generally applicable to companies and businesses operating in the PRC. Our PRC legal counsel is of the view that our PRC operations have complied with all the requirements set out in relevant laws and regulations to conduct business legally in PRC.

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

1. OUR CONTROLLING SHAREHOLDERS

Following the Distribution, PHL will beneficially own approximately 55% of our Shares. The single largest beneficial shareholder of PHL is our Chairman and an executive Director of the Company, Mr. Chan Chun Hoo, Thomas, who beneficially owns in aggregate approximately 39.8% of the PHL Shares, of which 39.42% is beneficially owned through Angers Investments Limited, a private company wholly and beneficially owned by Mr. Chan, and the remaining 0.39% is beneficially owned by Mr. Chan in his own name. PHL and Mr. Chan will each be entitled to exercise, or control of the exercise of, 30% or more of the voting rights in general meetings of our Company immediately after the Introduction. Consequently, our Controlling Shareholders immediately after the Introduction will comprise of Mr. Chan, Angers Investments Limited, PHL and certain of its group companies, namely PIL, PIL Investments Limited and PIL Toys. For further details regarding the PHL Group's and Mr. Chan's interests in our Company, please refer to the section entitled "SUBSTANTIAL SHAREHOLDERS", and the corporate structure charts in the section entitled "HISTORY AND REORGANIZATION", in this document.

Pursuant to Listing Rule 10.07(1), each of the Controlling Shareholders shall not and shall procure that the relevant registered holder shall not, without the prior written consent of the Stock Exchange and unless in compliance with the requirements of the Listing Rules:

- (i) during the period commencing on the date by reference to which disclosure of its shareholding is made in this document and ending on the date which is six months from the Listing Date dispose of, or enter into any agreement to dispose of or otherwise create any options, rights, interests or encumbrances in respect of, any of the Shares in respect of which it/he is shown by this document to be the beneficial owner; and
- (ii) during the period of six months commencing on the date on which the period referred to in (i) above expires, dispose of, or enter into any agreement to dispose of or otherwise create any options, rights, interests or encumbrances in respect of any of the Shares if, immediately following such disposal or upon the exercise or enforcement of such options, rights, interests or encumbrances, it/he would cease to be controlling shareholder of our Company.

Further, each of our Controlling Shareholders have undertaken to us and to the Stock Exchange that, within the period commencing on the date of the document and ending on the date which is 12 months from the date on which dealings in the Shares commence on the Stock Exchange, they will:

- (i) when they pledge or charge any securities beneficially owned by them in favour of an authorized institution (as defined in the Banking Ordinance (Cap 155 of the Laws of Hong Kong), immediately inform us of such pledge or charge together with the number of securities so pledged or charged; and

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

- (ii) when they receive indications, either verbal or written, from the pledgee or chargee that any of the pledged or charged securities will be disposed of, immediately inform us of such indication.

We will, pursuant to Note 3 to Rule 10.07(2) of the Listing Rules, inform the Stock Exchange as soon as we have been informed of matters referred to in paragraphs (i) and (ii) above by any of our Controlling Shareholders and disclose such matters by way of an announcement which is published in accordance with the Listing Rules as soon as possible.

2. COMPETITION WITH CONTROLLING SHAREHOLDERS AND DIRECTORS

None of the Controlling Shareholders or our Directors has any interest in a business, other than the Group's business, which competes or is likely to compete, either directly or indirectly, with the Company's business and which requires disclosure pursuant to Rule 8.10 of the Listing Rules.

As disclosed in further detail above, we are primarily engaged in the business of the design, development, marketing and distribution of toys and related products.

By contrast, the PHL Group is primarily engaged in the business of property investment, property management, securities and other non-toy businesses such as investments in food and beverage businesses.

Although PHL has retained a passive investment interest in Nippon Toys Limited ("Nippon Toys"), its interests in Nippon Toys amounts only to 0.01% as at the Latest Practicable Date subsequent to the subscription of new shares by Nippon Toys' other shareholder; and all directors of PHL who were also on the board of Nippon Toys, namely Mr. Chan Chun Hoo, Thomas and Mr. To Shu Sing, Sidney have resigned as directors of Nippon Toys. PHL therefore has no management or other control over Nippon Toys. Moreover, in contrast to our business, Nippon Toys is a company whose principal business activity is to act as a sourcing and purchasing agent for third party consumer goods companies of general merchandise. In 2006, the majority of sales made through Nippon Toys were from non-toy products such as headlamps and ear-warmers. By contrast, our business is focused principally on marketing of toys and we do not carry out sourcing or purchasing activities for any third parties. As the business of Nippon Toys is distinctly different from our business, Nippon Toys was not included in our Group pursuant to our Reorganization and, further, we believe that Nippon Toys does not and is not expected to compete with our business.

We and the PHL Group are therefore engaged in completely different industries and our business is significantly different in nature to that of the PHL Group. We therefore believe that the business of the PHL Group does not and is not expected to compete with our business.

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

3. INDEPENDENCE FROM THE PHL GROUP

Having considered the following factors, the Board is satisfied that we are capable of conducting our business independently of the PHL Group after the Listing Date:

(a) Independence of business operations

Our business focuses on the design, development, marketing and distribution of toys and related products. Please see the section “BUSINESS” in this document for further information relating to our business.

By contrast, the PHL Group is principally engaged in the business of property investment, property management, securities and other non-toy businesses such as investments in food and beverage businesses.

All of the key operating functions of our business, including licensing, product design, development, sales, marketing, distribution, engineering, sourcing and coordination of manufacturing activities conducted by third parties, are carried out by our Group independently of the PHL Group. As disclosed in the “Connected Transactions” section of this document, we will continue to lease certain premises from PHL Group for storage purposes in Hong Kong and occupy and use portions of 21/F, The Toy House under a license, however such premises only account for approximately 3% of the total size of all premises used for our operations.

Accordingly, we believe that the Group has sufficient operational capacity to operate our business independently of the PHL Group.

(b) Independence of directorship and management

Our Board, which includes three independent non-executive Directors, will function independently of the PHL Group, and will act in the interests of our Shareholders as a general body, where our interests and the interests of our Controlling Shareholders are actually or potentially in conflict.

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

Our Board comprises six Directors, including three executive Directors and three independent non-executive Directors. The Chairman of our Board and an executive Director of the Company, Mr. Chan Chun Hoo, Thomas will continue to serve as an executive director and the chairman of the board of directors of PHL. The other five Directors are independent of the PHL Group, and Mr. Chan is in a minority on our Board. In addition, Mr. Chan is also in a minority in relation to our executive Directors. Our two other executive Directors are Mr. Novak, Lou Robert and Mr. Soong, Ronnie, who are independent of the PHL Group. In accordance with the Listing Rules, matters considered by the Board which involve transactions between the Company and the PHL Group and its associates (excluding our Group) will be considered and voted upon by the Directors excluding Mr. Chan. Mr. Chan will not be counted in the quorum and will abstain from voting on such matters.

Mr. Chan, currently the single largest beneficial shareholder of PHL, joined the Playmates Group in 1967. In 1997, Mr. Chan was appointed the chairman of the Playmates Group. Throughout the years, Mr. Chan contributed to the Playmates Group's overall corporate direction and development. Mr. Chan's extensive experience in the management of Playmates Group's toy business is an important asset to our Company. In view of Mr. Chan's extensive experience and expertise, the Board believes that Mr. Chan's appointment to our Board as Chairman and an executive Director would be in the best interests of our Company. After the completion of the Spin-off and Introduction, Mr. Chan will be involved in overall corporate direction, strategic development, and major acquisition and investment decisions at both our Company and PHL.

The day-to-day operations of our Group will be managed by Mr. Novak, Lou Robert, our President and an executive Director of our Company, and his team of senior executives who are currently managing the day-to-day operations of the major subsidiaries forming our Group. Mr. Novak is independent of the PHL Group, and will have overall responsibility for the daily operations of our Group. Substantially all of the key operating functions of our Group, including licensing, design, marketing, sales and distribution, are based in California in the U.S., where Mr. Novak's office is located. Mr. Novak is supported by the Group's team of senior managerial staff who are all independent of the PHL Group. They include Mr. Rosten, Arthur Steven (Chief Financial Officer), Mr. Ed Chanda (Senior Vice President of Operations), Mr. Phil Jacobs (Senior Vice President of Sales), Mr. Lou Gioia (Senior Vice President of Marketing and Product Development), Ms. Lori Farbanish-Rotter (Vice President of Design and Development of Girls Toys), Mr. Herb Mitschele (Vice President of International Sales and Marketing) and Ms. André Lake Mayer (Vice President of Strategic Alliances and Business Development) who are all based in the U.S., and Mr. Soong, Ronnie (President of Asian Operations) who is based in Hong Kong.

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

Mr. Soong is also an executive Director of our Company and is independent of the PHL Group. Mr. Soong manages the daily operations of the Group's facilities in Hong Kong and the PRC and oversees all facets of product development, engineering, sourcing and coordination of manufacturing activities by third parties in Hong Kong and the PRC.

Immediately following the completion of the Introduction, other than Mr. Chan Chun Hoo, Thomas, the Directors' individual shareholdings in PHL do not exceed 2.1% each and hence the Board believes that such minimal shareholding interests will not affect the independence of the Directors from PHL.

Immediately following the completion of the Introduction, other than Mr. Chan Chun Hoo, Thomas, the PHL's directors' individual shareholdings in the Company do not exceed 0.5% each and hence the Board believes that such minimal shareholding interests will not affect the independence of PHL's directors from the Company.

Our Company Secretary, Ms. Ng Ka Yan, is currently, and will continue after the Introduction to serve as, the company secretary for PHL. Her responsibilities in both the Company and PHL are limited to company secretarial matters only. Ms. Ng joined the PHL Group in 2000 and has in-depth knowledge of our Group's history, business practices and organization structure, as well as extensive experience on the compliance and regulatory requirements applicable to a Hong Kong listed company. In view of Ms. Ng's experience and expertise, the Board believes her appointment as Company Secretary of our Company would be in the interests of our Company.

Except as disclosed in this document, no senior management staff of our Group will participate in the management of the PHL Group.

(c) Financial independence

All outstanding balances due to and from any member of our Group from/to the PHL Group will be settled before the Listing Date. In relation to guarantees provided by the PHL Group for the benefit of any member of our Group, arrangements will be made for our Company or another member of the Group to be substituted as guarantor, or other appropriate arrangements will be made for the release of such guarantees, before the Listing Date. Consequently, our Group will be financially independent from the PHL Group.

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

(d) Independence of access to customers and suppliers

The Group independently manages its own marketing, distribution and customer relationship operations, and does not rely on the PHL Group for access to customers.

The Group also independently manages all facets of its operations relating to product development, engineering, sourcing and coordination of manufacturing activities conducted by third party suppliers of its products, and does not rely on the PHL Group for access to such suppliers.

Further information relating to the Group's sales, distribution, marketing, product development, sourcing and production and suppliers, is set out in the section in this document entitled "BUSINESS".

CONNECTED TRANSACTIONS

EXEMPT CONTINUING CONNECTED TRANSACTIONS WITH THE PHL GROUP

Following the Distribution, PHL will indirectly own and control approximately 55% of our Shares. Consequently, each member of the PHL Group is a connected person of our Company under the Listing Rules.

Following the Introduction, the following transactions will be regarded as continuing connected transactions exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.33 of the Listing Rules.

A. Leases

Property License Agreement

Pursuant to a property license agreement dated 27 February 2007 entered into between PAS and Bagnols Limited and a supplemental license agreement dated 30 August 2007 (collectively "Property License Agreement"), Bagnols Limited agreed to grant to PAS a license to use the premises of Units 1A and 1B (with a saleable area of 2,250 square feet) of Phase I, Playmates Factory Building situated at No. 1, Tin Hau Road, Tuen Mun, New Territories, Hong Kong, for a term of one year commencing from 1 January 2007 and expiring on 31 December 2007, which can be renewed upon mutual consent. The monthly license fee and management fee payable under the Property License Agreement are HK\$7,227.9 and HK\$3,212.4 respectively.

Bagnols Limited is an indirect wholly owned subsidiary of PHL. PAS is an indirect wholly owned subsidiary of our Company. Transactions entered into between our Group and Bagnols Limited will be deemed to be connected transactions under the Listing Rules.

Our Directors confirm that (i) the license fee and management fee were determined through arm's length negotiation between the parties to the Property License Agreement; (ii) the Property License Agreement was entered into in the ordinary course of business and on normal commercial terms; and (iii) the terms of the Property License Agreement are fair and reasonable so far as the shareholders of our Company are concerned. The valuer, Savills Valuation and Professional Services Limited, confirms that the licence fee reflects market rates of comparable properties.

The estimated aggregate license fee and management fee, having regard to the prevailing market rate, payable under the Property License Agreement, if renewed, for the financial year ending 31 December 2008 shall be approximately HK\$140,000. Given that each of the applicable percentage ratios (other than the profits test) of the aggregate license fee and management fee payable during this period is less than 0.1%, the transaction falls below the de minimis threshold as stipulated under Rule 14A.33(3) of the Listing Rules and hence constitutes a continuing connected transaction exempt from the reporting, announcement and independent shareholders' approval requirements.

CONNECTED TRANSACTIONS

Tenancy Agreement

Pursuant to a tenancy agreement dated 27 February 2007 entered into between PAS and Bagnols Limited and a supplemental tenancy agreement dated 30 August 2007 (collectively “Tenancy Agreement”), PAS agreed to lease the property situated at Unit A, Ground Floor of Phase II, Playmates Factory Building at No. 1, Tin Hau Road, Tuen Mun, New Territories, Hong Kong from Bagnols Limited, for a term of two years commenced on 1 January 2007 and expiring on 31 December 2008.

The monthly rent payable under the Tenancy Agreement is HK\$13,303.8 and the monthly management charges payable is HK\$2,800.8 (subject to review).

Bagnols Limited is an indirect wholly owned subsidiary of PHL. PAS is an indirect wholly owned subsidiary of our Company. Transactions entered into between our Group and Bagnols Limited will be deemed to be connected transactions under the Listing Rules.

Our Directors confirm that (i) the rental amount and monthly management charges were determined through arm’s length negotiation between the parties to the Tenancy Agreement; (ii) the Tenancy Agreement was entered into in the ordinary course of business and on normal commercial terms; and (iii) the terms of the Tenancy Agreement are fair and reasonable so far as the shareholders of our Company are concerned. The valuer, Savills Valuation and Professional Services Limited confirms that the rental reflects market rates of comparable properties.

The aggregate rental amount and management charges payable under the Tenancy Agreement for the financial year ending 31 December 2008 shall be approximately HK\$193,000. Given that each of the applicable percentage ratios (other than the profits test) of the aggregate rental amount and management charges payable during each of these periods is less than 0.1%, the transaction falls below the de minimis threshold as stipulated under Rule 14A.33(3) of the Listing Rules and hence constitutes a continuing connected transaction exempt from reporting, announcement and independent shareholders’ approval requirements.

CONNECTED TRANSACTIONS

B. Intellectual Property

Playmates Trademark Assignment Agreement

Pursuant to the Playmates Trademark Assignment Agreement between Playmates IP Limited and our Company, upon listing, Playmates IP Limited will assign the trademarks as specified in the section headed “4. INTELLECTUAL PROPERTY OF THE GROUP” in Appendix IV of this Listing Document to our Group for our use in connection with our toy business. We will effect the registration or recordal of this assignment as soon as practicable in the name of one of our wholly-owned subsidiaries, and thereafter these trademarks will be registered in the name of such wholly-owned subsidiary. Under the assignment, neither party may unilaterally terminate or vary the Playmates Trademark Assignment Agreement.

Playmates IP Limited is an indirect wholly owned subsidiary of PHL. Transactions entered into between our Group and Playmates IP Limited will be deemed to be connected transactions under the Listing Rules.

The Playmates Trademark Assignment Agreement was entered into for nominal consideration. Given that each of the applicable percentage ratios (other than the profits test) of the aggregate amount payable is less than 0.1%, the transaction falls below the de minimis threshold as stipulated under Rule 14A.33(3) of the Listing Rules and hence constitutes a continuing connected transaction exempt from reporting, announcement and independent shareholders’ approval requirements.

C. Corporate Secretarial, Legal and Regulatory Compliance Services

Compliance Services Agreement

Pursuant to a compliance services agreement dated 27 December 2007 (the “**Compliance Services Agreement**”) entered into between PIL Finance Limited, an indirect wholly owned subsidiary of PHL, and our Company, our Company has appointed PIL Finance Limited on and as from the Listing Date to provide, or procure to be provided (for example by sub-contracting to third parties), certain compliance services to our Group. These compliance services include such company secretarial, regulatory compliance, legal and financial reporting services required to enable our Group to comply with the legal and accounting regulatory compliance obligations imposed on listed issuers (as such term is defined in the Listing Rules), and all related ancillary services (the “**Compliance Services**”).

CONNECTED TRANSACTIONS

We have a full accounting team that is responsible for, inter alia, the preparation of financial statements, budgeting and daily accounting functions. The services which PIL Finance Limited will provide pursuant to the Compliance Services Agreement include ancillary services such as to translate and convert the above to such presentation and format that complies with the legal and accounting regulatory compliance obligations imposed on a listed issuer in Hong Kong.

The fees payable by us to PIL Finance Limited for the provision of the Compliance Services are as follows:

- (i) Compliance Services provided by PIL Finance Limited or another member of the PHL Group

The fee payable shall be: (1) such amount of the total staff costs and related overhead costs incurred by PIL Finance Limited and/or the PHL Group on the provision of Compliance Services to both the PHL Group and our Group, as is proportionate to the percentage of time spent by employees of PIL Finance Limited and/or the PHL Group on providing Compliance Services to the Group; and (2) such amount of general costs such as postage, delivery, printing, international telephone calls and faxes and any other related administrative expenses incurred by PIL Finance Limited and/or the PHL Group on the provision of Compliance Services to the Group, which shall be charged on an actual use basis.

- (ii) Compliance Services subcontracted by PIL Finance Limited to a third party other than a member of the PHL Group

The fee payable shall be the costs charged by such third parties for the provision of the relevant Compliance Services.

The Compliance Services Agreement shall continue until terminated in accordance with its terms. Either PIL Finance Limited or we may terminate the Compliance Services Agreement without penalty by giving not less than three months' advance written notice to the other party. Either party may also terminate the Compliance Services Agreement at any time by written notice if: (a) the other party breaches any of its material obligations in the context of the Compliance Services Agreement and fails to remedy (if remediable) such breach within 60 days of being notified of the breach; (b) an encumbrancer takes or a receiver is compulsorily appointed over any property or assets of the other party; (c) the other party makes any voluntary agreement with its creditor or become subject to an administrative order; (d) the other party goes into liquidation (except for the purpose of amalgamation or reconstruction and the company resulting therefrom effectively agrees to be bound by the obligations imposed on that other party under the Compliance Services Agreement); or (e) anything having a substantially similar effect to any of the above.

The material obligations in the Compliance Services Agreement mentioned in the preceding paragraph include but are not limited to PIL Finance Limited providing the Compliance Services to us as and when requested, our obligation to pay PIL Finance Limited the fees for the provision of the Compliance Services pursuant to the Compliance Service Agreement, and both parties' requirement to keep confidential all information about the Compliance Services Agreement.

CONNECTED TRANSACTIONS

As the Compliance Services Agreement sets out the terms for the provision of certain identifiable Compliance Services on a cost basis, and provides for the allocation of the cost of such Compliance Services on a fair and equitable basis, the transaction falls under Rule 14A.33(2) of the Listing Rules and hence constitutes a continuing connected transaction exempt from reporting, announcement and independent shareholders' approval requirements.

The Sponsor is of the view that its nature reflect those allowed under Rule 14A.31(8) and are therefore exempted from all reporting, announcement and independent shareholders' approval requirements.

D. License

License to occupy office at The Toy House

Pursuant to a license dated 27 December 2007 entered into between a wholly owned subsidiary of PHL and our Company, a license was granted to us for the occupation and use by us of portions of 21/F, The Toy House, 100 Canton Road, Tsimshatsui, Kowloon, Hong Kong.

The monthly fee payable shall be HK\$8,000. The valuer, Savills Valuation and Professional Services Limited, confirms that the monthly fee reflects market rates of comparable properties. Given that each of the applicable percentage ratios (other than the profit test) of the aggregate amount payable during each of these periods is less than 0.1%, the transaction falls below the de minimis threshold as stipulated under Rule 14A.33(3) of the Listing Rules and hence constitutes a continuing connected transaction exempt from reporting, announcement and independent shareholders' approval requirements.

CONFIRMATION FROM THE DIRECTORS

Our Directors (including our independent non-executive Directors) confirm that the continuing connected transactions described above (i) were negotiated and will be conducted on an arm's length basis, (ii) are in the ordinary and usual course of our business and on normal commercial terms, and (iii) are fair and reasonable so far as our Shareholders are concerned.

CONFIRMATION FROM THE SPONSOR

The Sponsor is of the view that the continuing connected transactions described above are in the ordinary and usual course of business of the Group, are on normal commercial terms, are fair and reasonable and in the interests of our Shareholders as a whole, and will be conducted on an arm's-length basis.

DIRECTORS AND SENIOR MANAGEMENT

1. LIST OF DIRECTORS AND SENIOR MANAGEMENT

| Name | Age | Position |
|--|-----|--|
| <i>Executive Directors</i> | | |
| Chan Chun Hoo, Thomas | 57 | Chairman and Executive Director |
| Novak, Lou Robert | 60 | Executive Director and President of the Group |
| Soong, Ronnie | 61 | Executive Director and President of Asian Operations |
| <i>Independent Non-executive Directors</i> | | |
| Chow Yu Chun, Alexander | 60 | Independent Non-Executive Director |
| Lee Ching Kwok, Rin | 59 | Independent Non-Executive Director |
| Yang, Victor | 62 | Independent Non-Executive Director |
| <i>Company Secretary</i> | | |
| Ng Ka Yan | 33 | Company Secretary |
| <i>Qualified Accountant</i> | | |
| Lee Tak Fai, Thomas | 41 | Qualified Accountant |
| <i>Other Senior Management</i> | | |
| Rosten, Arthur Steven | 59 | Chief Financial Officer |
| Chanda, Ed | 54 | Senior Vice President of Operations |
| Farbanish-Rotter, Lori | 45 | Vice President of Design and Development of Girls Toys |
| Gioia, Lou | 61 | Senior Vice President of Marketing and Product Development |
| Jacobs, Phil | 57 | Senior Vice President of Sales |
| Mayer, André Lake | 47 | Vice President of Strategic Alliances and Business Development |
| Mitschele, Herb | 30 | Vice President of International Sales and Marketing |

DIRECTORS AND SENIOR MANAGEMENT

2. DIRECTORS

Executive Directors

CHAN Chun Hoo, Thomas (*Chairman*)

Mr. Chan, age 57, is the Chairman and an executive Director of the Company. He joined the predecessor company of the Playmates Group in 1967 when he took part in the manufacturing activities of the business. He has 40 years of experience in this industry. Mr. Chan is one of the main driving forces of the Playmates Group's businesses. The strategic decisions to turn the Playmates Group's toy business from a production based to a marketing based toy manufacturer, and the diversification of the business of the PHL Group, were initiated by Mr. Chan. Mr. Chan's involvement in the Group's overall corporate direction and development has made significant contributions to the Group. He was instrumental in developing the Group's global sales and marketing network. Mr. Chan's decision to take on the promotional toy business in 1985 led to the development of the Group into a pure toy development and marketing group. The Group's high level of productivity is attributable to his guiding management principles of creativity, flexibility and simplicity. Mr. Chan is also the Chairman and an executive director of PHL. In 1997, Mr. Chan was appointed the Chairman of the Playmates Group.

NOVAK, Lou Robert (*President of the Group*)

Mr. Novak, age 60, is the President of the Group and an executive director of the Company. He joined the Group in September 2001 as the President of toy business. Over the last five years Mr. Novak has focused his efforts on rebuilding the management team, expanding the product portfolio, returning the Group to profitability and positioning the Group for future growth.

Prior to joining the Group, Mr. Novak held a number of senior management positions at major toy companies including Mattel, Hasbro, Galoob and Coleco.

At Galoob, as chief operating officer, he developed and directed a strategic plan to reposition the company's products as long term brands and returned the company to profitability. He was part of the management team responsible for acquiring a number of significant licenses, including the license for *Star Wars* mini scale toys that drove the growth of Galoob and positioned the company as an attractive acquisition candidate. With the endorsement of the board, his efforts led to the friendly acquisition of Galoob by Hasbro. Mr. Novak was part of the post-acquisition team that was responsible for the successful integration of the Galoob brands into the Hasbro portfolio.

At Coleco, as senior vice president of operations, Mr. Novak directed product design and development activities, worldwide sourcing, production and distribution. Under his direction the design and development team created and brought to market a pipeline of new products that significantly contributed to the company's growth.

DIRECTORS AND SENIOR MANAGEMENT

At Mattel, as vice president of financial planning, Mr. Novak directed the assessment of Mattel's planning process and the analysis of subsidiary businesses. He developed and implemented new planning methodology and performance tracking systems. Based on the analysis of subsidiary businesses, he identified, evaluated, and proposed acquisitions and developed restructuring plans that resulted in the profitable deployment of assets.

As a 25 year veteran of the toy industry and with broad senior executive management experience in a number of leading companies, he brings with him a wealth of diverse business knowledge, outstanding management skills and a comprehensive understanding of consumer products, and the entertainment and retail industries.

SOONG, Ronnie (*President of Asian Operations*)

Mr. Soong, age 61, is the President of Asian Operations and an executive Director of the Company. He joined the Group in December 2000 when he was appointed to his current position. Prior to joining the Group, he held several Asian based senior management positions with U.S. toy companies including Hasbro, Galoob & Ertl. He has 30 years of experience in the toy industry and has a wide range of operational and management expertise. Mr. Soong manages the daily operations of the Group's facilities in Hong Kong and the PRC and oversees all facets of product development, engineering, sourcing and manufacturing activities in Hong Kong and the PRC. He has improved the efficiency and cost effectiveness of the Asia operations and implemented new IT infrastructure to streamline and optimize operational flow and controls.

Independent Non-Executive Directors

CHOW Yu Chun, Alexander

Mr. Chow, age 60, is an independent non-executive Director of the Company. He was appointed to his current position in July 2007 when he joined the Group. He is a fellow of The Association of Chartered Certified Accountants of the United Kingdom and a CPA of the Hong Kong Institute of Certified Public Accountants. He has over 30 years of experience in commercial, financial and investment management in Hong Kong and China. Mr. Chow was formerly an independent non-executive director of PHL and resigned from this appointment in December 2007. He was also formerly a director of New World Mobile Holdings Ltd., a company listed on the Stock Exchange of Hong Kong and he resigned from this appointment on 1 February 2007.

Mr. Chow currently holds directorships in the following publicly listed companies:

| Name of company | Stock Exchange | Title |
|--------------------------------|--------------------------|------------------------------------|
| New World China Land Limited | Hong Kong Stock Exchange | Executive director |
| Top Form International Limited | Hong Kong Stock Exchange | Independent non-executive director |
| Yu Ming Investments Limited | Hong Kong Stock Exchange | Independent non-executive director |

DIRECTORS AND SENIOR MANAGEMENT

LEE Ching Kwok, Rin

Mr. Lee, age 59, is an independent non-executive Director of the Company. He was appointed to his current position in July 2007 when he joined the Group. He has over 30 years of experience as a legal practitioner in the fields of property and financing, and was a partner and consultant in one of Hong Kong's largest law firms. Mr. Lee is a solicitor admitted to practise in Hong Kong and England and Wales. He also serves as an adviser to a number of private companies and organizations.

YANG, Victor

Mr. Yang, age 62, is an independent non-executive Director of the Company. He was appointed to his current position in July 2007 when he joined the Group. He is a founding partner of Messrs. Boughton Peterson Yang Anderson, Solicitors, Hong Kong SAR and he is also a qualified lawyer in Canada and the United Kingdom. Mr. Yang has over 30 years experience in legal practice primarily in the areas of corporate finance and commercial law, mergers, acquisitions and taxation. He acted as a director of Pearl Oriental Innovation Ltd., a public company listed on the Stock Exchange of Hong Kong and resigned from this appointment on 1 June 2007. He is presently a governor of the Canadian Chamber of Commerce, a member of the Major Sports Events Committee of the Home Affairs Bureau, Hong Kong SAR and a director of the Hong Kong Foundation for UBC Limited and was a board member of the Canadian International School in Hong Kong.

Mr. Yang currently holds directorships in the following publicly listed companies:

| Name of company | Stock Exchange | Title |
|---|--|------------------------------------|
| Lei Shing Hong Limited | Hong Kong Stock Exchange | Non-executive director |
| Ming Pao Enterprise Corporation Limited | Hong Kong Stock Exchange | Independent non-executive director |
| China Agri-Industries Holdings Limited | Hong Kong Stock Exchange | Independent non-executive director |
| Eupa International Corporation | NASD (Over-the-Counter Bulletin Board) | Independent non-executive director |

3. COMPANY SECRETARY

NG Ka Yan

Ms. Ng, age 33, is our Company Secretary. She joined the Playmates Group in 2000 as legal counsel and graduated from The University of Hong Kong with a Bachelor of Laws degree and was admitted to practise as solicitor in Hong Kong in 1999. Ms. Ng has over 9 years of experience in the legal field. She also holds a Master of Business Administration degree from The Hong Kong University of Science and Technology. Ms. Ng is also the Company Secretary for PHL. Her responsibilities in both the Company and PHL are limited to company secretarial matters only. Given the nature of Ms. Ng's responsibilities, the Directors believe that Ms. Ng can discharge her responsibilities in both the Company and PHL as Company Secretary.

DIRECTORS AND SENIOR MANAGEMENT

4. QUALIFIED ACCOUNTANT

LEE Tak Fai, Thomas

Mr. Lee, age 41, is the qualified accountant of the Group and Finance Director of a Group company in Hong Kong. Mr. Lee has joined the Group in October 1996. He is a member of our senior management. He has extensive experience in accounting, financial management and treasury. He holds a Master of Professional Accounting degree from the Hong Kong Polytechnic University and a Master of Business Administration degree from the University of Leicester, UK. Mr. Lee is a member of the Hong Kong Institute of Certified Public Accountants and a fellow member of The Association of Chartered Certified Accountants.

5. OTHER SENIOR MANAGEMENT

ROSTEN, Arthur Steven (*Chief Financial Officer*)

Mr. Rosten, age 59, Chief Financial Officer, joined the Group in January 2006 when he was appointed to his current position. He is responsible for the Group's finance, human resources, IT, legal and administration activities.

Mr. Rosten is a CPA, a Chartered Accountant and a registered member of the American Institute of Certified Public Accountants. Prior to joining the Group, he held a number of senior management and ownership positions at both public and private companies in the U.S. and Europe, including AMDL Inc., Group Equus and Nexia International.

At AMDL, a company listed on the American Stock Exchange, as chief financial officer, he managed all regulatory compliance activities, participated in multiple successful fundraising initiatives and subsequent share listings, established the company's Sarbanes-Oxley corporate governance program and managed all financial, human resources, IT and legal matters.

At Equus, as chief operating officer and chief financial officer, Mr. Rosten directed the financial and operational activities of this group of design, engineering and marketing companies. He developed and implemented a strategic plan to expand the group's capabilities and reach through a number of strategic alliances and licensing transactions in the U.S., Canada and Europe.

At Nexia, as executive director, Mr. Rosten managed international operations, expansion and integration for this global professional services organization. Under his direction the group increased revenues and expanded into new territories. Mr. Rosten headed task forces responsible for global strategy, managed and introduced a new corporate identity and negotiated mergers and alliances leading to improved integration and service capabilities.

With 22 years of experience in the accounting profession and over 16 years of commercial experience, Mr. Rosten brings a broad array of financial planning and reporting, corporate governance, operations and strategic planning to the Group.

DIRECTORS AND SENIOR MANAGEMENT

CHANDA, Ed (*Senior Vice President of Operations*)

Mr. Chanda, age 54, Senior Vice President of Operations, joined the Group in November 1991 as Director of Product Planning. Prior to joining the Group, he held senior management positions in buying and merchandising with Hills Department Stores. He brings 30 years of supply chain and retail management experience to the Group.

Mr. Chanda is responsible for product forecasting, inventory commitment and distribution operations for the U.S. market. He developed and implemented the Group's just-in-time inventory system which uses daily and weekly retail point-of-sales data to adjust the Group's forecasts and inventory commitments to maximize turnover and minimize obsolete inventory. He has worked with the Group's operations in Asia to reduce production lead times, and to ensure a high level of in-stock positions of inventory to support our marketing and sales goals.

FARBANISH-ROTTER, Lori (*Vice President of Design and Development of Girls Toys*)

Ms. Farbanish-Rotter, age 45, Vice President of Design and Development of Girls Toys, joined the Group in January 2000 as Vice President of Marketing of Girls Toys. With a degree in illustration and graphic design, Ms. Farbanish-Rotter's career started at Hallmark Cards where she created toy ideas for Mattel and Hasbro. Her illustration background then lead her to focus on educational and children's books illustration for Simon & Schuster and freelanced for several years doing children's book illustration.

Prior to joining the Group, Ms. Farbanish-Rotter held senior positions in giftware design for Russ Berrie Company as well as toy design for Mattel where she specialized in Disney licensed products. Her extensive knowledge of the Disney universe of classic characters and dedication to building a relationship with Disney Consumer Products has been instrumental in the development and expansion of the Group's licensed Disney brands. She has 23 years of experience in this industry.

GIOIA, Lou (*Senior Vice President of Marketing and Product Development*)

Mr. Gioia, age 61, Senior Vice President of Marketing and Product Development, joined the Group in May 2005 as a Vice President of Marketing of Boys Toys. He brings over 30 years of experience in senior management, marketing and product development, gained during his tenure with major toy companies including Kenner, Tonka, Mattel and Toy Biz.

He has launched such products as *Star Wars*, *Strawberry Shortcake* and *Care Bears* during his tenure at Kenner and also developed an internal vehicle and figure concept *M.A.S.K.* After the merger of Kenner with Tonka, he helped to turn-around a failing division through key product acquisitions, implemented a major repositioning and cost reduction program for the Tonka steel truck line, and a focused three year strategic plan to get the company back on track.

DIRECTORS AND SENIOR MANAGEMENT

During his tenure at Mattel, as senior vice president of boys toys, he achieved increased volume and profits of *Hot Wheels*, and launched several new licensed brands in the action figures category. At Toy Biz he oversaw all aspects of the business, including product development, marketing, licensing and sales and was instrumental in the launches of product lines based on the *Spiderman* movie from Sony Pictures and the *Lord of the Rings* trilogy from New Line Cinema.

Mr. Gioia oversees the marketing and product development functions of the Group and leads the implementation of the Group's growth strategy of category and brand expansion.

JACOBS, Phil (*Senior Vice President of Sales*)

Mr. Jacobs, age 57, Senior Vice President of Sales, joined the Group in April 2002 and has been in his current position since then. Prior to joining the Group, he held senior sales management positions with leading U.S. toy companies including Mattel and Tiger Electronics. Mr. Jacobs began his career at Mattel with a summer job as a tour guide. After graduating from the University of Florida, he rejoined Mattel in sales and was promoted through the ranks to the position of Senior Vice President of Sales and Merchandising of the Boys and Preschool Division. At Tiger Electronics, he was responsible for the sales effort of some of the industry's biggest hits; *Giga Pets*, *Pokemon*, *Furby* and *Poochi*. With over 30 years of toy industry sales experience, he has developed strong working relationships with senior merchandising executives at all major U.S. retailers.

Mr. Jacobs leads the Group's U.S. sales operations and manages a combined team of in-house sales staff and independent sales representative.

MAYER, André Lake (*Vice President of Strategic Alliances and Business Development*)

Ms. Mayer, age 47, Vice President of Strategic Alliances and Business Development, joined the Group in October 2006 and has been in her current position since then. Ms. Mayer brings with her two decades of experience and a wealth of knowledge in the licensing and consumer products arena worldwide, with affiliations such as Lucasfilm, Paramount Pictures and Turner Classic Movies. She has developed and launched thousands of products into the marketplace in conjunction with the promotion, marketing, retail and licensee management and brand development for major entertainment franchises including *Star Trek* and *Star Wars*.

Ms. Mayer leads the effort to identify and secure strategic growth opportunities for the Group through acquisitions of new licenses for entertainment franchises and new technologies and inventions.

DIRECTORS AND SENIOR MANAGEMENT

MITSCHELE, Herb (*Vice President of International Sales and Marketing*)

Mr. Mitschele, age 30, Vice President of International Sales and Marketing, joined the Group in May 2002 as Senior Manager of Licensing and Business Development. Prior to joining the Group, his previous toy experience included Mattel and ToyQuest. As a product manager of Mattel in the Matchbox division he helped to establish the *Matchbox Trucks* product line. At ToyQuest he managed product development for all licensed products within the company. During his tenure at ToyQuest, he established the international division and grew the business. He has 11 years of experience in this industry.

When he joined the Group in 2002, he participated in managing the licensing and international business development functions and in the acquisition of several Entertainment Licenses, including *King Kong* and *Land Before Time*. In 2006 he was promoted to his current position and is responsible for managing the third party international distribution for the Group. He participated in the growth of the international sales' proportion of the Group's revenue and expanded the distribution base from 13 customers in 2002 to over 70 customers in 2007.

6. AUDIT COMMITTEE

We established our audit committee on 11 July 2007 with written terms of reference in compliance with Rule 3.21 of the Listing Rules, the Code on Corporate Governance Practices set out in Appendix 14 to the Listing Rules. The primary duties of our audit committee are to assist our Board to provide an independent view of the effectiveness of our financial reporting process, internal control and risk management systems, to oversee the audit process, and to perform other duties and responsibilities as assigned by the Board.

Our audit committee comprises 3 independent non-executive Directors, namely, Mr. Lee Ching Kwok, Rin, Mr. Yang, Victor and Mr. Chow Yu Chun, Alexander. The chairman of our audit committee is Mr. Chow Yu Chun, Alexander.

7. REMUNERATION OF DIRECTORS

All Directors receive reimbursements from the Group for expenses which are necessarily and reasonably incurred by them for providing services to the Group or in the execution of their duties. The executive Directors, who are also employees of the Group, receive compensation in the form of salaries, housing allowances, other allowances and benefits in kind in their capacity as employees of the Group.

The aggregate amount of remuneration (including fees, salaries, contributions to pension schemes, housing allowances and other allowances and benefits in kind and discretionary bonuses) which were paid to our Directors for each of the years ended 31 December 2004, 2005 and 2006 were approximately HK\$17,413,000, HK\$14,318,000, and HK\$10,998,000, respectively. Under the current arrangements presently in force, the Directors will be entitled to receive remuneration which, for the year ending 31 December 2007 and 2008, is expected to be approximately HK\$10 million and HK\$11 million respectively, excluding the discretionary bonuses payable to the executive Directors.

DIRECTORS AND SENIOR MANAGEMENT

The aggregate amount of remuneration (including fees, salaries, contributions to pension schemes, housing allowances and other allowances and benefits in kind and discretionary bonuses) which were paid or payable by our Group to our five highest paid individuals (of which two are Directors) for each of the years ended 31 December 2004, 2005 and 2006 were approximately HK\$26,575,000, HK\$22,904,000 and HK\$19,083,000, respectively.

During the Track Record Period, HK\$1,500,000 was charged against the Group by PHL Group in 2004 as management fee in respect of discretionary bonus paid to Mr. Chan Chun Hoo, Thomas, an executive director of the Group, in relation to his contribution to the improved performance of the Group for that year.

No remuneration was paid by our Group to the Directors or the five highest individuals as an inducement to join or upon joining our Group or as a compensation for loss of office in respect of the three years ended 31 December 2006. Further, none of our Directors had waived any remuneration during the same period.

Each of our executive directors has entered into a service contract with our Company for an initial term of three years commencing from 17 December 2007. The annual remuneration of our three executive directors is determined and subject to annual review by our Board and compensation committee. Please see the section “8. COMPENSATION COMMITTEE” for further information.

Each of our independent non-executive directors has entered into a service contract with our Company. Each service contract is for an initial term of three years commencing from 17 December 2007. The aggregate fees payable to our independent non-executive directors under the service contract is HK\$525,000.00, which is in accordance with market practice.

Share-based compensation

Prior to the Spin-off, share options in PHL are granted to our Directors and employees under a share option plan and a share option scheme of PHL approved by the shareholders of PHL. The options are exercisable in stages and no option will be exercisable 10 years after its date of grant. After the listing of our Company, the share options in PHL granted to our Directors and employees will remain exercisable subject to the 10-year limitation as described above but no new share options in PHL will be granted under the share option plan nor the share option scheme of PHL. As of the Listing Date, our Directors will be entitled to participate in our Share Option Scheme and will not be entitled to participate in PHL’s share option plan and share option scheme. For each of the three years ended 31 December 2006, we recognized an expense in respect of such share-based compensation in the amount of HK\$6,432,000, HK\$7,304,000 and HK\$7,701,000 respectively.

Save as disclosed above, none of our Directors has or is proposed to have a service contract with any member of our Group (other than contracts expiring or determinable by the employer within one year without the payment of compensation other than the statutory compensation).

DIRECTORS AND SENIOR MANAGEMENT

8. COMPENSATION COMMITTEE

We established our compensation committee on 11 July 2007 with written terms of reference in compliance with the Code on Corporate Governance Practices set out in Appendix 14 to the Listing Rules. Members of the compensation committee include Mr. Lee Ching Kwok, Rin, Mr. Yang, Victor and Mr. Chow Yu Chun, Alexander. Mr. Yang, Victor is the chairman of our compensation committee.

The primary duties of the compensation committee include (without limitation):

- advising the Board on our policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policies on such remuneration;
- determining the terms of the specific remuneration package of our Directors and senior management; and
- reviewing and approving performance-based remuneration by reference to corporate goals and objectives resolved by our Directors from time to time.

In carrying out its functions and responsibilities, including the determination of our Directors, the compensation committee takes into consideration factors such as salaries paid by comparable companies, time commitment and responsibilities of the Directors, employment conditions elsewhere in the Group and the desirability of performance-based remuneration. The compensation committee ensures that no Director or any of his associates is involved in deciding his own remuneration.

9. COMPLIANCE ADVISOR

We have appointed WAG Worldsec Corporate Finance Limited as our compliance advisor pursuant to Rule 3A.19 of the Listing Rules to provide advisory services to the Company pursuant to the requirements thereunder. WAG Worldsec Corporate Finance Limited has agreed to, inter alia, provide advice to the Company with due care and skill on a timely basis when consulted by our Company in the following circumstances:

- (i) before the publication by our Company of any regulatory announcement (whether required by the Listing Rules or requested by the Stock Exchange or otherwise), circular or financial report;
- (ii) where a transaction, which might be a notifiable or connected transaction under Chapter 14 or 14A of the Listing Rules, is contemplated by our Company including share issues and share repurchases;
- (iii) where the Stock Exchange makes an inquiry of our Company under Rule 13.10 of the Listing Rules.

DIRECTORS AND SENIOR MANAGEMENT

In addition, our compliance advisor will also provide, inter alia, the following services to our Company:

- (a) if required by the Stock Exchange, deal with the Stock Exchange in respect of any or all matters listed in paragraphs (i) to (iii) above;
- (b) in relation to an application by our Company for a waiver from any of the requirements in Chapter 14A of the Listing Rules, advise our Company on its obligations and in particular the requirement to appoint an independent financial advisor; and
- (c) assess the understanding of all new members of the Board regarding the nature of their responsibilities and fiduciary duties as a director of a listed issuer, and, to the extent the compliance advisor forms an opinion that the new appointees' understanding is inadequate, discuss the inadequacies with the Board and make recommendations to the Board regarding appropriate remedial steps such as training.

The term of the appointment will commence on the Listing Date and end on the date on which our Company complies with Rule 13.46 of the Listing Rules in respect of its financial results for the first full financial year commencing after the Listing Date and such appointment may be subject to extension by mutual agreement.

10. SHARE OPTION SCHEME

We have adopted the Share Option Scheme which will be effective as from the Listing Date. For further details on the Share Option Scheme, please refer to the section titled "6. OUR SHARE OPTION SCHEME" in "APPENDIX IV – STATUTORY AND GENERAL INFORMATION".

11. DIRECTOR'S POTENTIAL CONFLICT OF INTERESTS

Mr. Chan Chun Hoo, Thomas, our executive director, is also an executive director of PHL. In a board meeting held to consider any contract, arrangement or proposal involving or relating to the PHL Group in which he or his associates have any material interest, although Mr. Chan may not be physically absent from such board meetings, he will abstain from voting on any board resolution approving such contracts, arrangement or proposal, nor will he be counted in the quorum present at the meeting.

Despite Mr. Chan's abstinence, we believe that the board consisting of Mr. Novak, Lou Robert and Mr. Soong, Ronnie, both of whom have extensive experience in the toy industry, together with the Independent Non-Executive Directors, will be able to function properly. Mr. Chow Yu Chun, Alexander, one of our Independent Non-Executive Directors, was formerly an independent non-executive director of PHL during which he gained experience in toy business. Although Mr. Lee Ching Kwok, Rin and Mr. Yang, Victor do not have specific experience in toy business, we believe their extensive business experience will contribute significantly to the Board.

SUBSTANTIAL SHAREHOLDERS

So far as our Directors were aware as at the Latest Practicable Date, immediately following completion of the Introduction, without taking account of any Shares which may be allotted and issued upon the exercise of any options that may be granted under the Share Option Scheme, the following persons will have interests or short positions in Shares or underlying Shares which would fall to be disclosed to us under the provisions of Divisions 2 and 3 of Part XV of the SFO, or will be directly and/or indirectly interested in 10% or more of the nominal value of the Shares carrying the right to vote in all circumstances at general meetings of the Company:

| Name | Nature of interest | Notes | Number of Shares | Approximate % of voting power immediately after the Introduction |
|---------------------------------|----------------------------------|--------|---------------------|---|
| Mr. Chan Chun Hoo, Thomas | Beneficial owner | (1) | 860,200 | 0.17% |
| | Interest of controlled companies | (1)(2) | 360,184,744 | 72.76% |
| Angers Investments Limited | Beneficial owner | (1) | 87,708,000 | 17.72% |
| | Interest of a controlled company | (1)(3) | 272,476,744 | 55.05% |
| PHL | Interest of a controlled company | (1)(4) | 272,476,744 | 55.05% |
| Playmates International Limited | Interest of a controlled company | (1)(4) | 272,476,744 | 55.05% |
| PIL Investments Limited | Interest of a controlled company | (1)(4) | 272,476,744 | 55.05% |
| PIL Toys Limited | Beneficial owner | (1) | 272,476,744 | 55.05% |

Notes:

- (1) Long position in the Shares.
- (2) Mr. Chan Chun Hoo, Thomas is the beneficial owner of all of the issued share capital of Angers Investments Limited, and is therefore deemed to be interested in the 87,708,000 Shares in aggregate which Angers Investments Limited is interested in and the 272,476,744 Shares in aggregate which PHL is interested in.
- (3) Angers Investments Limited directly owns approximately 39.42% of the shareholding of PHL, and is therefore deemed to be interested in the 272,476,744 Shares in aggregate which PHL is interested in.
- (4) Playmates International Limited is a wholly owned subsidiary of PHL; PIL Investments Limited is a wholly owned subsidiary of Playmates International Limited; and PIL Toys Limited is a wholly owned subsidiary of PIL Investments Limited. PHL, PIL and PIL Investments Limited are therefore deemed to be interested in the 272,476,744 Shares in which PIL Toys Limited is beneficially interested in.

SUBSTANTIAL SHAREHOLDERS

Except as disclosed above, the Directors are not aware of any other person who will, immediately following the Introduction, have an interest or short position in Shares or underlying Shares which would fall to be disclosed to us under the provisions of Divisions 2 and 3 of Part XV of the SFO, or be directly or indirectly interested in 10% or more of the nominal value of the Shares carrying the right to vote in all circumstances at general meetings of the Company.

SHARE CAPITAL

1. OUR SHARE CAPITAL

As at the Latest Practicable Date, our share capital was:

HK\$

Authorised share capital:

| | |
|----------------------|------------|
| 3,000,000,000 Shares | 30,000,000 |
|----------------------|------------|

Issued share capital:

| | |
|--------------------|-----------|
| 495,000,000 Shares | 4,950,000 |
|--------------------|-----------|

1.1 Assumptions

The table above does not take into account any of the Shares which may be issued pursuant to the exercise of any options that may be granted under the Share Option Scheme, or the general mandate referred to in paragraph 1.4 below or which may be repurchased by the Company under the mandate referred to in paragraph 1.5 below.

1.2 Ranking

The Shares will rank *pari passu* in all respects, and in particular will rank in full for all dividends or other distributions declared, made or paid on the Shares in respect of a record date which falls after the date of this document.

1.3 Share Option Scheme

We have conditionally adopted the Share Option Scheme which will become effective on the Listing Date. The principal terms of the Share Option Scheme are summarized in Appendix IV – Statutory and General Information.

SHARE CAPITAL

1.4 General Mandate to Issue Shares

Conditional on the conditions as stated in “INFORMATION ABOUT THIS LISTING DOCUMENT AND THE INTRODUCTION – CONDITIONS OF THE INTRODUCTION”, our Directors have been granted a general unconditional mandate to allot, issue and deal with Shares and to make or grant offers, agreements or options which might require such Shares to be allotted and issued or dealt with subject to the requirement that the aggregate nominal value of the Shares so allotted and issued or agreed conditionally or unconditionally to be allotted and issued (otherwise than pursuant to a rights issue, or scrip dividend scheme or similar arrangements, or a specific authority granted by our Shareholders) shall not exceed:

- (a) 20% of the aggregate nominal value of the share capital of the Company in issue immediately following the completion of the Introduction; and
- (b) the aggregate nominal value of the share capital of the Company repurchased by the Company (if any).

This general mandate to issue Shares will remain in effect until:

- (i) the conclusion of the Company’s next annual general meeting;
- (ii) the expiration of the period within which the Company’s next annual general meeting is required by any applicable law or its bye-laws to be held; or
- (iii) it is varied or revoked by an ordinary resolution of the Shareholders in general meeting,

whichever is the earliest.

For further details of this general mandate, please refer to Appendix IV – Statutory and General Information.

1.5 General Mandate to Repurchase Shares

Conditional on the conditions as stated in “INFORMATION ABOUT THIS LISTING DOCUMENT AND THE INTRODUCTION – CONDITIONS OF THE INTRODUCTION”, the Directors have been granted a general unconditional mandate to exercise all our powers to repurchase Shares (Shares which may be listed on the Stock Exchange or on any other stock exchange which is recognised by the SFC and the Stock Exchange for this purpose) with a total nominal value of not more than 10% of the aggregate nominal value of the Company’s share capital in issue immediately following the completion of the Introduction.

SHARE CAPITAL

This mandate only relates to repurchases made on the Stock Exchange, or on any other stock exchange on which the Shares are listed (and which is recognised by the SFC and the Stock Exchange for this purpose), and made in connection with all applicable laws and the requirements of the Listing Rules. A summary of the relevant Listing Rules is set out in the section headed “2. PURCHASE BY THE COMPANY OF ITS OWN SECURITIES” in Appendix IV to this document.

The general mandate to repurchase Shares will remain in effect until:

- (i) the conclusion of the Company’s next annual general meeting;
- (ii) the expiration of the period within which the Company’s next annual general meeting is required by any applicable law or its bye-laws to be held; or
- (iii) it is varied or revoked by an ordinary resolution of the Shareholders in general meeting,

whichever is the earliest.

For further details of this general mandate, please refer to “APPENDIX IV – STATUTORY AND GENERAL INFORMATION”.

FINANCIAL INFORMATION

The following discussion and analysis of our financial condition and results of operations together with our combined financial statements as at and for the three years ended 31 December 2004, 2005 and 2006, and the six months ended 30 June 2006 and 2007, and the accompanying notes, all included in the Accountants' Report set out in Appendix I to this document, should be read in conjunction with our consolidated financial statements included in the Accountants' Report in Appendix I and the selected financial data, in each case together with the accompanying notes thereto. The consolidated financial statements have been prepared in accordance with HKFRS.

OVERVIEW

We design, develop, market and distribute a diverse portfolio of innovative branded toys. We market and distribute our products in over 50 countries worldwide but generate most of our sales through our sales and distribution operations in the U.S. Our three largest U.S. customers collectively accounted for approximately 66%, 63% and 60% of our worldwide turnover in 2004, 2005 and 2006 respectively.

Our current product categories consist of action figures, vehicles, dolls, feature plush, role play toys and interactive electronic toys. We develop a wide range of products in these categories by acquiring rights in entertainment properties, and by developing brands internally. We also acquire rights in patented technologies and inventions for use in our products.

As licenses proliferated in the toy industry in mid-to-late 1990s, our profitability began to decline due to the unsatisfactory performance of a number of unproven licensing and entertainment initiatives. In 2001, new personnel with extensive experience in the toy industry joined our senior management in response to our declining financial results. We also restructured our operations and implemented a more stringent process of evaluating license opportunities. Beginning in 2002, the Group changed its strategy and discontinued non-performing brands. We prioritized new license acquisitions and proprietary product development based upon our assessment of the long term growth potential of these opportunities. We then focused on developing brands that we believe can generate long-term value and revenues. As a result, the Group significantly reduced loss as the strategy began to take effect.

In 2003, we re-launched the Turtles based upon a brand new animated television series. Consequently and significantly, the brand reached a new peak in generating revenues in 2004.

Sales in 2004, 2005 and 2006 were HK\$1,282,662,000, HK\$1,277,607,000 and HK\$1,127,997,000 respectively. Sales in 2005 were flat, compared to 2004. Sales in 2006 declined approximately 11.7% from 2005.

FINANCIAL INFORMATION

In 2005, the toy industry faced retail challenges and cost pressures that negatively impacted profitability of most toy companies. The U.S. toy market was characterized by continued retail consolidation, a slowdown in consumer spending and the adoption by several major retailers of conservative inventory policies in the fall season. Recently published industry data in Toy Industry Insights by NPD Group shows a 4% decline in overall U.S. toy retail sales in 2005. In 2005, *Amazing Amanda*, the first of a new generation of interactive dolls, was successfully launched by the Group and was a top selling doll in that year.

As indicated in the “INDUSTRY OVERVIEW” section, (i) there was a flat growth rate in U.S. toy industry sales comparing 2005 with 2006 and (ii) the sale of action figures decreased by 9% in 2006. The combined effect of such overall industry wide growth stagnation and the shrinkage of sales in action figure, one of our key toy categories directly contributed to the decline of toy sales in general for our Group. Nevertheless, we continued to invest in portfolio expansion in line with our growth strategies. In 2006, two new licensed brands were successfully introduced: *Strawberry Shortcake*, a highly recognizable doll brand with worldwide appeal, from American Greetings and *Disney Fairies* brand, a new Disney franchise based on tales of Tinker Bell and her friends.

In the U.S., a significant portion of our customer base includes mass market merchandisers and specialty toy retailers. We maintain a balance between these two major categories. In spite of continued retail consolidation, we were able to maintain the approximate relative share of our total U.S. sales accounted for the mass merchandisers and the toy specialists. U.S. sales to mass retailers represented 69%, 63% and 66% of our total U.S. sales in 2004, 2005 and 2006 respectively. U.S. sales to toy specialists represented 24%, 27% and 22% of our total U.S. sales in 2004, 2005 and 2006 respectively. Continued growth with the mass merchandisers and a commitment to broaden distribution beyond traditional mass market channels has positioned us to minimize the impact that any further retail consolidation may have upon our U.S. business.

Sales to non-U.S. markets in 2004, 2005, and 2006 were HK\$282,352,000, HK\$328,774,000 and HK\$280,642,000, representing 22.0%, 25.7% and 24.9% of total sales respectively.

Our non-U.S. proportion of sales provides a consistent balance and continues to be an opportunity for expansion. Our non-U.S. sales growth was led primarily by territorial expansion of all brands.

BASIS OF PREPARATION

In May 2007, we underwent the Reorganization to rationalise our business and corporate structure in preparation for the Introduction. As a result of the Reorganization, our Company was interposed between the PHL Group subsidiaries and the current subsidiaries of our Group. For more details, please see the section headed “HISTORY AND REORGANIZATION – OUR REORGANIZATION” in this document.

Upon completion of the Reorganization, the Group is regarded as a continuing entity since the companies that comprise the Group were controlled by the same ultimate shareholder before and immediately after the Reorganization. Accordingly, this financial information has been prepared as if the Company had been the holding company of our Group from the beginning of the earliest period presented.

FINANCIAL INFORMATION

Our financial information presents our combined results, cash flows and financial position as if our Group had been in existence throughout the Track Record Period and the structure after the Reorganization had been in place as of the earliest period presented, or since the effective dates of incorporation of the companies.

Before the Introduction and the Spin-off, the Group is wholly-owned by Playmates Group. The results and financial position of the Group were 100% consolidated into the financial statements of Playmates Group during the Track Record Period. The segment information for toy business was separately disclosed in notes to the accounts of the annual reports of Playmates Group for the respective years. The Group's operating profit/(loss) and the segment result of Playmates Group's toy business can be reconciled through reconciling items in respect of certain tax expenses of different classification. The Group's total assets and total liabilities and those of Playmates Group's toy business can also be reconciled through reconciling items including intra-group balances, deferred tax assets/liabilities, tax recoverable/payable, investment in associate and bank loans which were excluded from segment assets/liabilities in accordance with HKFRS.

FACTORS AFFECTING OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Distribution channels

In the U.S., we sell our products to a combination of national mass merchandise retailers, national toy specialty chain stores, membership warehouse clubs, supermarket and pharmacy chains and dollar stores through a combination of our in-house sales team and independent third-party representatives. Our three largest U.S. customers collectively accounted for approximately 66%, 63% and 60% of our worldwide turnover in 2004, 2005 and 2006 respectively. Outside the U.S., we distribute our products through a network of independent toy distributors that manage the marketing and distribution of our products in over 50 countries around the world. Two of our top five customers are our distributors for European countries including France, Germany, Italy, Spain and the United Kingdom.

Product mix

Our product mix broadly consists of boys and girls toys, which can be further divided into licensed and proprietary brands. Our current product categories consist of action figures, vehicles, dolls, feature plush, role play toys and interactive electronic toys and we intend to expand our product offerings into targeted growth categories such as arts and crafts, preschool and youth electronics. It is our goal to minimize our business risk by maintaining a balanced product portfolio among our various categories.

FINANCIAL INFORMATION

Licenses

A significant portion of our revenues are currently derived from the sale of products based on Entertainment Licenses, which accounted for approximately 81%, 74%, 65% and 87% of our total revenue for the year ended 31 December 2004, 2005, 2006 and for the six months ended 30 June 2007. Revenues are also derived from the sale of products under proprietary brands which incorporate technologies and inventions from Inventor Licenses. In some cases, we incorporate Inventor Licenses elements such as electronic technologies in our products based on Entertainment Licenses. Our current key Entertainment License for boy's business expires in 2011 with renewal options, and the licenses for girls' brands will expire between 2008 and 2009.

Advertising and marketing expenses

Marketing and promotion are a critical aspect of our operations and have significantly contributed to the enhancement of our licensed and proprietary brands and expansion of sales. In light of our unique product positioning, we have adopted a distinct and coherent marketing and promotion strategy focused on innovative character-rich and popular entertainment brands and franchises.

As a promotional toy group, our success heavily depends on the effects of advertising and marketing campaigns. The main components of our marketing expenses include TV media, production of commercials, production of TV shows, and royalties paid to licensors. As one of the most important marketing efforts is TV media, we carefully select the TV programs and targeted demographic audience we market our products to. TV media was purchased through one of the biggest media buying organizations in the U.S.

Seasonality and other factors

Our results of operations are subject to seasonality factors in the U.S. market. We achieve higher sales in the second half of a year when we sell products for the fall and holiday seasons. Furthermore, our sales are also affected by other seasonal spending patterns, such as the traditional holidays during Easter, Thanksgiving and Christmas. In addition, changes in consumer tastes and market trends may affect sales of our products timed for release during a particular season. For example, the relative success of an entertainment program or movie release may affect the sales of our products.

During 2004, 2005 and 2006, the sales generated in the first 6 months of the year accounted for 28.2% to 35.1% of the total annual worldwide sales, and the sales in second half of the year accounted for 64.9% to 71.8%. Although sales is relatively low in the first half year of the year, the Group still incurs regular costs in product development and marketing expenses as they planned in that year, and regular administrative expenses in this corresponding period. As a result, although the Group attained stable gross margin, it may make losses during the first half year of the year due to these seasonality factors. For the six months ended 30 June 2006 and 2007, the Group's net loss was HK\$17.9 million and HK\$14.6 million, respectively.

FINANCIAL INFORMATION

On the other hand, due to these seasonality factors, the Group maintains a higher level of cash and bank balance during the first half year as a result of higher sales in the second half year of preceding year. In order to meet the peak season sales, we make relatively larger purchases in the second half year. As a result, funding requirements for that period is high, so our bank borrowing is seasonal and is generally incurred in the second half year.

Other revenue

Other revenue represents interest income derived from the Group's seasonal surplus working capital parked in the Group's normal operating bank accounts. Interest income was not earned by lending money or investing in financial activities. Interest income is recognized on a time proportion basis, by reference to the principal outstanding and at the interest rate applicable.

The Group earned HK\$739,000, HK\$3,002,000, HK\$5,131,000 and HK\$2,421,000 interest income for the three years ended 31 December 2004, 2005 and 2006 and for the six months ended 30 June 2007 respectively. Continuous increase in the interest income was mainly due to increase in cash and bank balances generated from operations of the Group during the periods and continuous increase in bank interest rate in U.S. and Hong Kong since the second half year of 2004.

Taxation

During the Track Record Period, the Group has been involved in two tax cases. The movement of provision for the tax cases is set out below:

| | IRS case <i>(Note (a))</i> <i>HK\$'000</i> | FTB case <i>(Note (b))</i> <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|----------------------------|---|---|---------------------------------|
| At 1 January 2004 | 35,151 | – | 35,151 |
| Provision | <u>14,082</u> | <u>23,400</u> | <u>37,482</u> |
| At 31 December 2004 | 49,233 | 23,400 | 72,633 |
| Provision/(Over-provision) | <u>3,023</u> | <u>(2,552)</u> | <u>471</u> |
| At 31 December 2005 | 52,256 | 20,848 | 73,104 |
| Provision/(Over-provision) | 1,934 | (5,982) | (4,048) |
| Payment | <u>(54,190)</u> | <u>(14,866)</u> | <u>(69,056)</u> |
| At 31 December 2006 | <u>–</u> | <u>–</u> | <u>–</u> |

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(a) Transfer pricing policy and timing of certain deductions

In 2005, Playmates, Inc (“PI”) and its U.S. subsidiaries (collectively referred to as the “US Group”) agreed on a settlement on appeal with the Internal Revenue Service (“IRS”) pertaining to an examination of the US Group consolidated income tax return for the years ended 31 December 1996 through 1997. The principal issue resulting in the assessment related to transfer pricing. During the years at issue, the US Group used to purchase all its products from a fellow subsidiary, Playmates Toys Hong Kong Limited (“PTHK”). The US Group stopped purchasing its products from PTHK in 1999 which subsequently ceased business in 1999. The goods were originally priced based on a method the IRS considered unacceptable. In addition, the IRS disagreed with the US Group on the time period over which certain royalty costs were amortized and deducted.

In appeal, after much negotiation, the IRS and the US Group agreed on a Comparable Profits Method (“CPM”) to impute taxable income, and also agreed to amortize royalty expenses over the term of the related contract. In 2005, the Group signed the official Closing Agreements with the IRS and agreed a HK\$78 million transfer pricing adjustment on taxable profits, resulting in a total tax payment of HK\$54.2 million in 2006 including the corresponding interest payment of HK\$24.4 million and penalty payment of HK\$0.9 million. The Group also rectified the timing over royalty costs deductions.

As at 31 December 2003, the U.S. tax advisers estimated that the potential exposure including tax arising from the adjustment on taxable profits and accrued interest to the US Group was between HK\$35.2 million to HK\$46.8 million, based on a likely range of adjustment on taxable profits of HK\$46.8 million to HK\$78 million on taxable profits. The US Group consulted with our U.S. tax advisers and U.S. lawyers and based on the information available at the time considered that it was appropriate to make a total tax provision of HK\$35.2 million, including the corresponding interest accrual, as at 31 December 2003.

During 2004, the IRS made an informal, non-binding offer which would have resulted in a HK\$81.9 million adjustment of taxable profits. Based on this new development, the US Group, having consulted with our U.S. tax advisers and U.S. lawyers, increased the provision by HK\$14.1 million to HK\$49.2 million (including the corresponding interest accrual of HK\$19.5 million) for the year ended 31 December 2004.

Pursuant to the agreement with IRS on the adjustment to taxable profits in 2005, and based on advice from our U.S. tax advisers as to the corresponding interest, a further provision of HK\$3.0 million was provided for the year ended 31 December 2005.

The balance was fully settled in 2006 and accordingly a further provision of HK\$1.9 million in respect of additional accrued interest was made for the year ended 31 December 2006. The case was cleared and related expenses was fully settled in 2006.

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Having regard to this tax dispute, the US Group stopped purchasing goods from PTHK since 1999. Instead, since 1999, the US Group purchased goods directly from third party contract manufacturers in China and there have been no purchases of goods from related parties during the Track Record Period.

As this case was closed in 2006, the Group re-examined its operational efficiency and concluded that it would be more efficient to use a Hong Kong based company to act as the single purchasing arm for the Group. Subsequent to the Track Record Period, since September 2007, PTI and PTIL have been purchasing goods directly from PTA, a newly established Hong Kong subsidiary. The current transfer pricing is computed using a CPM approach and is supported by comparability study from our tax advisers.

During the Track Record Period, PTIL paid the royalties to PTI for the corresponding non-U.S. sales and PTI paid charges to PAS for its provision of supporting services in Hong Kong and China. These intra-group charges were on an arm's length basis. Our tax advisers will periodically review these arrangements and advise the Group accordingly. In January 2007, the IRS closed its examination on the US Group in respect of 2003 without proposing an adjustment.

Therefore, we do not believe any significant transfer pricing exposures exist during the Track Record Period.

(b) Apportionment of income to the State of California for the tax years 1988 to 1990

The State of California imposes a “franchise tax” based on income. Generally speaking, companies doing business in California must “apportion” their worldwide income based on a three-factor apportionment formula. The three factors are the proportion of payroll, property and sales which are within the state of California. The state of California also adopts a worldwide “unitary” tax approach which represent the filing of one unified tax return for all related companies who operate in an interdependent or common manner. For years ended 31 December 1988 through 1990, the California Franchise Tax Board (“FTB”) disagreed with the US Group’s tax filing position in regards to certain sales of PTHK, which at the time was considered unitary with the US Group. In an examination, the FTB determined that certain of PTHK’s sales to U.S. customers were shipped through California. The FTB asserted that all of PTHK’s sales shipped through California should be apportioned to the state, despite the fact that the bulk of these sales were destined for customers outside California.

Prior to 2004, the US Group believed that there would be a favorable outcome to the examination, and as such no provision was accrued. However, the US Group received a FTB collection notice amounted to HK\$23.4 million in 2004. Based on this notice and having consulted with the Group’s tax advisers, the US Group made full provision for this amount in 2004. During 2005, there was continuing dialogue among the FTB, the Group and its advisers; and the Group and its tax advisers were able to obtain a better understanding of the position of the FTB. Based on advice from our U.S. tax advisers, the US Group re-assessed its own estimate of the ultimate liability amounting to HK\$20.8 million (including the corresponding interest

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accrual of HK\$7.9 million and a provision for penalty of HK\$1.7 million) and therefore reduced the tax provision by HK\$2.6 million. In May 2006, the FTB imposed a formal assessment and demanded payment of tax, interest and penalties of HK\$14.9 million (including the interest payment of HK\$5.6 million and penalty payment of HK\$3.7 million). As such, the US Group reduced its provision by HK\$5.9 million in 2006. The full amount of HK\$14.9 million was settled in the second half of 2006.

However, the US Group continued to pursue its refund claim through litigation with FTB and in July 2007, the US Group and the FTB agreed in principle to an out-of-court settlement, which resulted in a refund of tax, interest and penalties of approximately HK\$22.6 million. This refund was fully received in August 2007. This beneficial development will be reflected in the financial statements for the second half of 2007. This case was cleared and related expenses was fully settled.

In light of this favorable settlement, the management of the Group believes that there is no further on-going implications of this tax case.

The amount of legal and professional expenses incurred in these two tax cases were HK\$1,604,000, HK\$1,685,000, HK\$1,294,000 and HK\$1,193,000 for the three year ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007 respectively.

All tax provision has been properly made during the Track Record Period. There is no other on-going tax investigation. To our best knowledge, the Group's current tax arrangement is in compliance with the U.S. tax regulations and relevant directives of the U.S. tax authorities.

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgments 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 set out in "APPENDIX I – ACCOUNTANTS' REPORT". The following sections discuss the accounting policies applied in preparing our financial information that we believe are most dependent on the application of these judgements and estimates and certain other significant accounting policies.

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Revenue recognition

Revenue from sales of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and title has been passed.

The Group grants credits to retail customers to facilitate the sale of slow moving merchandise held by such customers. The support provided to the retail customers by the Group provides a contribution towards the reduction of the retail price of the slow moving items. As of each annual and interim balance sheet date, an analysis is done of all customer requests for concessions which have been agreed or are pending. Each individual item is evaluated and any concession is based upon a specific agreed or estimated dollar value per unit. The concession per unit is determined by (i) negotiating an amount agreed with retail customers and/or (ii) estimating an amount based on management's experience with available contemporary and historical information. This concession amount is applied to the remaining retail inventory in the hands of the Group's retail customers to determine the total concession expected. Similar methodology is applied to other slow moving retail inventory determined through regular sales data provided by the Group's retail customers and based on management's experience with each individual retail customer and its historical performance. Credits are recorded net of gross sales.

All agreed concessions are processed through a Special Terms and Agreement form and all provisions are established for specific exposures. Agreed and estimated concessions are reviewed on a regular basis by management and any outstanding amounts are re-evaluated based upon subsequent events, including actual sales data of the agreed upon or provided for product items and claims made against the agreed concessions by retail customers. All claims received are compared to their respective Special Terms and Agreement to ensure correctness. Claims by retail customers may be received up to two years, or after, the relevant balance sheet date. Any adjustments to the amounts provided are recorded in the period of change.

The movement of allowance are set out below:

| | 2004 | 2005 | 2006 | 2007 |
|----------------------------------|-----------------|-----------------|----------------|--------------|
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| At 1 January | 27,407 | 28,290 | 13,366 | 8,560 |
| Addition allowance made | 26,248 | 14,540 | 14,823 | 4,390 |
| Allowance utilised | (9,987) | (9,653) | (17,973) | (5,717) |
| Reversal of unutilised allowance | <u>(15,378)</u> | <u>(19,811)</u> | <u>(1,656)</u> | <u>—</u> |
| At 31 December/30 June | <u>28,290</u> | <u>13,366</u> | <u>8,560</u> | <u>7,233</u> |

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Toy business is a trend driven business and many new product lines are introduced every year. However, some products may not enjoy consumer acceptance or meet retail expectations and hence one of our costs associated with these unsuccessful product lines is the granting of allowances for customer concessions to our retail customers, to facilitate the sale of any remaining slow moving merchandise held by our retail customers. For electronic products, which contain a higher percentage of costly components, the exposure for allowance is higher. A higher amount of customer concessions was provided for the year ended 31 December 2004 comparing to other years in the Track Record Period. It was mainly due to the poor retail performance of a newly launched electronic product at the time resulting in significant retail inventories carryover held by our retail customers and hence the allowance was made.

The Directors consider that the amount of the allowance made and the timing of the reversal in subsequent periods to be appropriate and that the provision policy adopted by the Group is in compliance with the applicable accounting standards. The method and procedures currently used are designed to ensure that all allowances are based on the best information and evidence available at the time and the collective judgment of senior management committees after thorough discussions, and that the rationale, assessments of the uncertainties and calculations of the provisions made are properly documented. The eventual outcome of these uncertainties may be different to the management's original assessment, and these over or under allowances will be adjusted in the income statement in subsequent periods.

Advanced royalties

Advanced royalties represent prepayments made to licensors of intellectual properties under licensing agreements which are recoupable against future royalties. Advanced royalties are amortized at the contractual royalty rate based on actual product sales. Management evaluates the future realization of advanced royalties periodically and charges to expense any amounts that management deems unlikely to be recoupable at the contractual royalty rate through product sales. All advanced royalties are amortized within the term of the license agreement and are written off upon the abandonment of the product or upon the determination that there is significant doubt as to the success of the product.

Royalties paid (including amortization of advanced royalties) are charged to the income statement as "Marketing expenses" and are also separately disclosed as "Royalties paid" in note 9 to the Accountants' Report.

Advanced royalties paid are included in the balance sheet as "Prepayments".

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Provisions

Provisions are recorded when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. Expenditures for which a provision has been recognised are charged against the related provision in the year in which the expenditures are incurred. Provisions are reviewed as of each published balance sheet date and adjusted to reflect the current best estimate. All provisions are current in nature and therefore the effect of the time value of money is not material. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

The Directors consider that the amount of the provision made and the timing of the reversal in subsequent periods to be appropriate and that the provision policy adopted by the Group is in compliance with the applicable accounting standards. The method and procedures currently used are designed to ensure that all provisions are based on the best information and evidence available at the time and the collective judgment of senior management committees after thorough discussions, and that the rationale, assessments of the uncertainties and calculations of the provisions made are properly documented. The eventual outcome of these uncertainties may be different to the management's original assessment, and these over or under provisions will be adjusted in the income statement in subsequent periods. Major provisions are described below:

Consumer Returns

The Group uses agreed customer allowances based on a percentage of sales and information on actual consumer returns of defective goods to estimate return percentages. The provision is calculated based on these factors and is adjusted for any fluctuations in the returns expected by management as of each period end.

Most of the Group's retail customers receive a fixed percentage of sales as their allowance. Some of these customers receive a higher percentage rate on electronic goods. The allowance for each retail customer is agreed and documented in the terms of trade. Certain customers receive an allowance based on their actual consumer return experience.

In evaluating the adequacy of the prior year provision, an analysis is done to determine the reasons for unclaimed deductions. If the analysis determines that some carry forward provision amounts were no longer appropriate based on actual claims experience, the proper adjustments will be made to release the over-accrued portion.

Cooperative Advertising

The Group participates in customer advertising programmes and allows certain customers to take a percentage of sales deduction, which is negotiated on an individual basis. In addition, the Group contributes toward specific expenses of customers for in-store sales promotions and advertising circulars. Please refer to "MARKETING" under "BUSINESS" section of this document for details.

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In the case of the fixed percentage, the amounts are negotiated and documented in the terms of trade with the respective customer. In the case of all special programs, the program application, limits and amounts are offered on a case-by-case basis by the Group. A Special Terms and Agreement form is prepared for each program. Some of the programs are set for defined periods of time or limited to a maximum number of units sold, and confirming data is provided by the retailer to finalize the actual program cost.

Claims for cooperative advertising may be received up to two years after the relevant balance sheet date and, in certain cases, later. The Group reviews the provisions periodically and any unutilized amount will be reversed at the year end.

Cancellation Charges

The provision represents the estimated amounts that would be payable to suppliers to settle the cost incurred by them for production orders which have been or are likely to be cancelled. The Group generally settles these amounts in the year after the year that the specific product ceases to be actively sold to customers.

In most cases, the vendor may try to mitigate the Group's exposure by utilizing the unused components in its other products. Such arrangement may also reduce the Group's potential cancellation exposure.

At each relevant balance sheet date, the Group will analyse the potential cancellation charge exposure for order cancellations due to commitments for finished goods, work in process items and material authorizations. The Group will also review if any items can be carried over to be produced and sold in the subsequent year. Those items are then deducted from the potential cancellation exposure. Once the exposure is adjusted for the carry over, the remaining exposure is adjusted by a factor representing the historical negotiated discount agreed with the suppliers.

We continually assess our exposure to these potential customer and supplier claims and, where necessary establish provisions for any such exposures. The Group also makes appropriate reserves for inventory write-downs and bad debts on a regular basis.

All provisions are established for specific exposures. Management relies on available contemporary and historical information to evaluate each potential exposure and exercises its best judgement to estimate the amount of provision necessary and sufficient for each potential exposure.

Over- or under-provision for the above exposures, arising from subsequent events and the eventual settlement, are adjusted in that subsequent period where appropriate.

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The movement of provisions and approximate provisions to sale ratio are set out below:

| | Consumer Returns <i>HK\$'000</i> | Cooperative Advertising <i>HK\$'000</i> | Cancellation Charges <i>HK\$'000</i> | Total <i>HK\$'000</i> | Sales <i>HK\$'000</i> | % to Sales |
|-----------------------------------|--|---|--|--------------------------|--------------------------|--------------|
| At 1 January 2004 | 13,561 | 34,464 | 2,615 | 50,640 | | |
| Addition provision made | 12,761 | 35,756 | 6,935 | 55,452 | <u>1,282,662</u> | <u>4.32%</u> |
| Provisions utilised | (7,844) | (25,854) | (1,449) | (35,147) | | |
| Reversal of unutilised provisions | <u>(3,050)</u> | <u>(3,086)</u> | <u>–</u> | <u>(6,136)</u> | | |
| At 31 December 2004 | 15,428 | 41,280 | 8,101 | 64,809 | | |
| Addition provision made | 16,328 | 33,535 | 3,880 | 53,743 | <u>1,277,607</u> | <u>4.21%</u> |
| Provisions utilised | (9,909) | (31,542) | (4,806) | (46,257) | | |
| Reversal of unutilised provisions | <u>(4,680)</u> | <u>(12,545)</u> | <u>(3,295)</u> | <u>(20,520)</u> | | |
| At 31 December 2005 | 17,167 | 30,728 | 3,880 | 51,775 | | |
| Addition provision made | 17,417 | 30,549 | 4,322 | 52,288 | <u>1,127,997</u> | <u>4.64%</u> |
| Provisions utilised | (16,549) | (32,819) | (2,302) | (51,670) | | |
| Reversal of unutilised provisions | <u>(2,907)</u> | <u>–</u> | <u>(226)</u> | <u>(3,133)</u> | | |
| At 31 December 2006 | 15,128 | 28,458 | 5,674 | 49,260 | | |
| Addition provision made | 3,028 | 10,665 | 915 | 14,608 | <u>347,579</u> | <u>4.20%</u> |
| Provisions utilised | (10,364) | (24,799) | (250) | (35,413) | | |
| Reversal of unutilised provisions | <u>(1,637)</u> | <u>(38)</u> | <u>–</u> | <u>(1,675)</u> | | |
| At 30 June 2007 | <u>6,155</u> | <u>14,286</u> | <u>6,339</u> | <u>26,780</u> | | |

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The provisions to sale ratio were stable during the Track Record Period. The reversal of unutilised provisions for the year ended 31 December 2005 was relatively high which was mainly due to a non-recurring reversal of provision for cooperative advertising in 2005 due to a modification in the terms of the Group's participation in one of our customers' advertising programmes from giving a fixed percentage to paying on actual basis.

The Directors consider the amount of provisions made and the timing of reversal in subsequent years to be appropriate in accordance with the relevant accounting standards. In addition, such provision and reversal reflect the best information and evidence available at the time, and the relevant terms of the agreements.

Deferred tax assets

Deferred taxation 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 accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred 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 taxation is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

In accordance with HKAS 12, temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures becomes different from the tax base of the investment or interest. Such differences may arise in a number of different circumstances, for example:

- i. the existence of undistributed profits of subsidiaries, branches, associates and joint ventures;
- ii. changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and
- iii. a reduction in the carrying amount of an investment in an associate to its recoverable amount.

An entity shall recognize a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

- i. the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and
- ii. it is probable that the temporary difference will not reverse in the foreseeable future.

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Deferred taxation is calculated in full on temporary differences under the liability method using taxation rate of 17.5% in Hong Kong, and federal and state tax rates of between 34% and 35% and between 7.32% and 8.84% respectively in the U.S.

The movement on the deferred tax assets/(liabilities) account is as follows:

| | 2004 | 2005 | 2006 | 2007 |
|---|----------------------|----------------------|----------------------|----------------------|
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| At 1 January | 146 | 68,391 | 85,458 | 79,896 |
| Credited/(charged) to income statement | <u>68,245</u> | <u>17,067</u> | <u>(5,562)</u> | <u>(4,981)</u> |
| At 31 December/30 June | <u><u>68,391</u></u> | <u><u>85,458</u></u> | <u><u>79,896</u></u> | <u><u>74,915</u></u> |

Balances (prior to offsetting of balances within the same taxation jurisdiction) represented by:

| | As at 31 December | | | As at |
|---|--------------------------|----------------------|----------------------|----------------------|
| | 2004 | 2005 | 2006 | 30 June |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Deferred tax assets, arising from | | | | |
| – Tax losses | 65,948 | 80,660 | 72,195 | 67,214 |
| – Employees benefits (<i>Note (a)</i>) | <u>2,443</u> | <u>5,068</u> | <u>7,795</u> | <u>7,795</u> |
| | 68,391 | 85,728 | 79,990 | 75,009 |
| Deferred tax liabilities, arising from | | | | |
| – Accelerated tax depreciation (<i>Note (b)</i>) | <u>–</u> | <u>(270)</u> | <u>(94)</u> | <u>(94)</u> |
| | <u><u>68,391</u></u> | <u><u>85,458</u></u> | <u><u>79,896</u></u> | <u><u>74,915</u></u> |

Notes:

- (a) Deferred tax assets arising from employees benefits are related to the share-based payment transactions for a U.S. subsidiary of the Group. The Group recognized an expense for the consumption of employee services received as consideration for share options granted, in accordance with HKFRS 2 Share-based payment, and did not receive a tax deduction for a U.S. subsidiary of the Group until the share options are exercised. As a result, the difference between the tax base of the employee services received to date and the carrying amount is deductible temporary difference that results in a deferred tax asset for a U.S. subsidiary of the Group. Such deferred tax asset is utilized when the share options are exercised. The balance of the deferred tax asset arising from employees benefits represents the deferred tax assets recognised upon granting of the share option, net of the deferred tax assets utilised upon exercising of the share options during the Track Record Period.

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- (b) Accelerated tax depreciation is taxable temporary difference that will result in taxable amounts in determining taxable profit of future periods when the carrying amount of the asset is recovered. The accelerated tax depreciation is arising from the difference between the carrying amount and tax base of property, plant and equipment and has been recognized as deferred tax liabilities in the Group's financial statements. When the difference between the carrying amount and tax base of property, plant and equipment reduced, deferred tax liabilities is decreased and credited to the Group's income statement.

The movement for deferred tax assets in respect of tax losses during the year/period is as follows:

Deferred tax assets

| | Tax losses | | | |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| At 1 January | – | 65,948 | 80,660 | 72,195 |
| Credited/(charged) to income statement: | | | | |
| Recognition of previously unrecognised tax losses | 133,930 | 22,600 | – | – |
| Tax losses recognised | – | – | – | 3,699 |
| Tax benefits on interest and state taxes associate with the tax cases | – | 15,996 | (2,152) | – |
| Utilization of deferred tax assets | (67,982) | (23,884) | (6,313) | (8,680) |
| | 65,948 | 14,712 | (8,465) | (4,981) |
| At 31 December/30 June | 65,948 | 80,660 | 72,195 | 67,214 |

Deferred tax assets arising from tax losses are recognized to the extent that it is probable that future profit will be available against which the tax losses can be utilized. The Group's deferred tax assets represented the recognized deferred tax assets in respect of the Group's net operating losses in U.S. ("NOL").

Deferred tax assets (i.e. crediting to income statement) are calculated according to federal tax rate and the applicable state tax rates for various states in the U.S., based on the NOL for the corresponding loss-making years. The utilization of deferred tax assets (i.e. charging to income statement) are calculated according to federal tax rate and the applicable state tax rates for various states in the U.S., based on taxable profits in U.S. for the corresponding profit-making years.

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As licenses proliferate in U.S. toy industry in the mid-to-late 1990s, the Group recorded losses in U.S. during that period. However, as it was not probable that future profit will be available, no deferred tax assets in respect of these NOL were recognized in these corresponding loss-making years. Although the Group re-commenced marking profit for the years ended 31 December 2002 and 2003 in U.S., the Group did not recognize its deferred tax assets in respect of NOL brought forward from previous years due to the uncertainties concerning its ability to utilize such deferred tax assets in the future. As at 31 December 2003, the available NOLs brought forward were approximately HK\$402.6 million, which can be carried forward to offset taxable profit in the next 17 to 22 years. The corresponding unrecognized deferred tax assets were approximately HK\$156.5 million.

In 2004, the Group recorded substantial profits and was able to utilise a substantial amount of the NOL. Based on prudent projections, the Group would continue to be profitable in 2005 and onwards. Accordingly, the directors were of the opinion that it was appropriate to recognise the deferred tax assets since it became more likely than not that the Group would have the ability to utilise such tax assets. In 2004, previously unrecognised deferred tax assets amounting to HK\$133.9 million (or approximately US\$17 million) were recognised by capitalising the NOL to the extent that realisation of the related tax benefits was probable through anticipated future taxable profits expected to be generated in 2005 and onwards. HK\$68.0 million of such deferred tax assets was utilised in 2004 offsetting all 2004 taxable profit in U.S. A deferred tax credit in the amount of HK\$22.6 million for NOL carried forward from 2003 was not recognised in 2004 due to the uncertainty of the outcome of the transfer pricing dispute with the IRS. Please refer to “Taxation” under this Financial Information section for details of this tax case.

In 2005, a settlement for the transfer pricing dispute was reached with IRS and therefore the Group recognised previously unrecognised deferred tax assets of HK\$22.6 million in respect of NOL. In 2005, the Group was able to obtain a better understanding of the position of the FTB. As the settlement with IRS included additional interest charges and provision for FTB case included additional state taxes and interest charges which are tax deductible and therefore would further increase NOL carried forward, the Group further recognised deferred tax assets of HK\$16.0 million in respect of the tax benefits on interest and state taxes associated with the tax cases. HK\$23.9 million of the such deferred tax assets was utilised in 2005 offsetting all 2005 taxable profit in U.S.

As a result of the reversal of provision for tax cases in 2006, the deferred tax credit benefiting on interest and state taxes associate with tax cases reduced by HK\$2.2 million and charged to income statement accordingly. HK\$6.3 million of the deferred tax assets in respect of NOL was utilised in 2006 offsetting all 2006 taxable profit in U.S. HK\$3.7 million of the deferred tax assets in respect of NOL was recognised for the period ended 30 June 2007 and HK\$8.7 million of deferred tax assets was utilised in respect of NOL offsetting the U.S. tax arising from the capital gain pursuant to the Reorganisation in the first half of 2007.

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Provision policy for accounts receivable

A provision for impairment of trade and other receivable 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 receivables. The amount of provision is recognized in the income statement and included allowance for customer concession that is arrived at by using available contemporary and historical information to evaluate the exposure.

Provision policy for inventory

Inventories comprise toys merchandise and are stated at the lower of cost or net realizable value. Cost is determined on a weighted average basis. Net realizable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

The Group reviews the condition of inventories at each balance sheet date, and makes allowance for inventories that are identified as obsolete, slow-moving or no longer recoverable. The Group carries out the inventory review on product-by-product basis and makes allowances by reference to the latest market prices and current market conditions.

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RESULTS OF OPERATIONS

The following table sets forth the summary combined income statement data of our Group for the three years ended 31 December 2006 and for the six months ended 30 June 2006 and 2007. We have derived the summary combined income statement data of our Group from “APPENDIX I – ACCOUNTANTS’ REPORT”, which has been prepared in accordance with HKFRS.

| | Year ended 31 December | | | Six months ended 30 June | |
|--|-------------------------|-------------------------|-------------------------|-----------------------------|-------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| | | | | (Unaudited) | |
| Turnover | 1,282,662 | 1,277,607 | 1,127,997 | 317,579 | 347,579 |
| Cost of sales | (584,035) | (637,264) | (586,826) | (173,510) | (183,254) |
| Gross profit | 698,627 | 640,343 | 541,171 | 144,069 | 164,325 |
| Marketing expenses | (318,646) | (305,822) | (296,536) | (92,840) | (79,525) |
| Selling, distribution and administrative expenses | (214,260) | (242,002) | (216,662) | (83,320) | (94,418) |
| Operating profit/(loss) | 165,721 | 92,519 | 27,973 | (32,091) | (9,618) |
| Non-operating income/(expenses) | | | | | |
| Interest expense and bank charges | (10,071) | (7,341) | (5,877) | (1,667) | (1,618) |
| Other revenue | 739 | 3,002 | 5,131 | 2,406 | 2,421 |
| Share of (loss)/profit of an associate | (1,140) | 1,149 | 2,930 | (923) | (485) |
| Profit/(loss) before taxation | 155,249 | 89,329 | 30,157 | (32,275) | (9,300) |
| Taxation credit/(charge) | 25,859 | 14,674 | (4,033) | 14,351 | (5,337) |
| Profit/(loss) for the year/period | <u>181,108</u> | <u>104,003</u> | <u>26,124</u> | <u>(17,924)</u> | <u>(14,637)</u> |
| Dividends | <u>–</u> | <u>–</u> | <u>–</u> | <u>–</u> | <u>36,660</u> |
| Earnings/(loss) per share | | | | | |
| | <i>HK Cents</i> | <i>HK Cents</i> | <i>HK Cents</i> | <i>HK Cents</i> | <i>HK Cents</i> |
| Basic | <u>36.59</u> | <u>21.01</u> | <u>5.28</u> | <u>(3.62)</u> | <u>(2.96)</u> |

FINANCIAL INFORMATION

DESCRIPTION OF SELECTED INCOME STATEMENT LINE ITEMS

Turnover

We are principally engaged in the design, development, marketing and distribution of toys and family entertainment activity products. Turnover recognized during the Track Record Period is as follows:

| | Year ended 31 December | | | Six months ended 30 June | |
|----------|-------------------------|-------------------------|-------------------------|-----------------------------|-----------------------|
| | 2004 | 2005 | 2006 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| | | | | (Unaudited) | |
| U.S. | 1,000,310 | 948,833 | 847,355 | 231,030 | 224,418 |
| Non-U.S. | <u>282,352</u> | <u>328,774</u> | <u>280,642</u> | <u>86,549</u> | <u>123,161</u> |
| Total | <u><u>1,282,662</u></u> | <u><u>1,277,607</u></u> | <u><u>1,127,997</u></u> | <u><u>317,579</u></u> | <u><u>347,579</u></u> |

The normal trade terms with customers are letter of credit or per accounts with credit term of 60 days on average but customers would settle the trade receivables around 100 days in general.

Cost of sales

Cost of sales includes cost of inventories sold, transportation charges to our warehouse or point of title transfer, our investments in product development, the cost of molds and tooling, and the cost of artwork and packaging.

Cost of sales accounted for 45.5%, 49.9%, 52.0%, 54.6% and 52.7% of our turnover for the fiscal years ended 31 December 2004, 2005 and 2006 and for the six months ended 30 June 2006 and 2007 respectively. Increases or decreases in the costs of sales percentage have been driven primarily by changes in our product mix, geographic sales mix, and level of investments in product development during the respective year/period.

In addition to direct product costs and transportation, cost of sales includes expenditures for all product development and artwork and packaging incurred during the financial year. It also includes the cost of molds and tooling for the products sold during the year. Firstly, these expenses are fixed and do not vary with the level of sales and thus the expenditure will be a greater percentage of the sales revenue when sales are reduced as from 2005 to 2006. Secondly, a significant portion of product development expenses are incurred in respect of subsequent year products and therefore the total expenses do not completely have a direct relationship to the sales of the year.

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The normal trade terms with suppliers are three weeks but actual payment is settled around two months in peak seasons.

The debtor turnover days, creditor turnover days and inventory turnover days are:

| | Year ended 31 December | | | Six months ended |
|---|------------------------|------|------|---------------------|
| | 2004 | 2005 | 2006 | 30 June 2007 |
| Inventory turnover days (<i>Note 1</i>) | 23 | 33 | 31 | 48 |
| Debtor turnover days (<i>Note 2</i>) | 104 | 110 | 118 | 67 |
| Creditor turnover days (<i>Note 3</i>) | 46 | 62 | 68 | 57 |

Notes:

- (1) Inventory turnover day equals to the year/period end balance of inventories divided by the cost of sales for the corresponding year/period and then multiplied it by 365 for each of the three years ended 31 December 2004, 2005 and 2006 or by 181 for the six months ended 30 June 2007.
- (2) Debtor turnover day equals to the year/period end balance of trade receivables (before allowance for customer concession and provision for doubtful debts) divided by the turnover for the corresponding year/period and then multiplied it by 365 for each of the three years ended 31 December 2004, 2005 and 2006 or by 181 for the six months ended 30 June 2007.
- (3) Creditor turnover day equals to the year/period end balance of trade payables divided by the purchases for the corresponding year/period and then multiplied it by 365 for each of the three years ended 31 December 2004, 2005 and 2006 or by 181 for the six months ended 30 June 2007.

All productions of our finished products are outsourced to independent OEM or ODM suppliers with manufacturing facilities in Mainland China. As discussed in the Business section, we place regular inventory orders with our manufacturing vendors to meet the anticipated seasonal demand of our customers throughout the year. We attempt to strike a balance between maximizing sales and minimizing end-of-season inventory by analyzing point-of-sale data and adjusting the volume, assortment and product mix of our inventory orders as appropriate. Accordingly, our inventory turnover days are always maintain at a low level. Inventory turnover day as at 30 June 2007 is higher due to the seasonality factors of sales which is higher at the second half year. Lower turnover days for year 2004 was mainly due to the adoption by several major U.S. customers of more conservative inventory policies beginning in the fall season in 2005 resulting in a higher inventory levels to meet just-in-time order of these customers.

As discussed in previous section, our results of operations are subject to seasonality factors and we achieve higher sales in the second half year. As the result, the Group usually record high level of trade receivables and trade payables as at each year end date. Therefore, debtor and creditor turnover days were relatively high for the years ended 31 December 2004, 2005 and 2006. Lower creditor turnover days for year 2004 was in line with the change in our inventory policy to maintain a higher inventory level as discussed above.

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Marketing expenses

Our marketing expenses consist primarily of expenses for TV media, commercial production, TV show production, promotions, toy fairs, and royalties to licensors. Our marketing expenses in aggregate were HK\$318,646,000, HK\$305,822,000, HK\$296,536,000, HK\$92,840,000 and HK\$79,525,000, representing 24.8%, 23.9%, 26.3%, 29.2% and 22.9% of our turnover for the fiscal years ended 31 December 2004, 2005 and 2006 and for the six months ended 30 June 2006 and 2007 respectively.

Our marketing expenses as a percentage of our turnover were generally steady during the three years ended 31 December 2006, except for a higher percentage for the year ended 31 December 2006 which was mainly due to the increase in marketing activities of spending in TV media to promote the launched of two new product lines – Strawberry Shortcake and Disney Fairies. The percentage for the six months ended 30 June 2007 compared to the same period in 2006 dropped because of the increased turnover and the containment of spending on marketing activities. We took advantage of the widely publicized and advertised TMNT movie which released in the first quarter of 2007 without investing much in marketing activities to promote our toy sales related to the action figure product.

Selling, distribution and administrative expenses

Selling expenses include sales commission, sales aids and samples, and provision for cooperative advertising programs and consumer returns. Our selling expenses were HK\$57,410,000, HK\$50,377,000, HK\$58,770,000, HK\$15,277,000 and HK\$15,103,000, constituting 4.5%, 3.9%, 5.2%, 4.8% and 4.3% of our turnover for the fiscal years ended 31 December 2004, 2005 and 2006 and for the six months ended 30 June 2006 and 2007 respectively. Our selling expenses as a percentage of our turnover were generally steady during the three years ended 31 December 2006 and the six months ended 30 June 2006 and 2007, except for a lower percentage for the year ended 31 December 2005 which was primarily due to a non-recurring reversal of provision for cooperative advertising in 2005 due to a modification in the terms of the Group's participation in one of our customers' advertising programmes from giving a fixed percentage to paying on actual basis.

Our distribution costs consist primarily of the rent for our 110,000 square-foot warehouse located in the U.S. and the wages for the employees and temporary labourers working at the premises. We also incur certain freight charges on delivering goods to customers' premises. Our distribution expenses were HK\$31,013,000, HK\$37,002,000, HK\$27,025,000, HK\$9,307,000 and HK\$9,884,000, constituting 2.4%, 2.9%, 2.4%, 2.9% and 2.8% of our turnover for the fiscal years ended 31 December 2004, 2005 and 2006 and for the six months ended 30 June 2006 and 2007 respectively. Our distribution expenses as a percentage of our turnover were generally steady during the three years ended 31 December 2006. The percentage for the six months ended 30 June 2006 and 2007 were relatively higher as a result of lower sales during the corresponding period due to the seasonality factors.

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Our administrative expenses consist mainly of staff cost, operating leases in respect of office buildings, and professional fees in respect of accounting, tax, compliance, information system support, legal and other advisory services. Our administrative expenses were HK\$125,837,000, HK\$154,623,000, HK\$130,867,000, HK\$58,736,000 and HK\$69,431,000, accounting for 9.8%, 12.1%, 11.6%, 18.5% and 20.0% of our turnover for the fiscal years ended 31 December 2004, 2005 and 2006 and for the six months ended 30 June 2006 and 2007 respectively. Again, expenses in the first half of the year are generally higher as a percentage of turnover due to seasonality factors and in addition, in the first half of 2007, due to increased legal and professional expenses related to certain litigation matters, the Reorganization and the Spin-off.

Our administrative expenses were relatively high for the year ended 31 December 2005 which were mainly due to the increase in legal and professional fees. For the three years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2006 and 2007, total legal and professional fees were HK\$8,788,000, HK\$29,170,000, HK\$13,579,000, HK\$3,938,000 and HK\$12,349,000 respectively. During the year ended 31 December 2005, the Group performed a corporate reorganization exercise which incurred legal and professional expenses amounted to HK\$17,856,000. For the Reorganization and the Spin-off, legal and professional expenses of HK\$2,340,000 was incurred and charged to the income statement for the six months ended 30 June 2007. All legal and professional fees incurred for the U.S. tax cases, the corporate reorganization exercise in 2005 and the Reorganization and the Spin-off have been charged to the Group and none of them was absorbed by PHL.

Interest expense and bank charges

This cost consists primarily of interest expenses for bank borrowings, receivable processing charges and other bank charges.

The Group outsources its credit activities, including credit analysis, credit approval and collection processing to a factoring and receivable processing agent. The factoring and receivable processing agent also guarantees collectability in the case of default by customers. Receivable processing fees represent those servicing charges paid to the factoring and receivable processing agent.

Other bank charges include L/C handling charges and charges for ordinary bank services.

Taxation

Our taxation represents corporate income tax and deferred tax for the companies in our Group.

Hong Kong profits tax has been provided at the rate of 17.5% on the estimated assessable profit for the year. Overseas taxation is provided on the profit of the overseas subsidiaries in accordance with the tax laws of the countries in which these entities operate.

Deferred taxation is calculated in full on temporary differences under the liability method using taxation rate of 17.5% in Hong Kong, and of between 34% and 35% for federal and the applicable state tax rates for various states in the U.S.

FINANCIAL INFORMATION

The Group has sought professional tax advices in Hong Kong and U.S. to regularly update and review on the Group's position. The Group has complied with all relevant tax laws and regulations.

The taxation credit/(charge) for the Track Record Period can be reconciled to the profit/(loss) before taxation as follows:

| | Year ended 31 December | | | Six months ended 30 June | |
|---|-------------------------|-------------------------|-------------------------|-----------------------------|-------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| | | | | (Unaudited) | |
| Profit/(loss) before taxation | 155,249 | 89,329 | 30,157 | (32,275) | (9,300) |
| Applicable U.S. taxation rate | 42.57% | 42.32% | 43.46% | 43.46% | 42.84% |
| Calculated at above taxation rate | (66,093) | (37,805) | (13,105) | 14,026 | 3,984 |
| Effect of different taxation rates in other countries (<i>Note a</i>) | 64 | 2,701 | 3,460 | (3,492) | (894) |
| Tax on gain of transfer of subsidiaries in the U.S. arising from the Reorganization (<i>Note b</i>) | - | - | - | - | (8,680) |
| Non-taxable income (<i>Note b</i>) | 30 | 3,186 | 2,316 | 142 | 193 |
| Non-deductible expenses for tax purposes (<i>Note b</i>) | (1,485) | (350) | (3,388) | (401) | (211) |
| Unrecognised temporary differences (<i>Note b</i>) | (3,105) | 8,637 | 2,601 | (7) | - |
| Recognition of previously unrecognised deferred tax assets (<i>Note c</i>) | 133,930 | 38,596 | - | - | - |
| (Provisions)/over provisions for tax cases (<i>Note d</i>) | (37,482) | (471) | 4,048 | 3,558 | - |
| Prior year over/(under) provision | - | 171 | (94) | - | - |
| Others | - | 9 | 129 | 525 | 271 |
| Taxation credit/(charge) | 25,859 | 14,674 | (4,033) | 14,351 | (5,337) |

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Notes:

- (a) The “effect of different taxation rates in other countries” is mainly arising from the subsidiaries operate in Hong Kong, and their profits are calculated at Hong Kong profit tax rate.
- (b) These balances are calculated by using applicable tax rates on the following items:
- (i) Gain of transfer of subsidiaries in the U.S. which represents the capital gain arising from the process of the Reorganization.
 - (ii) Non-taxable income which is mainly comprised of bank interest income and share of profit of an associate.
 - (iii) Non-deductible expenses which are mainly comprised of share of loss of an associate, meals and entertainment, share option expenses, withholding tax on royalty and foreign tax.
 - (iv) Unrecognized temporary differences which are differences between the carrying amount of an asset or liability in the balance sheet and its tax based that have not been recognized in the financial statements of the Group.
- (c) Recognition of previously unrecognised deferred tax assets are mainly tax losses recognised and tax benefits on interest and state taxes associate with tax cases. Please refer to “Deferred tax assets” under “Critical Accounting Estimates and Judgements” in this Financial Information section for details.
- (d) Please refer to “Taxation” under “Factors Affecting Our Results of Operations and Financial Condition” in this Financial Information section for details.

SIX MONTHS ENDED 30 JUNE 2007 COMPARED TO SIX MONTHS ENDED 30 JUNE 2006

Turnover

Our turnover increased by 9.4% to HK\$347.6 million in the six months ended 30 June 2007, compared with HK\$317.6 million in the six months ended 30 June 2006. This resulted primarily from an increase in sales volumes due to the growth in non-U.S. sales, which increased from HK\$86.5 million to HK\$123.2 million.

| | Six months ended 30 June | | | |
|-------|---------------------------------|----------------------|-----------------------|----------------------|
| | 2006 | | 2007 | |
| | <i>HK\$'000</i> | <i>% of total</i> | <i>HK\$'000</i> | <i>% of total</i> |
| Boys | 152,373 | 48.0% | 200,110 | 57.6% |
| Girls | <u>165,206</u> | <u>52.0%</u> | <u>147,469</u> | <u>42.4%</u> |
| Total | <u><u>317,579</u></u> | <u><u>100.0%</u></u> | <u><u>347,579</u></u> | <u><u>100.0%</u></u> |

FINANCIAL INFORMATION

| | Six months ended 30 June | | | |
|--------------|---------------------------------|----------------------|-----------------------|----------------------|
| | 2006 | | 2007 | |
| | <i>HK\$'000</i> | <i>% of total</i> | <i>HK\$'000</i> | <i>% of total</i> |
| U.S. | 231,030 | 72.7% | 224,418 | 64.6% |
| Non-U.S. | <u>86,549</u> | <u>27.3%</u> | <u>123,161</u> | <u>35.4%</u> |
| Total | <u>317,579</u> | <u>100.0%</u> | <u>347,579</u> | <u>100.0%</u> |

Boys products increased to 57.6% of turnover in the six months ended 30 June 2007 from 48.0% in the prior period. This increase of HK\$47.7 million, or 31.3%, in dollar terms, is due to the increase in our action products, principally related to the release of a movie property, TMNT, in March 2007. Girls products decreased to 42.4% of turnover in the six months ended 30 June 2007 from 52.0% in the prior period. This decrease of HK\$17.7 million, or 10.7%, in dollar terms, is principally related to the phasing out of one of our doll lines.

Turnover from U.S. sales remained relatively constant in dollar terms during the first half of both years; however, as a percentage of turnover, sales to U.S. customers accounted for 64.6% in 2007 compared to 72.7% in 2006. This change is attributable to the increase in non-U.S. turnover in 2007 in the amount of HK\$36.6 million, or 42.3% compared to 2006. The increase is attributable to an increased sales in the action figures category, also coincident with the movie release, the introduction of new brands in certain non-U.S. markets and market expansion to more countries outside the U.S.

Cost of sales

Our cost of sales for the six months ended 30 June 2007 was HK\$183.3 million, an increase of HK\$9.8 million, or 5.6%, compared with our cost of sales of HK\$173.5 million for the six months ended 30 June 2006. The increase was primarily due to the increase in cost of inventories sold attributable to the increase in sales volume. This increase was partially offset by the decrease in product development costs.

Gross profits

Our gross profits for the six months ended 30 June 2007 were HK\$164.3 million, an increase of HK\$20.2 million or 14.1%, from our gross profits of HK\$144.1 million for the six months ended 30 June 2006. Our gross profit margin for the six months ended 30 June 2007 was 47.3%, compared with our gross profit margin of 45.4% for the six months ended 30 June 2006. The increase in our gross profit margin was primarily due to the decrease in product development cost as a result of the reduction of new products in the first quarter of 2007 as compared to the same period in 2006.

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Marketing expense

Our marketing expense totalled HK\$79.5 million for the six months ended 30 June 2007, a decrease of HK\$13.3 million or 14.3% from our marketing expense of HK\$92.8 million for the six months ended 30 June 2006. The decrease was primarily due to the net effect from (i) the increase in royalties as in line with increase in sales, and (ii) the reduction of spending in TV Media, a marketing activity in spring 2007.

Selling, distribution and administrative expenses

Our selling expenses for the six months ended 30 June 2007 were HK\$15.1 million, a decrease of HK\$0.2 million, or 1.1%, as compared with our selling expenses of HK\$15.3 million for the six months ended 30 June 2006. There was no material change.

Our distribution costs for the six months ended 30 June 2007 were HK\$9.9 million, an increase of HK\$0.6 million, or 6.2%, as compared with our distribution costs of HK\$9.3 million for the six months ended 30 June 2006. This increase was in line with the increase in sales.

Our administrative expenses for the six months ended 30 June 2007 were HK\$69.4 million, an increase of HK\$10.7 million, or 18.2%, as compared with our administrative expenses of HK\$58.7 million for the six months ended 30 June 2006. The increase was primarily due to a HK\$8.4 million increase in legal and professional expenses in relation to litigation issues (please refer to “LEGAL MATTERS” under “BUSINESS” section of this document for details) and the Reorganization and the Spin-off.

Operating profit/(loss)

Our operating loss for the six months ended 30 June 2007 was HK\$9.6 million, a decrease of HK\$22.5 million, or 70.0%, as compared with our operating loss of HK\$32.1 million for the six months ended 30 June 2006. Our operating loss margin for the six months ended 30 June 2007 was 2.8%, compared with our operating loss margin of 10.1% for the six months ended 30 June 2006. The improvement was primarily caused by the increase in turnover and gross profit margin and a decrease in marketing expenses as a percentage of sales.

Interest expense and bank charges

For the six months ended 30 June 2007 our costs were HK\$1.6 million, a decrease of HK\$0.1 million, or 2.9%, as compared with our cost of HK\$1.7 million for the six months ended 30 June 2006. The change is not material.

Profit/(loss) before taxation

As a result of the foregoing factors, our loss before income tax for the six months ended 30 June 2007 was HK\$9.3 million, a decrease of HK\$23.0 million, or 71.2%, as compared with our loss before income tax of HK\$32.3 million for the six months ended 30 June 2006.

FINANCIAL INFORMATION

Taxation

Our income tax charge for the six months ended 30 June 2007 was HK\$5.3 million compared with our income tax credit of HK\$14.4 million for the six months ended 30 June 2006. Tax credit was reduced due to the reduced loss incurred for the six months ended 30 June 2007. On the other hand, tax expenses incurred arose from the Reorganization.

Profit/(loss) after taxation

Our loss after taxation for the six months ended 30 June 2007 was HK\$14.6 million, a decrease of HK\$3.3 million, or 18.3%, from our loss after taxation of HK\$17.9 million for the six months ended 30 June 2006.

As discussed above under “FACTORS AFFECTING OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION” in this Financial Information section, we made loss for both six months ended 30 June 2006 and 2007 due to the seasonality factor.

Our net loss margin for the six months ended 30 June 2007 was 4.2%, compared with our net loss margin of 5.6% for the six months ended 30 June 2006. The improvement was mainly due to (i) the increase in gross profit margin as a result of decrease in product development cost, (ii) the decrease in marketing expenses as a percentage of sales due to reduction of marketing activity in spring 2007, (iii) a decrease in deferred tax credit in respect of tax losses as a result of the reduction in tax losses and (iv) tax expenses incurred arose from the Reorganization.

FINANCIAL INFORMATION

2006 COMPARED TO 2005

Turnover

Our turnover decreased by 11.7% to HK\$1,128.0 million in 2006 from HK\$1,277.6 million in 2005. The decrease was primarily due to a reduction in the sales of our action figures products during the transition year leading up to the release of a feature movie in March 2007. This decrease was partially offset by continuing introduction of new brands in our dolls products line, Disney Fairies and Strawberry Shortcake. As a result, sales of our girls products increased by HK\$285.6 million in 2006, representing 70.1% of our total turnover. We set forth in the tables below our turnover analysis by product categories and geographic segments in 2005 and 2006.

| | Year ended 31 December | | | |
|--------------|-------------------------------|----------------------|-------------------------|----------------------|
| | 2005 | | 2006 | |
| | <i>HK\$'000</i> | <i>% of total</i> | <i>HK\$'000</i> | <i>% of total</i> |
| Boys | 772,418 | 60.5% | 337,202 | 29.9% |
| Girls | <u>505,189</u> | <u>39.5%</u> | <u>790,795</u> | <u>70.1%</u> |
| Total | <u>1,277,607</u> | <u>100.0%</u> | <u>1,127,997</u> | <u>100.0%</u> |

| | Year ended 31 December | | | |
|--------------|-------------------------------|----------------------|-------------------------|----------------------|
| | 2005 | | 2006 | |
| | <i>HK\$'000</i> | <i>% of total</i> | <i>HK\$'000</i> | <i>% of total</i> |
| U.S. | 948,833 | 74.3% | 847,355 | 75.1% |
| Non-U.S. | <u>328,774</u> | <u>25.7%</u> | <u>280,642</u> | <u>24.9%</u> |
| Total | <u>1,277,607</u> | <u>100.0%</u> | <u>1,127,997</u> | <u>100.0%</u> |

In the third year after the initial launched of the Turtles animated television series, as viewership leveled out, the programs were aired less frequently and consequently sales declined. In addition, in 2005 and again in 2006, there were also other boys' action movies, such as Star Wars and Spiderman that drove their respective action figure toy products in direct competition with the Turtles brand. Therefore the boys categories declining in turnover as compared from year 2004 to 2006. During and subsequent to the Track Record Period, the Group has fulfilled the royalty payment and the annual minimum royalty under the Turtles license, therefore write-off of license fee is not necessary. Also, prepayment of royalty in advance is not even required from the Group under the Turtles license.

During 2006, there was no material change in our geographic sales mix; both segments recorded a decrease as the effect of the above-mentioned factors applied to both segments.

FINANCIAL INFORMATION

Cost of sales

Our cost of sales decreased by 7.9% to HK\$586.8 million in 2006 from HK\$637.3 million in 2005. The decrease was primarily due to the decline in cost of inventories sold and transportation costs attributable to the decrease in sales volume.

Gross profits

Our gross profits decreased by 15.5% to HK\$541.2 million in 2006 from HK\$640.3 million in 2005. Our gross profit margin for 2006 was 48.0%, compared with our gross profit margin of 50.1% in 2005. The decrease in our gross profit margin was primarily caused by the change in product mix with slightly lower profit margin and continuing investments in product development despite the decrease in sales.

Marketing expenses

Our marketing expenses decreased by HK\$9.3 million, or 3.0% to HK\$296.5 million in 2006 from HK\$305.8 million in 2005. The decrease was primarily due to the net result of (i) the reduction of royalties to licensors due to the lower sales volume, and (ii) the increase in marketing activities mainly in TV media expenses to promote our new products lines in the Girls Category.

Selling, distribution and administrative expenses

Our selling expense increased by HK\$8.4 million, or 16.7%, to HK\$58.8 million in 2006 from HK\$50.4 million in 2005. The increase was mainly due to a non-recurring reversal of provision for cooperative advertising in 2005 due to a modification in the terms of the Group's participation in one of our customers' advertising programmes from paying a fixed rate to paying on actual basis.

Our distribution costs decreased by 27.0% to HK\$27.0 million in 2006 from HK\$37.0 million in 2005. The decrease was mainly due to lower warehouse rent and the change of shipment terms for certain customers.

Our administrative expenses decreased by 15.3% from HK\$154.6 million in 2005 to HK\$130.9 million in 2006. The decrease was mainly due to the non-recurring legal and professional expenses amounted to HK\$17.9 million incurred in 2005 for a corporate reorganisation exercise.

Operating profit/(loss)

Our operating profit decreased by 69.8% from HK\$92.5 million in 2005 to HK\$28.0 million in 2006. Our operating profit margin for 2006 was 2.5%, compared with our operating profit margin 7.2% in 2005. The decrease in operating profit margin was primarily caused by the decrease in gross profit margin, as well as an increase in marketing expenses and selling expenses as a percentage of sales.

Interest expense and bank charges

Our costs decreased by 19.9% from HK\$7.3 million in 2005 to HK\$5.9 million in 2006. The decrease was primarily caused by a favourable renegotiation of the rate of receivable processing charges as well as a decrease in receivable processing charges due to the decrease in U.S. sales in 2006.

FINANCIAL INFORMATION

Profit/(loss) before taxation

As a result of the foregoing factors, our profit before income tax for 2006 was HK\$30.1 million, a decrease of HK\$59.2 million, or 66.2%, as compared with our profit before income tax HK\$89.3 million in 2005.

Taxation

Our income tax expenses for 2006 was HK\$4.0 million, compared with the net tax credits of HK\$14.7 million recognized in 2005. The credit in 2005 was due to the further recognition of deferred tax assets amounted to HK\$38.6 million while no such credit was recorded in 2006.

Profit/(loss) after taxation

Our profit after taxation decreased by 74.9% to HK\$26.1 million in 2006 from HK\$104.0 million in 2005. The decrease in our net profit by approximately HK\$77.9 million was mainly due to net effect of (i) the decrease in gross profit by approximately HK\$99.2 million due to the change in product mix and continuing investments in product development, (ii) the decrease in distribution costs by approximately HK\$10.0 million due to a lower warehouse rent and the change of shipment terms for certain customers, (iii) the decrease in administrative expenses by approximately HK\$23.7 million as a result of decrease in legal and professional expenses which mainly due to the non-recurring reorganization expenses incurred in 2005, and (iv) the decrease in tax credit by approximately HK\$18.7 million as no further recognition of deferred tax assets as in 2005.

Accordingly our net profit margin dropped from 8.1% in 2005 to 2.3% in 2006.

2005 COMPARED TO 2004

Turnover

Our turnover in 2005 was basically flat at HK\$1,277.6 million in 2005 compared to HK\$1,282.7 million in 2004; there was a reduction in the sales of two of our action figure products and vehicle products, and an increase in the sales of our dolls product line with the introduction of a new large doll, Amazing Amanda. The turnover analysis by product categories and geographic segments is shown in the following tables.

| | Year ended 31 December | | | |
|-------|------------------------|---------------|------------------|---------------|
| | 2004 | | 2005 | |
| | HK\$'000 | % of total | HK\$'000 | % of total |
| Boys | 913,360 | 71.2% | 772,418 | 60.5% |
| Girls | <u>369,302</u> | <u>28.8%</u> | <u>505,189</u> | <u>39.5%</u> |
| Total | <u>1,282,662</u> | <u>100.0%</u> | <u>1,277,607</u> | <u>100.0%</u> |

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| | Year ended 31 December | | | |
|--------------|-------------------------|----------------------|-------------------------|----------------------|
| | 2004 | | 2005 | |
| | <i>HK\$'000</i> | <i>% of total</i> | <i>HK\$'000</i> | <i>% of total</i> |
| U.S. | 1,000,310 | 78.0% | 948,833 | 74.3% |
| Non-U.S. | <u>282,352</u> | <u>22.0%</u> | <u>328,774</u> | <u>25.7%</u> |
| Total | <u>1,282,662</u> | <u>100.0%</u> | <u>1,277,607</u> | <u>100.0%</u> |

Our non-U.S. sales increased by 16.4% to HK\$328.8 million in 2005, which was mainly contributed by the increase in expanding sales to more European countries.

Cost of sales

Our cost of sales increased by 9.1% to HK\$637.3 million in 2005 from HK\$584.0 million in 2004. The increase was primarily due to increases in cost of inventories sold, transportation costs and investments in product development.

Gross profits

Our gross profits decreased by 8.3% to HK\$640.3 million in 2005 from HK\$698.6 million in 2004. Our gross profit margin for 2005 was 50.1%, compared with our gross profit margin of 54.5% in 2004. The decrease in our gross profit margin was primarily caused by lower product margins due to changes in product mix and geographic sale mix and increased spending on product development on new products which in line with our development strategies. There was also a one-time docking charges incurred in 2005 penalizing the delay of unloading goods from the shipyard.

Marketing expense

Our marketing expenses decreased by HK\$12.8 million, or 4.0% to HK\$305.8 million in 2005 from HK\$318.6 million in 2004. The decrease was mainly caused by the reduction of royalties to licensors due to the change in product mix with lower agreed royalty rates.

Selling, distribution and administrative expenses

Our selling expense decreased by HK\$7.0 million, or 12.3%, to HK\$50.4 million in 2005 from HK\$57.4 million in 2004. The decrease was primarily due to a non-recurring reversal of provision for cooperative advertising in 2005 due to a modification in the terms of the Group's participation in one of our customers' advertising programmes from paying a fixed rate to payment to actual basis.

Our distribution expenses increased by 19.3% to HK\$37.0 million in 2005 from HK\$31.0 million in 2004. The increase was primarily due to the increased fuel surcharges, increased use of airfreight, and the increase in the smaller shipments at higher rates due to retailer managing inventories more closely.

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Our administrative expenses increased by 22.9% from HK\$125.8 million in 2004 to HK\$154.6 million in 2005. The increase in administrative expenses was mainly due to the increase in legal and professional expenses incurred for a corporate reorganisation in 2005 amounted to HK\$17.9 million which ultimately had not been executed.

Operating profit/(loss)

Our operating profit decreased by 44.2% from HK\$165.7 million in 2004 to HK\$92.5 million in 2005. Our operating profit margin for 2005 was 7.2%, compared with our operating profit margin of 12.9% in 2004. The decrease in operating profit margin was primarily caused by the decrease in gross profit margin, as well as increases in distribution expenses and administrative expenses as a percentage of sales.

Interest expense and bank charges

Our costs decreased by 27.1% from HK\$10.1 million in 2004 to HK\$7.3 million in 2005. The decrease was primarily caused by the lower average borrowing balance as well as the reduced receivable processing charges due to the decrease in U.S. sale in 2005 compared to 2004.

Profit/(loss) before taxation

As a result of the foregoing factors, our profit before income tax decreased 42.5% from HK\$155.2 million in 2004 to HK\$89.3 million in 2005.

Taxation

In 2004, the net tax credits of HK\$25.9 million were the results of (i) the recognition of deferred tax assets in the amount of HK\$133.9 million in our U.S. subsidiaries by capitalizing net operating losses carried forward to the extent that realization of the related tax benefit through probable future taxable profits that were expected to be generated in future years, (ii) utilisation to deferred tax assets in the amount of HK\$68.0 million for taxable profits of the U.S. subsidiaries in 2004, and (iii) netting against a provision made for the tax cases in the U.S. amounting to HK\$37.5 million.

In 2005, the net tax credits of HK\$14.7 million were the results of (i) the recognition of deferred tax assets amounting to HK\$16.0 million in respect of tax benefits on interest and state taxes associated with the tax cases, (ii) the recognition of further deferred tax assets in the amount of HK\$22.6 million from our U.S. subsidiaries' net operating losses carried forward, and netting against (iii) utilisation of deferred tax assets for tax charges for taxable profits of these U.S. subsidiaries in 2005.

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Profit/(loss) after taxation

Our profit after taxation decreased by 42.6% to HK\$104.0 million in 2005 from HK\$181.1 million in 2004. The decrease in our net profit by approximately HK\$77.1 million was mainly due to net effect of (i) the decrease in gross profit by approximately HK\$58.3 million due to the change in product mix and geographic sale mix and continuing investments in product development, (ii) the decrease in marketing expenses by approximately HK\$12.8 million as a result of the reduction in royalties due to the change in product mix, (iii) the increase in administrative expenses by approximately HK\$28.8 million as a result of increase in legal and professional expenses which was mainly due to the non-recurring reorganization expenses incurred in 2005, and (iv) the decrease in tax credit by approximately HK\$11.2 million.

Accordingly our net profit margin dropped from 14.1% in 2004 to 8.1% in 2005.

OVERALL ANALYSIS FOR 2004, 2005 AND 2006

Turnover for the three years ended 31 December 2004, 2005 and 2006 was HK\$1,282.7 million, HK\$1,277.6 million and HK\$1,128.0 million respectively. There was no significant change in turnover for 2005 while that was dropped by 11.7% in 2006. The decrease in turnover in 2006 was mainly due to overall industry wide growth stagnation and the shrinkage of sales in action figures, one of our key toy categories.

Net profit for the three years ended 31 December 2004, 2005 and 2006 was HK\$181.1 million, HK\$104.0 million and HK\$26.1 million respectively. Net profit of the Group was materially affected by the following charging/crediting factors:

- (i) Recognition of previously unrecognized deferred tax assets (2004: a credit of HK\$133.9 million; 2005: a credit of HK\$38.6 million; 2006: Nil)
- (ii) Provisions for tax cases (2004: HK\$37.5 million; 2005: HK\$0.5 million; 2006: a credit of HK\$4.0 million)
- (iii) A non-recurring legal and professional expenses incurred for 2005 corporate reorganization (2004: Nil; 2005: HK\$17.9 million; 2006: Nil)

The above factors were not the only causes for the decline of the Group's profitability during the Track Record Period. As the Group still incurred relatively high fixed costs (including product development cost, marketing and administrative expenses) even through turnover was dropped by 11.7%, the net profit margin was comparatively lower for the year ended 31 December 2006.

Since the Group mainly engages in toy designing and marketing, one of its prime objectives is to enhance and extend the brand equity of its licensed brands and proprietary brands by introducing new product lines to enhance the appeal and to extend the life of these brands. Therefore, the Group has to commit considerable amounts of product development costs, marketing and promotional expenses in order to maintain a profitable business. At the same time, the Group incurs regular administrative expenses which are fixed or relatively fixed in nature, such as staff cost, rental expenses and legal and professional fees. As a result, the Group operated on a relatively high cost base in terms of its level of sales volume during the Track Record Period and we may make losses in the future if we

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are unable to achieve a higher level of sales volume that allows us to benefit considerably from an economy of scale. The management believes that an increase in the sales volume of the Group could be achieved through having a larger number of successful product brands and/or generate a larger sales volume from established product brands.

The Company will be implementing the growth strategy as described in the section headed “BUSINESS – OUR GROWTH STRATEGY” which we believe would be beneficial to the future business prospects and profit generating power of the Company.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of liquidity and capital resources have been, and are expected to continue to be, cash flow from operating activities and bank borrowings. Our principal uses of cash have been, and expect to continue to be, for the payment to suppliers of manufactured goods, marketing and various operating expenses.

Our cash flow

The following table presents selected data from our combined cash flow statements for the years ended 31 December 2004, 2005 and 2006 and for periods ended 30 June 2006 and 2007, as derived from “APPENDIX I – ACCOUNTANTS’ REPORT”.

| | Year ended 31 December | | | Six months ended 30 June | |
|--|-------------------------|-------------------------|-------------------------|-----------------------------|-------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| | | | | (Unaudited) | |
| Net cash generated from/ (used in) operating activities | 111,256 | 42,136 | (41,688) | 53,262 | 72,712 |
| Net cash (used in)/generated from investing activities | (2,600) | (1,063) | 4,672 | 2,231 | 1,380 |
| Net cash (used in)/generated from financing activities | (122,411) | (407) | 47,500 | (19,000) | (67,530) |
| Exchange rate changes | – | – | – | (103) | – |
| Cash and cash equivalents at 1 January | 53,146 | 39,391 | 80,057 | 80,057 | 90,541 |
| Cash and cash equivalents at 31 December/30 June | <u>39,391</u> | <u>80,057</u> | <u>90,541</u> | <u>116,447</u> | <u>97,103</u> |

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Cash flow from operating activities

Net cash generated from operating activities for the six months ended 30 June 2007 was HK\$72.7 million while the loss before taxation was HK\$9.3 million. The difference of HK\$82.0 million was primarily due to the decrease in receivables of HK\$224.9 million offset by a decrease of accrued charges and provisions of HK\$131.5 million.

Net cash used in operating activities for the year ended 31 December 2006 was HK\$41.7 million while the profit before taxation was HK\$30.2 million. The difference of HK\$71.9 million was mainly due to overseas tax payment to settle cases in the U.S. related to our subsidiaries in the aggregate amount of HK\$69.1 million.

Net cash generated from operating activities for the year ended 31 December 2005 was HK\$42.1 million while the profit before taxation was HK\$89.3 million. The difference of HK\$47.2 million was principally due to the increase of inventories and receivables of HK\$20.9 million and HK\$47.7 million respectively offset by an increase of payables of HK\$19.4 million.

Net cash generated from operating activities for the year ended 31 December 2004 was HK\$111.3 million while the profit before taxation was HK\$155.2 million. The difference of HK\$43.9 million was principally due to the increase of receivables of HK\$72.6 million offset by an increase in payables of HK\$30.2 million.

Cash flow from investing activities

Net cash generated from investing activities for the six months ended 30 June 2007 was HK\$1.4 million as a result of interest income from bank deposits in the amount of HK\$2.4 million net of the purchase of fixed assets in the amount of HK\$1.0 million.

Net cash generated from investing activities for the year ended 31 December 2006 was HK\$4.7 million as a result of interest income from bank deposits in the amount of HK\$5.1 million net of the purchase of fixed assets of HK\$0.4 million.

Net cash used in investing activities for the year ended 31 December 2005 was HK\$1.1 million as a result of the purchase of fixed assets of HK\$4.1 million net of interest income from bank deposits in the amount of HK\$3 million.

Net cash used in investing activities for the year ended 31 December 2004 was HK\$2.6 million as a result of the purchase of fixed assets of HK\$3.3 million net of interest income from bank deposits in the amount of HK\$0.7 million.

Cash flow from financing activities

Net cash used in financing activities for the six months ended 30 June 2007 was HK\$67.5 million and was mainly represented repayment of bank loans in the amount of HK\$66.5 million and dividend payment by one of the Group's subsidiaries, and offset by contribution by the Group's intermediate holding company as a result of the Reorganisation.

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Net cash generated from financing activities for the year ended 31 December 2006 was HK\$47.5 million related to an increase in outstanding bank loans at year end.

Net cash used in financing activities for the year ended 31 December 2005 was HK\$0.4 million related to the net repayment of bank loans.

Net cash used in financing activities for the year ended 31 December 2004 was HK\$122.4 million related to the net repayment of bank loans.

INDEBTEDNESS

Borrowings

Our borrowings as at 31 December 2004, 2005 and 2006, 30 June 2007 and 31 October 2007, are set forth below:

| | As at 31 December | | | As at 30 June | As at 31 October |
|----------------------|-------------------|-----------------|-----------------|------------------|---------------------|
| | 2004 | 2005 | 2006 | 2007 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Current: | | | | | |
| Unsecured bank loans | 19,500 | 19,000 | 66,500 | – | – |

At the close of business on 31 October 2007, being the latest practicable date prior to the printing of this document for the purpose of ascertaining information in respect of the indebtedness of the Group, the Group had banking facilities amounting to approximately HK\$255 million (31 December 2004, 2005 and 2006, and 30 June 2007: HK\$255 million). As at 31 October 2007, the Group had unutilized banking facilities amounting to approximately HK\$255 million (31 December 2004: HK\$235.5 million; 31 December 2005: HK\$236 million; 31 December 2006: HK\$188.5 million; 30 June 2007: HK\$255 million).

Our bank borrowings, denominated in HK dollars, are unsecured short-term working capital loans from various banking institutions. The borrowed funds are primarily used to pay manufacturers of our products. Similar to our business cycle, our bank borrowing is seasonal and is generally incurred in the third or fourth quarter of the year and repaid in the first quarter of the following year.

During the Track Record Period, the Group's cash and bank balances were continuously increased (31 December 2004: HK\$39.4 million; 31 December 2005: HK\$80.1 million; 31 December 2006: HK\$90.5 million; 30 June 2007: HK\$97.1 million). In the second half year of 2006, the Group settled its tax payable in relation to two tax cases amounted to approximately HK\$69 million with its internal resources. Subsequently, in order to fulfill its seasonal funding requirements, the Group borrowed loan of approximately HK\$66.5 million in 2006 and repaid the loan in early 2007.

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At the close of businesses on 31 October 2007, being the latest practicable date prior to the printing of this document for the purpose of ascertaining information in respect of the indebtedness of the Group, the Group did not have any loan capital issued and outstanding or agreed to be issued, bank overdrafts, loans or other similar indebtedness, liabilities under acceptances or acceptable credits, debentures, mortgages, charges, hire purchase commitments, guarantees or other material contingent liabilities.

Off-balance sheet arrangements

As at 30 June 2007, we did not have any off-balance sheet arrangements with unconsolidated entities.

CAPITAL EXPENDITURES

Our capital expenditures are primarily related to our purchase of equipment, furniture and fixtures, computer hardware and software, and leasehold improvements. We have funded our historical capital expenditure through cash flows generated from operating activities.

Our capital expenditures were HK\$3,339,000, HK\$4,065,000 and HK\$463,000 for the years ended 31 December 2004, 2005 and 2006. Capital expenditures in the future are expected to be in the range of HK\$2,000,000 to HK\$5,000,000 per year.

COMMITMENTS

Licensing commitments

In the normal course of business, we enter into contractual licensing agreements to secure rights to design, develop, market and distribute certain toys and family entertainment activity products for future sales. Certain licensing agreements contain financial commitments to the licensors to be fulfilled during the terms of the contracts. The amounts of financial commitments contracted but not provided for at the end of the year/period were payable as follows:

| | As at 31 December | | | As at |
|---|-------------------|---------------|---------------|---------------|
| | 2004 | 2005 | 2006 | 30 June |
| | HK\$'000 | HK\$'000 | HK\$'000 | 2007 |
| | | | | HK\$'000 |
| Within one year | 17,470 | 31,220 | 24,469 | 38,083 |
| In the second to fifth years inclusive | 15,990 | 20,475 | 19,188 | 22,698 |
| | <u>33,460</u> | <u>51,695</u> | <u>43,657</u> | <u>60,781</u> |

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Operating lease commitments

The Group acts as lessee under operating leases. Details of the Group's commitments under non-cancellable operating leases are set out as follows:

At the balance sheet dates, the future aggregate minimum lease payments under non-cancellable operating leases for office and warehouse facilities payable by the Group were as follows:

| | As at 31 December | | | As at 30 June |
|---|-------------------|-----------------|-----------------|------------------|
| | 2004 | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Within one year | 9,925 | 9,871 | 7,731 | 6,722 |
| In the second to fifth years inclusive | 25,282 | 19,122 | 11,548 | 8,999 |
| After the fifth year | 1,274 | – | – | – |
| | 36,481 | 28,993 | 19,279 | 15,721 |

WORKING CAPITAL

Taking into account our operating cash flow and available banking facilities, we believe that we have sufficient working capital for our present requirements and for the next 12 months from the date of this document.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

We are exposed to various types of market risks, including changes in interest rate risks and foreign exchange risks and credit risk in the normal course of business.

Interest rate

The Group maintains revolving credit facilities with commercial banks that is used as the primary source of financing for the short term seasonal working capital requirement.

Foreign exchange

We conduct our business primarily in U.S. dollars and Hong Kong dollars. All sales are denominated in U.S. dollars while purchases of our products from our vendors are in Hong Kong dollars. Other operating expenses are mainly in U.S. dollars and Hong Kong dollars. We are exposed to foreign currency risks primarily through sales that are denominated in a currency other than the functional currency of the operations of certain subsidiaries to which they relate. The currency giving rise to this risk is principally U.S. dollars. We do not hedge our foreign currency risks, as the rate of

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exchange between U.S. dollars to Hong Kong dollars is controlled within a tight range. Permanent changes in foreign exchange rates would have an impact on combined earnings.

Credit risk

Financial instruments that subject the Group to credit risk include cash equivalents and trade receivables. Cash equivalents consist principally of deposits and short-term money market funds placed with major financial institutions. These instruments are short-term in nature and bear minimal risk. To date, we have not experienced any losses on cash equivalents.

We sell our products primarily to national and regional mass-market retailers in the U.S. and to third party independent distributors outside the U.S. Credit is extended to U.S. customers for domestic sales based on an evaluation of the customers' financial condition and generally collateral is not required. We assign the majority of our U.S. trade receivables to factoring and receivable processing agencies. It is a common industrial practice in the United States. The factoring and receivable processing agent would perform credit analysis of our customers, credit approval and collection processing of the receivables. These agreements transfer the credit risk due to a customer's inability to pay to the factoring and receivable processing agent so as to mitigate credit exposure of the Group. Generally, direct shipments to customers who are located either in the U.S. or outside of the U.S. are secured by letters of credit. We did not experience material credit losses during the Track Record Periods.

Financial Instruments

We have not entered into any financial instruments for hedging purposes.

DISCLOSURE REQUIRED UNDER THE LISTING RULES

We confirm that, as of 30 June 2007 we are not aware of any circumstances that would give rise to a disclosure requirement under Listing Rules 13.13 to 13.19.

DISTRIBUTABLE RESERVES

The Company was incorporated in Bermuda on 11 April 2005. Distributable reserves of the Company amounted to HK\$146 million as at 30 June 2007, being the date which our latest audited financial statements were made of.

DIVIDEND POLICY

We may distribute dividends by way of cash or by other means that we consider appropriate. A decision to distribute any dividends would require the approval of our Board and will be at their discretion, subject to any requirements in our Bye-laws. In addition, any final dividend for a financial year will be subject to Shareholders' approval.

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A decision to declare or to pay any dividends in the future, and the amount of any dividends, depend on a number of factors, including our results of operations, working capital requirements, financial condition, statutory and regulatory restrictions on the payment of dividends, taxation considerations, future prospects and other factors that our Directors may consider important.

There can be no assurance that we will declare or distribute any dividend. There has been no historical dividend distribution (other than a distribution solely for the purposes of effecting the Reorganisation) and we currently do not have a definitive dividend payout plan or policy and tentative dividend payout ratio. The dividend distribution record of PHL in the past may not be used as a reference or basis to determine the level of dividends that may be declared or paid by us in the future.

NO MATERIAL ADVERSE CHANGE

The Directors have confirmed that there has been no material adverse change in our financial or trading position since 30 June 2007, being the date of our latest audited combined financial results as set out in “APPENDIX I – ACCOUNTANTS’ REPORT” to this document.

CHANGE OF AUDITORS OF PLAYMATES GROUP

During the Tack Record Period, PricewaterhouseCoopers resigned as the auditors of Playmates Group and Moores Rowland Mazars was appointed as the auditors of Playmates Group. PHL announced this change of auditors and the reasons therefor in its announcement dated 9 December 2005 (the “2005 Announcement”). PHL understood from PricewaterhouseCoopers that the admission from a senior officer of PTI, a principal subsidiary of the Group, related to deliberate; (1) over provisioning for potential customer claims of mark down allowances (which was disclosed as allowance for customer concession in this listing document) due to unsold goods owned by customers at the end of 2004 financial year; and (2) incorrect recognition of revenue on sales goods on freight prepaid terms at the time when they leave their warehouse. Base on the finding of an investigation conducted by an independent legal counsel in U.S. and investigation of PHL’s audit committee, PHL’s audit committee was of the view, and its board of directors concurred that (a) in relation to issue (1), there is no evidence to substantiate any deliberate over provisioning on the part of PHL’s management; and (b) in relation to issue (2), the issue was an accounting oversight which had not been raised in previous audits but which had an insignificant effect on the accounts of Playmates Group. For further details, please refer to the 2005 Announcement.

Management of the Group considers that the above issue has no material impact on its results of operations or financial position.

FUTURE PLANS AND STRATEGIES

We will continue to grow our business by acquiring license rights on children's entertainment properties by working closely with our existing and potential licensing partners. We intend to expand our product offerings into targeted growth categories such as arts and crafts, preschool and youth electronics to capture the latest market trends. In fall 2008, we will introduce our new range of youth electronic toys, Playmates Electronics.

We intend to broaden domestic and worldwide distribution channels by placing our products into non-traditional channels and capitalize on growth opportunities outside the U.S. by expanding our network of independent distributors in over 50 countries around the world.

REASONS FOR THE INTRODUCTION

We believe that listing on the Stock Exchange is a significant positive step in the long term strategic development of our business. In particular, we believe a listing on the Stock Exchange may benefit the Company in the following ways:

- (i) ***Enhancing our business profile:*** a listing on the Stock Exchange will enhance our profile amongst licensors, customers, suppliers and other business partners, as well as our ability to recruit the best talents available.
- (ii) ***Improving our profile with major customers:*** with the ongoing trend of retail consolidation in our key markets, competition for the business of a diminishing number of customers becomes more and more severe. Retailers, including our existing customers such as Wal-Mart, Target and Toys “R” Us, are continuously rationalising the number of suppliers that they deal with by focusing on suppliers who not only can offer unique products, but also have the financial means to provide marketing and selling supports for their products. Our enhanced profile described at paragraph (i) above, resulting from a listing on an internationally recognised exchange such as the Stock Exchange, would enhance our ability to compete with our direct competitors (including U.S. listed companies such as Mattel Inc., Hasbro Inc., Jakks Pacific Inc. and RC2 Corporation) for, and to retain, major customers.
- (iii) ***Securing major licences:*** a key element of our success lies in our ability to continue to create new products and brands. A major source of new products and brands comes from licensors of intellectual properties from the entertainment industry (examples of which include Disney, Universal Studios, Warner Bros Studio, DreamWorks, 20th Century Fox and Nickelodeon). Our enhanced profile described at paragraph (i) above would enhance our ability to compete with our direct competitors in securing such licences.
- (iv) ***Providing new sources of capital opportunity:*** a listing on the Stock Exchange will enable us to directly and independently access both equity and debt capital markets, as well as secure bank credit facilities.
- (v) ***Incentivizing executives and staff:*** as a listed company we would be able to offer an equity based incentive program (such as a stock option scheme) that correlates directly to the performance of the toy business to our employees and we would therefore be in a better position to motivate our employees with incentive programs that closely align with the objective of shareholder value creation.

REASONS FOR THE INTRODUCTION

- (vi) ***Increasing management focus and motivation:*** our independent listing will lead to a more direct alignment of our management responsibilities and accountability with our operating and financial performance. This will result in enhanced management focus, which should in turn lead to improved decision-making processes, faster response-times to market changes and increased operational efficiency. Our top management will be under direct and heightened scrutiny from the investor community and it will be possible to measure their performance against our stock market performance relative to our industry peers listed on international stock exchanges. It will also be possible to link management incentives to such performance, thereby increasing management motivation and commitment.

- (vii) ***Creating our own investor base:*** our separate listing will enable us to create our own investor base and improve our ability to raise capital for our future growth and expansion. Our position as a standalone company would lead to the availability of clearer and more transparent information on our business operations and financial status, thereby allowing the investment community to analyze us more objectively and making us more comparable to industry peers that are listed on international stock exchanges.

- (viii) ***Clarity of credit profile:*** separate listing will also provide clarity of credit profile for rating agencies and financial institutions that wish to analyze and lend against the credit or rating of a pure toy business company.

As there is no current funding requirement for the Group, no raising funds is arranged as part of this Introduction.

Moores Rowland

摩斯倫 會計師事務所

Chartered Accountants
Certified Public Accountants701 Sunning Plaza
10 Hysan Avenue
Causeway Bay, Hong Kong
香港銅鑼灣希慎道10號新寧大廈701室Tel 電話 : (852) 2218 3000
Fax 傳真 : (852) 2218 3500

31 December 2007

The Directors

Playmates Toys Limited**WAG Worldsec Corporate Finance Limited**

Dear Sirs,

We set out below our report on the financial information (the “Financial Information”) relating to Playmates Toys Limited (the “Company”, formerly known as Playmates Limited) and its subsidiaries (hereinafter collectively referred to as the “Group”) for each of the three years ended 31 December 2004, 2005 and 2006 and the six months ended 30 June 2007 (the “Relevant Periods”) for inclusion in the listing document of the Company dated 31 December 2007 (the “Listing Document”) in connection with the listing of the entire issued share capital of the Company on the Main Board of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) by way of introduction.

The Company was incorporated as an exempted company with limited liability in Bermuda on 11 April 2005 under the Companies Act 1981 of Bermuda. Pursuant to the group reorganization as described in Note 1 of Section VI below and Appendix IV to this Listing Document (the “Reorganization”), the Company became the holding company of the subsidiaries now comprising the Group as at the date of this report.

As at the date of this report, the Company has direct and indirect interests in the following subsidiaries:

| Name of company | Place of incorporation/ establishment | Date of incorporation | Total issued and fully paid ordinary/registered capital | Proportion of ownership interest held by the Company | | Principal activities, place of operation |
|------------------------------------|--|-----------------------|---|--|------------|--|
| | | | | Directly | Indirectly | |
| Playmates Toys Enterprises Limited | The British Virgin Islands | 17 May 2007 | 1 ordinary share of US\$1 | 100% | – | Investment holding, Hong Kong |
| Playmates Inc. | Delaware, U.S. | 21 October 1996 | 31,020,400 common stock of US\$0.01 each | – | 100% | Investment holding, U.S. |

| Name of company | Place of incorporation/ establishment | Date of incorporation | Total issued and fully paid ordinary/registered capital | Proportion of ownership interest held by the Company | | Principal activities, place of operation |
|--------------------------------------|--|-----------------------|---|--|------------|--|
| | | | | Directly | Indirectly | |
| Playmates Asia Services Limited | The British Virgin Islands | 5 January 1999 | 1 ordinary share of US\$1 | - | 100% | Provision of services, Hong Kong and PRC |
| Playmates Toys Inc. | California, U.S. | 29 November 1982 | 305,000 common stock of US\$30 each | - | 100% | Toys development, marketing and distribution, U.S. |
| Playmates Toys International Limited | Hong Kong | 22 December 2004 | 1 ordinary share of US\$1 | - | 100% | Toys distribution in non-U.S. markets, Hong Kong |
| Playmates Toys Asia Limited | Hong Kong | 25 May 2007 | 1 ordinary share of HK\$1 | - | 100% | Provision of services and trading, Hong Kong |
| Next Electronix, LLC | California, U.S. | 1 September 2004 | No registered capital* | - | 100% | Inactive |
| Regarding Play Inc. | Delaware, U.S. | 23 June 1999 | 270,230,000 common stock of US\$0.01 each | - | 100% | Inactive |
| Playmates China Holdings Limited | Hong Kong | 25 May 2007 | 1 ordinary share of HK\$1 | - | 100% | Investment holding, Hong Kong |
| Playmates Toys China Limited | PRC | 26 November 2007 | HK\$1,000,000 registered capital | - | 100% | Provision of services, PRC |

* The Limited Liability Operating Agreement is entered between Next Electronix, LLC and Playmates Toys Inc., a California corporation as the sole member of Next Electronix, LLC and no capital contribution was required.

All companies comprising the Group adopt 31 December as the financial year end date.

We have acted as the auditors of Playmates Holdings Limited, the ultimate holding company of the Company and its subsidiaries, for the years ended 31 December 2005 and 2006 and we have issued audited financial statements for the following Hong Kong and British Virgin Islands subsidiaries of the Group for the years then ended:

Playmates Asia Services Limited
Playmates Toys International Limited

PricewaterhouseCoopers were the auditors of Playmates Holdings Limited for the year ended 31 December 2004 and have issued audited financial statements for the following British Virgin Islands subsidiary of the Group for the year then ended:

Playmates Asia Services Limited

Playmates Toys International Limited was incorporated in December 2004, therefore no audited financial statements were prepared for the year ended 31 December 2004. Playmates Toys Asia Limited and Playmates China Holdings Limited were incorporated in May 2007, no audited financial statements have been issued since their dates of incorporation.

We have audited the consolidated financial statements of Playmates Inc. and its subsidiaries for the years ended 31 December 2004, 2005 and 2006. The subsidiaries of Playmates Inc. included Playmates Asia Services Limited, Playmates Toys Inc., Playmates Toys International Limited, Next Electronix, LLC and Regarding Play Inc.

Since its date of incorporation, the Company has not carried on any business, other than the Reorganization and other events stated in Appendix IV of the Listing Document. We have audited the consolidated financial statements of the Company and its subsidiaries for the six months ended 30 June 2007.

Except for Playmates Asia Services Limited and Playmates Inc. no audited financial statements have been issued for individual companies of the Group that were incorporated in the British Virgin Islands and United States since their respective dates of incorporation as there are no statutory audit requirements in these jurisdictions.

Playmates Toys China Limited was incorporated on 26 November 2007 in the PRC, no audited financial statements have been issued since its date of incorporation.

For the purpose of this report, the Financial Information has been prepared by the directors of the Company based on the audited financial statements of the companies comprising the Group, on the basis set out in Note 1 of Section VI below, after making such adjustments as are appropriate.

The directors of the Company are responsible for the preparation and true and fair presentation of the Financial Information in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of Financial Information 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 circumstance. The directors of the Company are also responsible for the contents of the Listing Document in which this report is included. It is our responsibility to form an independent opinion on the Financial Information and to report our opinion to you.

For the Financial Information for the Relevant Periods, we have carried out independent audit procedures on the Financial Information in accordance with Hong Kong Standards on Auditing issued by the HKICPA. We examined the Financial Information and carried out such additional procedures as are necessary in accordance with Auditing Guideline 3.340 "Prospectuses and the Reporting Accountants" issued by HKICPA.

In our opinion, on the basis of preparation set out in Note 1 of Section VI below, the Financial Information gives, for the purpose of this report, a true and fair view of the state of affairs of the Company as at 31 December 2005 and 2006 and 30 June 2007 and of the Group as at 31 December 2004, 2005 and 2006 and 30 June 2007 and of the combined results and cash flows of the Group for the Relevant Periods.

The comparative combined income statement, combined cash flow statement and combined statement of changes in equity of the Group for the six months ended 30 June 2006 together with the notes thereon have been extracted from the Group's combined financial statements for the same period ("30 June 2006 Financial Information") which were prepared by the directors of the Company solely for the purpose of this report. We have reviewed the 30 June 2006 Financial Information in accordance with Hong Kong Standard on Review Engagements 2410 "Review of interim financial information performed by the independent auditor of the entity" issued by the HKICPA. Our review consisted principally of making enquiries of Group management and applying analytical procedures

to the 30 June 2006 Financial Information and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the 30 June 2006 Financial Information. On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the 30 June 2006 Financial Information.

I. COMBINED INCOME STATEMENTS

| | <i>Notes</i> | <u>Year ended 31 December</u> | | | <u>Six months ended 30 June</u> | |
|--|--------------|-------------------------------|-----------------------|----------------------|---------------------------------|------------------------|
| | | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2006</u> | <u>2007</u> |
| | | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| | | | | | (Unaudited) | |
| Turnover | 5 | 1,282,662 | 1,277,607 | 1,127,997 | 317,579 | 347,579 |
| Cost of sales | | <u>(584,035)</u> | <u>(637,264)</u> | <u>(586,826)</u> | <u>(173,510)</u> | <u>(183,254)</u> |
| Gross profit | | 698,627 | 640,343 | 541,171 | 144,069 | 164,325 |
| Marketing expenses | | (318,646) | (305,822) | (296,536) | (92,840) | (79,525) |
| Selling expenses | | (57,410) | (50,377) | (58,770) | (15,277) | (15,103) |
| Distribution costs | | (31,013) | (37,002) | (27,025) | (9,307) | (9,884) |
| Administrative expenses | | <u>(125,837)</u> | <u>(154,623)</u> | <u>(130,867)</u> | <u>(58,736)</u> | <u>(69,431)</u> |
| Operating profit/(loss) | 9 | 165,721 | 92,519 | 27,973 | (32,091) | (9,618) |
| Non-operating income/(expenses) | | | | | | |
| Interest expense and bank charges | 7 | (10,071) | (7,341) | (5,877) | (1,667) | (1,618) |
| Other revenue | 5 | 739 | 3,002 | 5,131 | 2,406 | 2,421 |
| Share of (loss)/profit of an associate | | <u>(1,140)</u> | <u>1,149</u> | <u>2,930</u> | <u>(923)</u> | <u>(485)</u> |
| Profit/(loss) before taxation | | 155,249 | 89,329 | 30,157 | (32,275) | (9,300) |
| Taxation credit/(charge) | 8 | <u>25,859</u> | <u>14,674</u> | <u>(4,033)</u> | <u>14,351</u> | <u>(5,337)</u> |
| Profit/(loss) for the year/period | | <u><u>181,108</u></u> | <u><u>104,003</u></u> | <u><u>26,124</u></u> | <u><u>(17,924)</u></u> | <u><u>(14,637)</u></u> |
| Dividends | 12 | <u><u>-</u></u> | <u><u>-</u></u> | <u><u>-</u></u> | <u><u>-</u></u> | <u><u>36,660</u></u> |
| Earnings/(loss) per share | | <i>HK cents</i> | <i>HK cents</i> | <i>HK cents</i> | <i>HK cents</i> | <i>HK cents</i> |
| Basic | 13 | <u><u>36.59</u></u> | <u><u>21.01</u></u> | <u><u>5.28</u></u> | <u><u>(3.62)</u></u> | <u><u>(2.96)</u></u> |

II. COMBINED BALANCE SHEETS

| | Notes | As at 31 December | | | As at |
|---|-------|-------------------|------------------|------------------|-----------------------------|
| | | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 30 June 2007 HK\$'000 |
| Non-current assets | | | | | |
| Property, plant and equipment | 14 | 7,277 | 8,324 | 5,904 | 5,521 |
| Investment in an associate | 16 | 24,717 | 25,866 | 26,346 | 25,861 |
| Deferred tax assets | 26 | 68,391 | 85,728 | 80,077 | 75,096 |
| | | <u>100,385</u> | <u>119,918</u> | <u>112,327</u> | <u>106,478</u> |
| Current assets | | | | | |
| Inventories | 17 | 36,736 | 57,606 | 49,353 | 48,917 |
| Trade receivables | 18 | 336,433 | 371,370 | 353,212 | 121,593 |
| Other receivables, deposits and prepayments | 19 | 31,685 | 44,442 | 59,759 | 66,452 |
| Amount due from a fellow subsidiary | 20(a) | – | 130 | 244 | 29 |
| Amount due from intermediate holding companies | 20(a) | 2,450 | 2,543 | 4,993 | 4,993 |
| Taxation recoverable | 21 | – | – | 1,043 | 1,059 |
| Cash and bank balances | 29(b) | 39,391 | 80,057 | 90,541 | 97,103 |
| | | <u>446,695</u> | <u>556,148</u> | <u>559,145</u> | <u>340,146</u> |
| Current liabilities | | | | | |
| Bank loans | 24 | 19,500 | 19,000 | 66,500 | – |
| Trade payables | 22 | 61,643 | 90,777 | 91,041 | 47,517 |
| Other payables and accrued charges | 23 | 129,149 | 132,489 | 122,976 | 57,458 |
| Amount due to a fellow subsidiary | 20(a) | 1,500 | – | – | – |
| Amount due to the ultimate holding company | 20(a) | 6,884 | 14,245 | 19,942 | 8,355 |
| Provisions | 25 | 64,809 | 51,775 | 49,260 | 26,780 |
| Taxation payable | 21 | 72,998 | 72,817 | 755 | 1,183 |
| | | <u>356,483</u> | <u>381,103</u> | <u>350,474</u> | <u>141,293</u> |
| Net current assets | | <u>90,212</u> | <u>175,045</u> | <u>208,671</u> | <u>198,853</u> |
| Total assets less current liabilities | | <u>190,597</u> | <u>294,963</u> | <u>320,998</u> | <u>305,331</u> |
| Non-current liabilities | | | | | |
| Deferred tax liabilities | 26 | – | 270 | 181 | 181 |
| Net assets | | <u>190,597</u> | <u>294,693</u> | <u>320,817</u> | <u>305,150</u> |
| Capital and reserves | | | | | |
| Share capital | 27(a) | 2,420 | 93 | 93 | 93 |
| Reserves | | <u>188,177</u> | <u>294,600</u> | <u>320,724</u> | <u>305,057</u> |
| Shareholders' funds | | <u>190,597</u> | <u>294,693</u> | <u>320,817</u> | <u>305,150</u> |

III. BALANCE SHEETS OF THE COMPANY

| | <i>Notes</i> | As at 31 December | | As at |
|--|--------------|--------------------------|-----------------|-----------------|
| | | 2005 | 2006 | 30 June |
| | | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>2007</i> |
| | | | | <i>HK\$'000</i> |
| Non-current assets | | | | |
| Investment in a subsidiary | 15 | – | – | 146,171 |
| Current assets | | | | |
| Other receivables, deposits and prepayments | | 32 | 32 | 50 |
| Amount due from an intermediate holding company | 20(b) | 93 | 93 | 93 |
| | | 125 | 125 | 143 |
| Current liabilities | | | | |
| Other payables | | – | – | 40 |
| Amount due to a fellow subsidiary | 20(b) | 56 | 106 | 106 |
| | | 56 | 106 | 146 |
| Net current assets/(liabilities) | | 69 | 19 | (3) |
| Net assets | | 69 | 19 | 146,168 |
| Capital and reserves | | | | |
| Share capital | 27(a) | 93 | 93 | 93 |
| Contributed surplus | 27(b) | – | – | 146,171 |
| Accumulated losses | | (24) | (74) | (96) |
| | | 69 | 19 | 146,168 |

IV. COMBINED STATEMENTS OF CHANGES IN EQUITY

| | Share capital <i>(Note 27(a))</i> <i>HK\$'000</i> | Capital reserves <i>(Note 27(b))</i> <i>HK\$'000</i> | Retained profits/ (accumulated losses) <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|--|--|---|--|--------------------------|
| At 1 January 2004 | 2,420 | 108,120 | (101,051) | 9,489 |
| Profit for the year | <u>–</u> | <u>–</u> | <u>181,108</u> | <u>181,108</u> |
| At 31 December 2004 and 1 January 2005 | 2,420 | 108,120 | 80,057 | 190,597 |
| Arising from the Reorganization | (2,420) | 2,420 | – | – |
| Issue of shares | 93 | – | – | 93 |
| Profit for the year | <u>–</u> | <u>–</u> | <u>104,003</u> | <u>104,003</u> |
| At 31 December 2005 and 1 January 2006 | 93 | 110,540 | 184,060 | 294,693 |
| Profit for the year | <u>–</u> | <u>–</u> | <u>26,124</u> | <u>26,124</u> |
| At 31 December 2006 and 1 January 2007 | 93 | 110,540 | 210,184 | 320,817 |
| Loss for the period | – | – | (14,637) | (14,637) |
| Dividend paid | – | – | (36,660) | (36,660) |
| Arising from the Reorganization | <u>–</u> | <u>35,630</u> | <u>–</u> | <u>35,630</u> |
| At 30 June 2007 | <u><u>93</u></u> | <u><u>146,170</u></u> | <u><u>158,887</u></u> | <u><u>305,150</u></u> |
| At 1 January 2006 | 93 | 110,540 | 184,060 | 294,693 |
| Loss for the period | <u>–</u> | <u>–</u> | <u>(17,924)</u> | <u>(17,924)</u> |
| At 30 June 2006 | <u><u>93</u></u> | <u><u>110,540</u></u> | <u><u>166,136</u></u> | <u><u>276,769</u></u> |

V. COMBINED CASH FLOW STATEMENTS

| | Notes | Year ended 31 December | | | Six months ended 30 June | |
|---|-------|------------------------|----------------|-----------------|-----------------------------|-----------------|
| | | 2004 | 2005 | 2006 | 2006 | 2007 |
| | | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| | | | | | | (Unaudited) |
| Cash flows from operating activities | | | | | | |
| Cash generated from operations | 29(a) | 120,061 | 45,275 | 31,225 | 67,361 | 72,774 |
| Interest paid | | (1,086) | (565) | (1,337) | (45) | (118) |
| Hong Kong profits tax paid | 21 | (76) | – | (3,257) | (278) | (425) |
| Hong Kong profits tax refunded | 21 | – | – | – | – | 497 |
| Overseas tax paid | 21 | (7,643) | (2,574) | (69,633) | (15,081) | (16) |
| Overseas tax refunded | 21 | – | – | 1,314 | 1,305 | – |
| Net cash generated from/ (used in) operating activities | | <u>111,256</u> | <u>42,136</u> | <u>(41,688)</u> | <u>53,262</u> | <u>72,712</u> |
| Cash flows from investing activities | | | | | | |
| Purchases of property, plant and equipment | | (3,339) | (4,065) | (463) | (175) | (1,041) |
| Proceeds from disposal of property, plant and equipment | | – | – | 4 | – | – |
| Interest received | | 739 | 3,002 | 5,131 | 2,406 | 2,421 |
| Net cash (used in)/generated from investing activities | | <u>(2,600)</u> | <u>(1,063)</u> | <u>4,672</u> | <u>2,231</u> | <u>1,380</u> |
| Cash flows from financing activities | | | | | | |
| Net new bank loan | | – | – | 47,500 | – | – |
| Issue of shares | | – | 93 | – | – | – |
| Contributed by the intermediate holding company as a result of the Reorganization | | – | – | – | – | 35,630 |
| Net repayment of bank loans | | (122,411) | (500) | – | (19,000) | (66,500) |
| Dividend paid | | – | – | – | – | (36,660) |
| Net cash (used in)/generated from financing activities | | <u>(122,411)</u> | <u>(407)</u> | <u>47,500</u> | <u>(19,000)</u> | <u>(67,530)</u> |
| Net (decrease)/increase in cash and cash equivalents | | <u>(13,755)</u> | <u>40,666</u> | <u>10,484</u> | <u>36,493</u> | <u>6,562</u> |
| Effect on exchange rate changes | | – | – | – | (103) | – |
| Cash and cash equivalents at 1 January | | <u>53,146</u> | <u>39,391</u> | <u>80,057</u> | <u>80,057</u> | <u>90,541</u> |
| Cash and cash equivalents at 31 December/30 June | 29(b) | <u>39,391</u> | <u>80,057</u> | <u>90,541</u> | <u>116,447</u> | <u>97,103</u> |

VI. NOTES TO THE FINANCIAL INFORMATION**1. THE REORGANIZATION AND BASIS OF PRESENTATION**

The Company (formerly known as Playmates Limited) was incorporated in Bermuda on 11 April 2005 as a wholly-owned subsidiary of Playmates International Limited (“PIL”), PIL itself being an intermediate holding company wholly owned by Playmates Holdings Limited (“PHL”) which is listed on the Main Board of the Hong Kong Stock Exchange.

The companies comprising the Group underwent the Reorganization to combine under the Company. The Group which will principally engage in the design, development, marketing and distribution of toys and toy and family entertainment activity products (the “Toys Business”). Prior to the Reorganization, PIL, directly and indirectly owned the companies operating the Toys Business. Pursuant to the Reorganization commencing on 31 May 2007, PIL’s ownership of the companies operating the Toys Business was transferred to Playmates Toys Enterprises Limited, which is the wholly-owned subsidiary of the Company and the Company became the holding company of the subsidiaries now comprising the Group.

Upon completion of the Reorganization, the Group is regarded as a continuing entity resulting from the Reorganization since all of the entities operating the Toys Business which took part in the Reorganization were controlled by the same ultimate shareholders before and immediately after the Reorganization. Consequently, immediately after the Reorganization, there was a continuation of the risks and benefits to the ultimate shareholders that existed prior to the Reorganization. The Reorganization has been accounted for as a reorganization under common control in a manner similar to pooling of interests. Accordingly, the Financial Information has been prepared on the basis of merger accounting in accordance with the Accounting Guideline No. 5 “Merger Accounting for Common Control Combinations” issued by the HKICPA, under which the Company is considered as the holding company of the Group during the Relevant Periods. The results and cash flows of the Group for the Relevant Periods include the results and cash flows of the Company and its subsidiaries from 1 January 2004, or since the Company’s and its subsidiaries’ respective dates of incorporation/establishment if shorter, as if the current group structure had been in existence throughout the Relevant Periods. The combined balance sheets as at respective balance sheet dates of the Relevant Periods is a combination of the balance sheets of the Company and its subsidiaries at each balance sheet date as if the current group structure had been in existence at these dates.

All intra-group transactions and balances have been eliminated on combination.

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS**Statement of compliance**

The Financial Information set out in this report are prepared in accordance with Standards and Interpretation of the Hong Kong Financial Reporting Standards (herein collectively referred to as “HKFRS”) issued by the HKICPA and accounting principles generally accepted in Hong Kong, which have been consistently applied throughout the Relevant Periods. The Financial

Information also comply with all applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange as applicable to the accountants' report included in the prospectus.

Basis of preparation of Financial Information

The Group has early adopted those HKFRS which are effective for accounting periods beginning on before 1 January 2007 issued by the HKICPA for the preparation of these Financial Information of the Group throughout the Relevant Periods. HKFRS 1 "First-time Adoption of Hong Kong Financial Reporting Standards" has been applied in preparing these Financial Information. These Financial Information are the first set of financial statements prepared in accordance with HKFRS by the Group.

The accounting policies set out below have been applied consistently to all periods presented in these Financial Information and in preparing an opening HKFRS balance sheet at 1 January 2004 for the purpose of the first set of HKFRS financial statements. The accounting policies have been applied consistently by the Group. The following is the list of HKFRS which are relevant to the Group's operation as at the beginning of the Relevant Periods:

| | |
|---------------------|--|
| HKAS 1 | Presentation of Financial Statements |
| HKAS 1 (Amendment) | Capital Disclosures |
| HKAS 2 | Inventories |
| HKAS 7 | Cash Flow Statements |
| HKAS 8 | Accounting Policies, Changes in Accounting Estimates and Errors |
| HKAS 10 | Events after the Balance Sheet Date |
| HKAS 12 | Income Taxes |
| HKAS 14 | Segment Reporting |
| HKAS 16 | Property, Plant and Equipment |
| HKAS 17 | Leases |
| HKAS 18 | Revenue |
| HKAS 19 | Employee Benefits |
| HKAS 21 | The Effects of Changes in Foreign Exchange Rates |
| HKAS 23 | Borrowing Costs |
| HKAS 24 | Related Party Disclosures |
| HKAS 27 | Consolidated and Separate Financial Statements |
| HKAS 32 | Financial Instruments: Disclosure and Presentation |
| HKAS 33 | Earning Per Share |
| HKAS 36 | Impairment of Assets |
| HKAS 37 | Provisions, Contingent Liabilities and Contingent Assets |
| HKAS 39 | Financial Instrument: Recognition and Measurement |
| HKAS 39 (Amendment) | Transitional and Initial Recognition of Financial Assets and Financial Liabilities |
| HKFRS 1 | First-time Adoption of Hong Kong Financial Reporting Standards |
| HKFRS 2 | Share-based Payment |
| HKFRS 3 | Business Combinations |
| HKFRS 7 | Financial Instruments: Disclosures |

At the date of this report, the HKICPA has issued the following new standards and interpretations. However, the Group has not early applied these new standards or interpretations that have been issued but are not yet effective as of period ended 30 June 2007. Management anticipates that the application of these standards, amendment and interpretations will have no material impact on the Financial Information of the Group.

| | |
|--------------------|--|
| HKAS 23 (Revised) | Borrowing Costs ¹ |
| HKFRS 8 | Operating Segments ¹ |
| HK(IFRIC) – INT 11 | Group and Treasury Share Transactions ² |
| HK(IFRIC) – INT 12 | Service Concession Arrangement ³ |

¹ Effective for annual periods beginning on or after January 1, 2009.

² Effective for annual periods beginning on or after March 1, 2007.

³ Effective for annual periods beginning on or after January 1, 2008.

3. SIGNIFICANT ACCOUNTING POLICIES

The Financial Information has been prepared in accordance with HKFRSs and accounting principles generally accepted in Hong Kong. These financial statements also comply with the applicable disclosure requirements of the Hong Kong Companies Ordinance and the disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange. The Financial Information has been prepared under the historical cost basis. A summary of the significant accounting policies adopted by the Group is set out below.

Subsidiaries

Subsidiaries are entities over which the Group has the power to govern its financial and operating policies so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

Investments in subsidiaries are recorded in the Company's books at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

As explained in Note 1 of Section VI above, the Reorganization has been accounted for using the merger method of accounting. Inter-company transactions, balances and unrealised gain on transactions between group companies are eliminated in full in preparing the combined financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Associate

An associate is an entity over which the Group has significant influence, but not control, over its management, including participation in the financial and operating policy decision, generally accompanying a shareholding of between 20% and 50% of the voting rights.

Investment in an associate is accounted for in the combined financial statements using the equity method of accounting and is initially recognised at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's net assets.

The Group's share of its associate's post-acquisition profits or losses is recognised in the combined income statement, and its share of post-acquisition movements in reserves is recognised in reserves. When the Group's share of the associate's losses 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.

Property, plant and equipment

All property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. 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. All other repairs and maintenance costs are expensed in the income statement during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost to their residual values over their estimated useful lives, as follows:

| | |
|--|------------|
| Leasehold improvements | 5-10 years |
| Machinery, equipment, furniture and fixtures | 3-10 years |
| Computers | 3-5 years |

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.

Impairment of assets

Property, plant and equipment, investments in subsidiaries and associate are reviewed for impairment annually and 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).

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the asset's recoverable amount and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognised.

Inventories

Inventories comprise toys merchandise and are stated at the lower of cost or net realisable value. Cost is determined on a weighted average basis. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

The Group reviews the condition of inventories at each balance sheet date, and makes allowance for inventories that are identified as obsolete, slow-moving or no longer recoverable. The Group carries out the inventory review on product-by-product basis and makes allowances by reference to the latest market prices and current market conditions.

Operating leases

Operating leases are leases where substantially all the rewards and risks of ownership of assets remain with the lessors. Related rental payments are charged to the income statement on a straight-line basis over the lease term.

Foreign currency translation*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 combined financial statements are presented in Hong Kong dollars, which is the Company's functional and presentation currency.

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. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Group companies

The results and financial position of all the group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (a) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (b) income and expenses for each income statement are translated at average exchange rates;

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, cash investments with a maturity of three months or less from date of investment less bank overdrafts.

Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost less impairment losses for bad debts and allowance for customer concession.

A provision for impairment of trade and other receivable 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 receivables.

The amount of provision is recognised in the income statement and included allowance for customer concession that is arrived at by using available contemporary and historical information to evaluate the exposure.

Financial liabilities

The Group's financial liabilities include trade payables, other payables and bank loans. They are recognised initially at their fair value and subsequently stated at amortised cost using the effective interest method.

Employee benefits*Employee leave entitlements*

Employees' entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Pension obligations

The Group operates defined contribution provident fund schemes for its employees, the assets of which are held separately from those of the Group in independently administered funds. The Group's contributions under the schemes are charged to the income statement as incurred. The amount of the Group's contributions is based on specified percentages of the basic salaries of employees. Any contributions forfeited by employees who leave the Group, relating to unvested benefits, are used to reduce the Group's ongoing contributions otherwise payable.

Share-based compensation

All share-based payment arrangements granted after 7 November 2002 and had not yet vested on 1 January 2004 are recognised in the financial statement.

The Group's ultimate holding company 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 with a corresponding credit to the current account with the ultimate holding company. 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). At each balance sheet date, the ultimate holding company revises the number of options that are expected to become exercisable. The Group recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to the current account with the ultimate holding company.

Current taxation

Current income tax assets and/or liabilities comprise those obligations to, or claims from, fiscal authorities relating to the current or prior reporting period, that are unpaid at the balance sheet date. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in the income statement.

Deferred taxation

Deferred taxation 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 accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred 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 taxation is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Revenue recognition

Revenue from sales of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and title has been passed.

The Group grants credits to retail customers to facilitate the sale of slow moving merchandise held by such customers. The support provided to the retail customers by the Group provides a contribution towards the reduction of the retail price of the slow moving items. As of each annual and interim balance sheet date, an analysis is done of all customer requests for concessions which have been agreed or are pending. Each individual item is evaluated and any concession is based upon a specific agreed or estimated dollar value per unit. The concession per unit is determined by (i) negotiating an amount agreed with retail customers and/or (ii) estimating an amount based on management's experience with available contemporary and historical information. This concession amount is applied to the remaining retail inventory in the hands of the Group's retail customers to determine the total concession expected. Similar methodology is applied to other slow moving retail inventory determined through regular sales data provided by the Group's retail customers and based on management's experience with each individual retail customer and its historical performance. Credits are recorded net of gross sales.

All agreed concessions are processed through a Special Terms and Agreement form and all provisions are established for specific exposures. Agreed and estimated concessions are reviewed on a regular basis by management and any outstanding amounts are re-evaluated based upon subsequent events, including actual sales data of the agreed upon or provided for product items and claims made against the agreed concessions by retail customers. All claims received are compared to their respective Special Terms and Agreement to ensure correctness. Claims by retail customers may be received up to two years, or after, the relevant balance sheet date. Any adjustments to the amounts provided are recorded in the period of change.

Interest income is recognised on a time proportion basis, by reference to the principal outstanding and at the interest rate applicable.

Advertising and marketing expenses, advanced royalties and product development costs

Advertising and marketing expenses are expensed as incurred, except for the production costs of commercials and television programming costs which are deferred and expensed in the year the commercial or television programme is first aired.

Advanced royalties represent prepayments made to licensors of intellectual properties under licensing agreements which are recoupable against future royalties. Advanced royalties are amortised at the contractual royalty rate based on actual product sales. Management evaluates the future realisation of advanced royalties periodically and charges to expense any amounts that management deems unlikely to be recoupable at the contractual royalty rate through product sales. All advanced royalties are amortised within the term of the license agreement and are written off upon the abandonment of the product or upon the determination that there is significant doubt as to the success of the product.

Expenses relating to product development are charged to the income statement as incurred.

Borrowing costs

Borrowing costs are charged to the income statement in the year in which they are incurred.

Segment reporting

In accordance with the Group's internal financial reporting, the Group has determined that business segments be presented as the primary reporting format and geographical segments as the secondary reporting format for the purposes of the Financial Information.

Segment assets consist primarily of property, plant and equipment, inventories, receivables and operating cash. Segment capital expenditure comprises additions to property, plant and equipment.

In respect of geographical segment reporting, turnover is based on the country in which the customer is located. Assets and capital expenditure are based on where the assets are located.

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 embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. Expenditures for which a provision has been recognised are charged against the related provision in the year in which the expenditures are incurred. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. All provisions are current in nature and therefore the effect of the time value of money is not material. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

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:

Deferred tax assets

As at the balance sheet dates, deferred tax assets of HK\$67 million (2004: HK\$66 million; 2005: HK\$81 million and 2006: HK\$72 million) in relation to unused tax losses had been recognised in the balance sheet. The recognition of the deferred tax asset mainly depends on whether sufficient future profits or taxable temporary differences will be available in the future. In cases where the actual future profits generated are less than expected, a material reversal of deferred tax assets may arise, which would be recognised in the income statement in which such a reversal takes place. The management evaluates at each balance sheet date whether the operations of the subsequent fiscal years are expected to produce profitable results or whether losses should be anticipated, which enables to form the basis of the assessment of the recoverability of the deferred tax asset. The management expects the deferred tax assets would be fully utilized in subsequent financial years. As a result, no such reversal have taken place at the balance sheet dates during the Relevant Period.

5. TURNOVER AND REVENUE

The Group is principally engaged in the design, development, marketing and distribution of toys and family entertainment activity products. Revenues recognised during the Relevant Periods are as follows:

| | Year ended 31 December | | | Six months ended 30 June | |
|--|-------------------------|-------------------------|-------------------------|-----------------------------|-----------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| | | | | (Unaudited) | |
| Turnover | | | | | |
| Sales of toys | 1,282,662 | 1,277,607 | 1,127,997 | 317,579 | 347,579 |
| Other revenue – Interest income | <u>739</u> | <u>3,002</u> | <u>5,131</u> | <u>2,406</u> | <u>2,421</u> |
| Total revenue | <u><u>1,283,401</u></u> | <u><u>1,280,609</u></u> | <u><u>1,133,128</u></u> | <u><u>319,985</u></u> | <u><u>350,000</u></u> |

6. SEGMENT INFORMATION

Business segments

No business segment analysis is shown as the Group's principal activities of the business segment is design, development, marketing and distribution of toys and toy and family entertainment activity products.

Geographical segments

The geographical analysis of the Group's turnover, assets and capital expenditure for the Relevant Periods is as follows:

| | Year ended 31 December | | | Six months ended 30 June | |
|-----------------|-------------------------|-------------------------|-------------------------|-----------------------------|-------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| | | | | (Unaudited) | |
| Turnover | | | | | |
| Americas | | | | | |
| – USA | 1,000,310 | 948,833 | 847,355 | 231,030 | 224,418 |
| – Others | 58,494 | 52,766 | 81,408 | 28,049 | 29,906 |
| Europe | 183,101 | 236,402 | 154,278 | 42,707 | 70,680 |
| Asia Pacific | 39,493 | 37,323 | 41,415 | 14,709 | 21,967 |
| Others | 1,264 | 2,283 | 3,541 | 1,084 | 608 |
| | <u>1,282,662</u> | <u>1,277,607</u> | <u>1,127,997</u> | <u>317,579</u> | <u>347,579</u> |
| | | | | | |
| | As at 31 December | | | As at 30 June | |
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> | |
| Assets | | | | | |
| USA | 438,384 | 519,785 | 491,031 | 305,223 | |
| Asia Pacific | <u>15,588</u> | <u>44,687</u> | <u>72,975</u> | <u>39,385</u> | |

| | Year ended 31 December | | | Six months ended 30 June | |
|----------------------------|------------------------|------------|------------|-----------------------------|-------------|
| | 2004 | 2005 | 2006 | 2006 | 2007 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| | | | | | (Unaudited) |
| Capital expenditure | | | | | |
| USA | 2,726 | 3,390 | 342 | 161 | 755 |
| Asia Pacific | <u>613</u> | <u>675</u> | <u>121</u> | <u>14</u> | <u>286</u> |

7. INTEREST EXPENSE AND BANK CHARGES

| | Year ended 31 December | | | Six months ended 30 June | |
|--|------------------------|--------------|--------------|-----------------------------|--------------|
| | 2004 | 2005 | 2006 | 2006 | 2007 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| | | | | | (Unaudited) |
| Interest on bank loans | | | | | |
| wholly repayable within five years | 1,086 | 565 | 1,337 | 45 | 118 |
| Receivable processing fees (<i>Note</i>) | 5,738 | 4,287 | 2,955 | 1,080 | 783 |
| Other bank charges (<i>Note</i>) | <u>3,247</u> | <u>2,489</u> | <u>1,585</u> | <u>542</u> | <u>717</u> |
| | <u>10,071</u> | <u>7,341</u> | <u>5,877</u> | <u>1,667</u> | <u>1,618</u> |

Note: The Group outsources its credit activities, including credit analysis, credit approval and collection processing to a factoring and receivable processing agent. The factoring and receivable processing agent also guarantees collectability in the case of default by customers. Receivable processing fees represent those servicing charges paid to the factoring and receivable processing agent.

Other bank charges include L/C handling charges and charges for ordinary bank services.

8. TAXATION CREDIT/(CHARGE)

Hong Kong profits tax has been provided at the rate of 17.5% (2004 – 2006: 17.5%) on the estimated assessable profit for the year. Overseas, mainly the U.S., taxation is provided on the profits/losses of the overseas subsidiaries in accordance with the tax laws of the countries in which these entities operate. Subsidiaries operating in the U.S. are subject to U.S. federal and state tax on its assessable income. The tax rate for federal tax is between 34% and 35% whilst the tax rate for state tax of California, the principal place of business of the Company's major subsidiary is between 7.32% and 8.84%.

The amount of taxation credited/(charged) to the combined financial information represents:

| | Year ended 31 December | | | Six months ended 30 June | |
|---|------------------------|------------------|------------------|-----------------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| | | | | (Unaudited) | |
| Current taxation | | | | | |
| Hong Kong profits tax | (312) | (1,450) | (2,363) | – | (356) |
| Overseas taxation | (4,592) | (643) | (62) | – | – |
| (Provisions)/over provisions for tax cases (<i>Note</i>) | (37,482) | (471) | 4,048 | 3,558 | – |
| (Under)/over provision in prior years | – | 171 | (94) | – | – |
| | (42,386) | (2,393) | 1,529 | 3,558 | (356) |
| Deferred taxation | | | | | |
| Origination and reversal of temporary differences | 68,245 | 17,067 | (5,562) | 10,793 | (4,981) |
| | <u>25,859</u> | <u>14,674</u> | <u>(4,033)</u> | <u>14,351</u> | <u>(5,337)</u> |

Note: These relate to the examination by the US Tax Authorities of certain tax returns of the U.S. subsidiaries (“the Subsidiaries”) of the Group.

Transfer pricing policy and timing of certain deductions

In 2004, the Internal Revenue Service (“IRS”) of the United States of America had completed its examination of the federal income tax returns of the Subsidiaries for the tax years 1996 and 1997 and had proposed adjustments to these returns in respect of the Subsidiaries’ transfer pricing policy and timing of certain deductions.

Prior to 2004, the Subsidiaries has made a provision of HK\$35,151,000. In the year 2004, the Subsidiaries made an additional provision of HK\$14,082,000. Pursuant to the agreement with IRS on the tax adjustments in 2005, a further provision of HK\$3,023,000 was provided for the year ended 31 December 2005. In 2006, the Group agreed with IRS on total settlement amount of HK\$54,190,000, including interest.

Apportionment of income to the State of California

The California Franchise Tax Board (“FTB”) had completed its examination of the state tax returns of the Subsidiaries for the tax years 1988 through 1990 and had proposed adjustments to the Subsidiaries’ apportionment of income to the State of California for these tax years.

Prior to 2004, the Subsidiaries believed that there would be a favourable outcome to the examination, and as such no provision was accrued. However, the Subsidiaries received a FTB collection notice amounted to HK\$23,400,000 in 2004, the Subsidiaries made full provision for this amount in 2004. In 2005, the Subsidiaries re-assessed the tax provision and reduced it by HK\$2,552,000. In May 2006, the FTB imposed a formal assessment and demanded payment of tax, interest and penalties of HK\$14,866,000. As such, the Subsidiaries reduced its provision by HK\$5,982,000 in 2006.

The Group had performed periodical reviews and estimated the liability in respect of the abovementioned tax proceedings. Included in tax payable of the Group at both 31 December 2004 and 2005 were provisions of HK\$72,633,000 and HK\$73,104,000 respectively, for the tax liability related to the above tax matters. The provisions at 31 December 2004 and 2005 were based on best available information at the time such provisions were made and represented reasonable estimates of tax liabilities that might be due.

In the second half of 2006, the Group has settled all their tax liabilities regarding the tax cases. The final settlement was approximately HK\$69,056,000 and the over provision amounting to HK\$4,048,000 was credited in the 2006 income statement. Accordingly, no provisions were required for the above tax cases as at 31 December 2006 and 30 June 2007. However, the Group continued to pursue its refund claim through litigation with the California Franchise Tax Board and in July 2007, the Group and the FTB agreed in principle to an out-of-court settlement, which resulted in a refund of tax, interest and penalties of approximately HK\$22,620,000. This beneficial development will be reflected in the financial statements for the second half of 2007.

The U.S. taxable profits for the years ended 31 December 2004, 2005 and 2006 were absorbed by unused tax losses brought forward from previous years, as a result, there were no significant current overseas taxation for the years.

According to relevant tax regulations, the deferred tax assets arising from U.S. tax losses cannot be used to offset the Hong Kong profits tax.

The taxation credit/(charge) for the Relevant Periods can be reconciled to the profit/(loss) before taxation as follows:

| | Year ended 31 December | | | Six months ended 30 June | |
|---|------------------------|------------------|------------------|-----------------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| Profit/(loss) before taxation | <u>155,249</u> | <u>89,329</u> | <u>30,157</u> | <u>(32,275)</u> | <u>(9,300)</u> |
| Calculated at applicable U.S. taxation rate of 42.84% (2004, 2005 and 2006: 42.57%, 42.32% and 43.46%, respectively) | (66,093) | (37,805) | (13,105) | 14,026 | 3,984 |
| Effect of different taxation rates in other countries (<i>Note a</i>) | 64 | 2,701 | 3,460 | (3,492) | (894) |
| Tax on gain of transfers of subsidiaries in the U.S. arising from the Reorganization (<i>Note e</i>) | - | - | - | - | (8,680) |
| Non-taxable income (<i>Note b</i>) | 30 | 3,186 | 2,316 | 142 | 193 |
| Non-deductible expenses for tax purposes (<i>Note c</i>) | (1,485) | (350) | (3,388) | (401) | (211) |
| Unrecognised temporary differences | (3,105) | 8,637 | 2,601 | (7) | - |
| Recognition of previously unrecognised deferred tax assets (<i>Note d</i>) | 133,930 | 38,596 | - | - | - |
| (Provisions)/over provisions for tax cases | (37,482) | (471) | 4,048 | 3,558 | - |
| Prior year over/(under) provision | - | 171 | (94) | - | - |
| Others | - | 9 | 129 | 525 | 271 |
| Taxation credit/(charge) | <u>25,859</u> | <u>14,674</u> | <u>(4,033)</u> | <u>14,351</u> | <u>(5,337)</u> |

Note:

- (a) The effect of different taxation rates in other countries is mainly arising from the subsidiaries operate in Hong Kong, and their profits are calculated at Hong Kong profits tax rate.
- (b) Non-taxable income is mainly comprised of bank interest income and share of profit of an associate.
- (c) Non-deductible expenses are mainly comprised of share of loss of an associate, meals and entertainment, share option expenses, withholding tax on royalty and foreign tax.
- (d) Recognition of previously unrecognised deferred tax assets are mainly tax losses recognised and tax benefits on interest and state taxes associated with tax cases.
- (e) Tax on gain of transfer of subsidiaries in the U.S. arising from the Reorganization represents the tax paid on the capital gain which arose when transfer of the subsidiaries during the process of the Reorganization.

9. OPERATING PROFIT/(LOSS)

Operating profit/(loss) is stated after charging/(crediting) the following:

| | Year ended 31 December | | | Six months ended 30 June | |
|--|------------------------|------------------|------------------|---------------------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 (Unaudited) | 2007 HK\$'000 |
| Cost of inventories sold | 527,141 | 560,095 | 522,981 | 143,563 | 159,436 |
| Product development costs | 15,728 | 21,847 | 22,073 | 14,759 | 7,173 |
| Royalties paid | 145,874 | 125,965 | 102,488 | 32,965 | 33,549 |
| Allowance for customer concession | 26,248 | 14,540 | 14,823 | 1,025 | 4,390 |
| Reversal of unutilised allowance for customer concession | (15,378) | (19,811) | (1,656) | – | – |
| Provision for customer and supplier claims (<i>Note 25</i>) | 55,452 | 53,743 | 52,288 | 12,189 | 14,608 |
| Reversal of unutilised provision for customer and supplier claims (<i>Note 25</i>) | (6,136) | (20,520) | (3,133) | (89) | (1,675) |
| Reversal of provision for doubtful debts | – | – | – | – | (1,591) |
| Inventories written down | 922 | 251 | 1,521 | 310 | 961 |
| Depreciation of property, plant and equipment | 4,328 | 2,846 | 2,810 | 1,423 | 1,417 |
| Staff costs, including directors' remuneration (<i>Note 10</i>) | 85,277 | 83,593 | 84,503 | 38,809 | 42,051 |
| Operating lease expense on office and warehouse facilities | 11,314 | 13,449 | 12,987 | 6,111 | 5,063 |
| Loss on disposal of fixed assets | 507 | 172 | 69 | 39 | 7 |
| Exchange loss/(gain) | 1,027 | 2,132 | (1,614) | 488 | (232) |
| Donation | 1,302 | 1,664 | 802 | 223 | 311 |
| Auditors' remuneration | 1,132 | 1,076 | 1,380 | 687 | 1,194 |
| Professional fees, include accounting, tax, compliance, information system support, legal and other advisory services | 8,788 | 29,170 | 13,579 | 3,938 | 12,349 |

10. STAFF COSTS

| | Year ended 31 December | | | Six months ended 30 June | |
|---|------------------------|------------------|------------------|-----------------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| Wages, salaries and other benefits | 77,151 | 74,304 | 74,674 | 32,942 | 38,822 |
| Share-based compensation | 6,432 | 7,304 | 7,701 | 4,719 | 1,977 |
| Employer's contributions to provident fund | 1,835 | 2,005 | 2,215 | 1,148 | 1,252 |
| Forfeited contributions | (141) | (20) | (87) | - | - |
| | <u>85,277</u> | <u>83,593</u> | <u>84,503</u> | <u>38,809</u> | <u>42,051</u> |

11. EMOLUMENTS OF THE DIRECTORS AND THE FIVE HIGHEST PAID INDIVIDUALS

(a) Directors' emoluments

Remuneration of the directors disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

| Name of director | For the year ended 31 December 2004 | | | | | | |
|---|-------------------------------------|--------------------|-------------------|---|-------------------------------|--|-------------------|
| | Fee HK\$'000 | Salary HK\$'000 | Bonus HK\$'000 | Share-based compensation HK\$'000 | Other benefits HK\$'000 | Employer's contribution to provident fund HK\$'000 | Total HK\$'000 |
| <i>Executive directors:</i> | | | | | | | |
| - Chan Chun Hoo, Thomas | - | - | - | - | - | - | - |
| - Novak, Lou Robert | - | 3,011 | 6,067 | 3,669 | 228 | 101 | 13,076 |
| - Soong, Ronnie | - | 2,210 | 1,861 | 244 | 10 | 12 | 4,337 |
| <i>Independent non-executive directors:</i> | | | | | | | |
| - Chow Yu Chun, Alexander | - | - | - | - | - | - | - |
| - Lee Ching Kwok, Rin | - | - | - | - | - | - | - |
| - Yang, Victor | - | - | - | - | - | - | - |
| | <u>-</u> | <u>5,221</u> | <u>7,928</u> | <u>3,913</u> | <u>238</u> | <u>113</u> | <u>17,413</u> |

For the year ended 31 December 2005

| Name of director | Fee HK\$'000 | Salary HK\$'000 | Bonus HK\$'000 | Share-based compensation HK\$'000 | Other benefits HK\$'000 | Employer's contribution to provident fund | Total HK\$'000 |
|---|-----------------|--------------------|-------------------|---|-------------------------------|--|-------------------|
| | | | | | | HK\$'000 | |
| <i>Executive directors:</i> | | | | | | | |
| - Chan Chun Hoo, Thomas | - | - | - | - | - | - | - |
| - Novak, Lou Robert | - | 3,276 | 2,122 | 4,704 | 252 | 98 | 10,452 |
| - Soong, Ronnie | - | 2,271 | 1,207 | 356 | 20 | 12 | 3,866 |
| <i>Independent non-executive directors:</i> | | | | | | | |
| - Chow Yu Chun, Alexander | - | - | - | - | - | - | - |
| - Lee Ching Kwok, Rin | - | - | - | - | - | - | - |
| - Yang, Victor | - | - | - | - | - | - | - |
| | <u>-</u> | <u>5,547</u> | <u>3,329</u> | <u>5,060</u> | <u>272</u> | <u>110</u> | <u>14,318</u> |

For the year ended 31 December 2006

| Name of director | Fee HK\$'000 | Salary HK\$'000 | Bonus HK\$'000 | Share-based compensation HK\$'000 | Other benefits HK\$'000 | Employer's contribution to provident fund | Total HK\$'000 |
|---|-----------------|--------------------|-------------------|---|-------------------------------|--|-------------------|
| | | | | | | HK\$'000 | |
| <i>Executive directors:</i> | | | | | | | |
| - Chan Chun Hoo, Thomas | - | - | - | - | - | - | - |
| - Novak, Lou Robert | - | 3,510 | 637 | 3,278 | 271 | 103 | 7,799 |
| - Soong, Ronnie | - | 2,381 | 364 | 364 | 78 | 12 | 3,199 |
| <i>Independent non-executive directors:</i> | | | | | | | |
| - Chow Yu Chun, Alexander | - | - | - | - | - | - | - |
| - Lee Ching Kwok, Rin | - | - | - | - | - | - | - |
| - Yang, Victor | - | - | - | - | - | - | - |
| | <u>-</u> | <u>5,891</u> | <u>1,001</u> | <u>3,642</u> | <u>349</u> | <u>115</u> | <u>10,998</u> |

For the six months ended 30 June 2006

| Name of director | Fee HK\$'000 (Unaudited) | Salary HK\$'000 (Unaudited) | Bonus HK\$'000 (Unaudited) | Share-based compensation HK\$'000 (Unaudited) | Other benefits HK\$'000 (Unaudited) | Employer's contribution to provident fund HK\$'000 (Unaudited) | Total HK\$'000 (Unaudited) |
|---|--------------------------------|-----------------------------------|----------------------------------|--|--|---|----------------------------------|
| <i>Executive directors:</i> | | | | | | | |
| - Chan Chun Hoo, Thomas | - | - | - | - | - | - | - |
| - Novak, Lou Robert | - | 1,714 | - | 2,694 | 32 | 78 | 4,518 |
| - Soong, Ronnie | - | 1,278 | - | 212 | 23 | 6 | 1,519 |
| <i>Independent non-executive directors:</i> | | | | | | | |
| - Chow Yu Chun, Alexander | - | - | - | - | - | - | - |
| - Lee Ching Kwok, Rin | - | - | - | - | - | - | - |
| - Yang, Victor | - | - | - | - | - | - | - |
| | <u>-</u> | <u>2,992</u> | <u>-</u> | <u>2,906</u> | <u>55</u> | <u>84</u> | <u>6,037</u> |

For the six months ended 30 June 2007

| Name of director | Fee HK\$'000 | Salary HK\$'000 | Bonus HK\$'000 | Share-based compensation HK\$'000 | Other benefits HK\$'000 | Employer's contribution to provident fund HK\$'000 | Total HK\$'000 |
|---|-----------------|--------------------|-------------------|---|-------------------------------|--|-------------------|
| <i>Executive directors:</i> | | | | | | | |
| - Chan Chun Hoo, Thomas | - | - | - | - | - | - | - |
| - Novak, Lou Robert | - | 1,843 | - | 1,186 | 33 | 80 | 3,142 |
| - Soong, Ronnie | - | 1,283 | - | 95 | 39 | 6 | 1,423 |
| <i>Independent non-executive directors:</i> | | | | | | | |
| - Chow Yu Chun, Alexander | - | - | - | - | - | - | - |
| - Lee Ching Kwok, Rin | - | - | - | - | - | - | - |
| - Yang, Victor | - | - | - | - | - | - | - |
| | <u>-</u> | <u>3,126</u> | <u>-</u> | <u>1,281</u> | <u>72</u> | <u>86</u> | <u>4,565</u> |

No directors of the Company waived any emoluments during the Relevant Periods.

No emoluments were paid to the directors of the Company as an inducement to join or upon joining the Group or as compensation for loss of office during the Relevant Periods.

For the year ended 31 December 2004, HK\$1,500,000 was charged against the Group by PHL Group as management fee in respect of discretionary bonus paid to Mr. Chan Chun Hoo, Thomas in relation to his contribution to the improved performance of the Group.

(b) Five highest paid individuals' emoluments

For the Relevant Periods, two of the five highest paid individuals were directors, whose emoluments are disclosed above. Details of the emoluments of the other three highest paid individuals are as follows:

| | Year ended 31 December | | | Six months ended 30 June | |
|--|-------------------------|-------------------------|-------------------------|-----------------------------|-------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| | | | | (Unaudited) | |
| Salaries, other allowances and benefits in kind | 6,105 | 7,916 | 7,153 | 6,132 | 3,346 |
| Share-based compensation | 340 | 423 | 305 | 235 | 210 |
| Performance bonus | 2,422 | – | 421 | – | – |
| Employer's contribution to provident fund | 295 | 247 | 206 | 192 | 100 |
| | <u>9,162</u> | <u>8,586</u> | <u>8,085</u> | <u>6,559</u> | <u>3,656</u> |

The emoluments of these individuals are within the following bands:

| HK\$ | Year ended 31 December | | | Six months ended 30 June | |
|-----------------------|--|--|--|--|--|
| | 2004 <i>Number of individuals</i> | 2005 <i>Number of individuals</i> | 2006 <i>Number of individuals</i> | 2006 <i>Number of individuals</i> | 2007 <i>Number of individuals</i> |
| Nil to 2,000,000 | – | – | – | 3 | 3 |
| 2,000,001 – 2,500,000 | 1 | – | 1 | – | – |
| 2,500,001 – 3,000,000 | 1 | 2 | 1 | – | – |
| 3,000,001 – 3,500,000 | – | 1 | 1 | – | – |
| 3,500,001 – 4,000,000 | 1 | – | – | – | – |
| | <u>3</u> | <u>3</u> | <u>3</u> | <u>3</u> | <u>3</u> |

12. DIVIDENDS

During the six months ended 30 June 2007, a subsidiary of the Group, solely for the purposes of effecting the Reorganization, proposed and then paid a dividend of HK\$36,660,000 to PIL.

13. EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share is based on the profit/(loss) attributable to the Company's equity holders for each of the Relevant Periods and on the 495,000,000 ordinary shares issued (being the number of shares of the Company prior to the listing of the Company's shares on the Stock Exchange) as if these shares had been in issue on 1 January 2004.

No diluted earnings/(loss) per share have been presented as the Company has no dilutive potential shares.

14. PROPERTY, PLANT AND EQUIPMENT

| | Leasehold improvements HK\$'000 | Machinery, equipment, furniture and fixtures HK\$'000 | Computers HK\$'000 | Total HK\$'000 |
|---------------------------------|---------------------------------------|---|-----------------------|-------------------|
| Cost | | | | |
| At 1 January 2004 | 11,477 | 16,228 | 31,335 | 59,040 |
| Additions | 315 | 621 | 2,403 | 3,339 |
| Disposals | (600) | (1,162) | (3,909) | (5,671) |
| At 31 December 2004 | 11,192 | 15,687 | 29,829 | 56,708 |
| Additions | 850 | 1,075 | 2,140 | 4,065 |
| Disposals | – | (45) | (907) | (952) |
| At 31 December 2005 | 12,042 | 16,717 | 31,062 | 59,821 |
| Additions | – | – | 463 | 463 |
| Disposals | (8,392) | (7,086) | (4,032) | (19,510) |
| At 31 December 2006 | 3,650 | 9,631 | 27,493 | 40,774 |
| Additions | – | 21 | 1,020 | 1,041 |
| Disposals | – | (42) | (59) | (101) |
| At 30 June 2007 | 3,650 | 9,610 | 28,454 | 41,714 |
| Accumulated Depreciation | | | | |
| At 1 January 2004 | 9,720 | 15,037 | 25,510 | 50,267 |
| Charge for the year | 687 | 300 | 3,341 | 4,328 |
| Disposals | (95) | (1,161) | (3,908) | (5,164) |
| At 31 December 2004 | 10,312 | 14,176 | 24,943 | 49,431 |
| Charge for the year | 568 | 329 | 1,949 | 2,846 |
| Disposals | – | (26) | (754) | (780) |
| At 31 December 2005 | 10,880 | 14,479 | 26,138 | 51,497 |
| Charge for the year | 501 | 339 | 1,970 | 2,810 |
| Disposals | (8,388) | (7,018) | (4,031) | (19,437) |
| At 31 December 2006 | 2,993 | 7,800 | 24,077 | 34,870 |
| Charge for the period | 233 | 161 | 1,023 | 1,417 |
| Disposals | – | (94) | – | (94) |
| At 30 June 2007 | 3,226 | 7,867 | 25,100 | 36,193 |
| Carrying values | | | | |
| At 31 December 2004 | <u>880</u> | <u>1,511</u> | <u>4,886</u> | <u>7,277</u> |
| At 31 December 2005 | <u>1,162</u> | <u>2,238</u> | <u>4,924</u> | <u>8,324</u> |
| At 31 December 2006 | <u>657</u> | <u>1,831</u> | <u>3,416</u> | <u>5,904</u> |
| At 30 June 2007 | <u>424</u> | <u>1,743</u> | <u>3,354</u> | <u>5,521</u> |

15. INVESTMENT IN A SUBSIDIARY

| | <u>As at 31 December</u> | | <u>As at</u> |
|--------------------------|--------------------------|-----------------|-----------------|
| | 2005 | 2006 | 30 June |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Unlisted shares, at cost | <u>–</u> | <u>–</u> | <u>146,171</u> |

16. INVESTMENT IN AN ASSOCIATE

| | <u>As at 31 December</u> | | | <u>As at</u> |
|---------------------|--------------------------|-----------------|-----------------|-----------------|
| | 2004 | 2005 | 2006 | 30 June |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Share of net assets | <u>24,717</u> | <u>25,866</u> | <u>26,346</u> | <u>25,861</u> |

As at 30 June 2007, the Group held interests in the following associate:

| Name of company | Place of incorporation | Particulars of issued shares held | Effective percentage holding |
|---------------------------------------|-------------------------------|--|-------------------------------------|
| Unimax Holdings Limited ("Unimax") | The British Virgin Islands | 98 ordinary shares of US\$1 each | 49% |

The associate is held indirectly by the Company and operates in Hong Kong.

Unimax is an investment holding company whose subsidiaries are principally engaged in the design and marketing of pre-school toys, dolls and die cast models.

Summary financial information of the associate

| | Assets <i>HK\$'000</i> | Liabilities <i>HK\$'000</i> | Equity <i>HK\$'000</i> | Revenues <i>HK\$'000</i> | Profit/(loss) <i>HK\$'000</i> |
|----------------------------|---------------------------|--------------------------------|---------------------------|-----------------------------|----------------------------------|
| 31 December 2004 | | | | | |
| 100 per cent | 67,397 | 16,955 | 50,442 | 97,833 | (2,326) |
| Group's effective interest | <u>33,024</u> | <u>8,307</u> | <u>24,717</u> | <u>47,938</u> | <u>(1,140)</u> |
| 31 December 2005 | | | | | |
| 100 per cent | 68,087 | 15,300 | 52,787 | 100,984 | 2,345 |
| Group's effective interest | <u>33,363</u> | <u>7,497</u> | <u>25,866</u> | <u>49,482</u> | <u>1,149</u> |
| 31 December 2006 | | | | | |
| 100 per cent | 71,583 | 17,814 | 53,769 | 114,481 | 5,979 |
| Group's effective interest | <u>35,075</u> | <u>8,729</u> | <u>26,346</u> | <u>56,096</u> | <u>2,930</u> |
| 30 June 2007 | | | | | |
| 100 per cent | 69,333 | 16,556 | 52,777 | 41,533 | (991) |
| Group's effective interest | <u>33,973</u> | <u>8,112</u> | <u>25,861</u> | <u>20,351</u> | <u>(485)</u> |

17. INVENTORIES

| | As at 31 December | | | As at 30 June |
|----------------|-------------------|-----------------|-----------------|------------------|
| | 2004 | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Finished goods | <u>36,736</u> | <u>57,606</u> | <u>49,353</u> | <u>48,917</u> |

As at 30 June 2007, the carrying amount of inventories that are carried at net realisable value amounted to HK\$8,250,000 (31 December 2004: HK\$3,599,000, 31 December 2005: HK\$5,482,000, 31 December 2006: HK\$8,848,000).

18. TRADE RECEIVABLES

| | As at 31 December | | | As at |
|--|-------------------|----------------|----------------|----------------|
| | 2004 | 2005 | 2006 | 30 June |
| | HK\$'000 | HK\$'000 | HK\$'000 | 2007 |
| Trade receivables | 366,314 | 386,327 | 363,363 | 128,826 |
| Less: Allowance for customer concession | (28,290) | (13,366) | (8,560) | (7,233) |
| Provision for doubtful debts | (1,591) | (1,591) | (1,591) | — |
| | <u>336,433</u> | <u>371,370</u> | <u>353,212</u> | <u>121,593</u> |

The following is an aging analysis of trade receivables at the respective balance sheet dates:

| | As at 31 December | | | As at |
|--------------|-------------------|----------------|----------------|----------------|
| | 2004 | 2005 | 2006 | 30 June |
| | HK\$'000 | HK\$'000 | HK\$'000 | 2007 |
| 0 – 30 days | 335,141 | 367,555 | 342,115 | 111,033 |
| 30 – 60 days | 17 | 317 | 4,291 | 9,151 |
| Over 60 days | 1,275 | 3,498 | 6,806 | 1,409 |
| | <u>336,433</u> | <u>371,370</u> | <u>353,212</u> | <u>121,593</u> |

The normal trade terms with toys business customers are letters of credit at sight or usance or on open accounts with credit term of 60 days on average.

19. OTHER RECEIVABLES, DEPOSITS AND PREPAYMENTS

| | As at 31 December | | | As at |
|-------------------|-------------------|---------------|---------------|---------------|
| | 2004 | 2005 | 2006 | 30 June |
| | HK\$'000 | HK\$'000 | HK\$'000 | 2007 |
| Prepayments | 28,749 | 36,291 | 52,813 | 56,974 |
| Deposits | 2,434 | 2,503 | 2,607 | 2,027 |
| Other receivables | 502 | 5,648 | 4,339 | 7,451 |
| | <u>31,685</u> | <u>44,442</u> | <u>59,759</u> | <u>66,452</u> |

20. AMOUNTS DUE FROM/(TO) RELATED COMPANIES

(a) Group

| | As at 31 December | | | As at 30 June |
|--|-------------------|-----------------|-----------------|------------------|
| | 2004 | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Amount due from a fellow subsidiary under current assets (<i>Note (i)</i>) | | | | |
| – Non-interest bearing, arising from expenses paid on behalf of the fellow subsidiary | <u>–</u> | <u>130</u> | <u>244</u> | <u>29</u> |
| Amount due from intermediate holding companies under current assets (<i>Notes (ii) and (iv)</i>) | | | | |
| – Non-interest bearing, comprising mainly dividends received from the associate | <u>2,450</u> | <u>2,543</u> | <u>4,993</u> | <u>4,993</u> |
| Amount due to a fellow subsidiary under current liabilities (<i>Note (i)</i>) | | | | |
| – Non-interest bearing, arising from the management services fee paid | <u>(1,500)</u> | <u>–</u> | <u>–</u> | <u>–</u> |
| Amount due to the ultimate holding company under current liabilities (<i>Note (iii)</i>) | | | | |
| – Non-interest bearing, arising from the share-based compensation | <u>(6,884)</u> | <u>(14,245)</u> | <u>(19,942)</u> | <u>(8,355)</u> |

(b) Company

| | As at 31 December | | As at |
|--|--------------------------|-----------------|-----------------|
| | | | 30 June |
| | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Amount due from an intermediate holding company under current assets (<i>Note (iv)</i>) | | | |
| – Non-interest bearing, arising from paid-in capital receivable | <u>93</u> | <u>93</u> | <u>93</u> |
| | | | |
| Amount due to a fellow subsidiary under current liabilities (<i>Note (i)</i>) | | | |
| – Non-interest bearing, arising from expenses paid on behalf of the Company | <u>(56)</u> | <u>(106)</u> | <u>(106)</u> |

Note:

These balances are non-tradable in nature and will be fully settled before listing. Name of these related parties:

- (i) PIL Finance Limited
- (ii) PIL Investments Limited
- (iii) Playmates Holdings Limited
- (iv) Playmates International Limited

21. TAXATION RECOVERABLE/TAXATION PAYABLE

Movement of taxation recoverable/(payable):

| | As at 31 December | | | As at 30 June |
|--|------------------------|------------------------|-------------------|---------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| At 1 January | (38,331) | (72,998) | (72,817) | 288 |
| Hong Kong Profits Tax paid | 76 | – | 3,257 | 425 |
| Hong Kong Profits Tax refunded | – | – | – | (497) |
| Overseas tax paid | 7,643 | 2,574 | 69,633 | 16 |
| Overseas tax refunded | – | – | (1,314) | – |
| Current taxation (<i>Note 8</i>) | <u>(42,386)</u> | <u>(2,393)</u> | <u>1,529</u> | <u>(356)</u> |
| At 31 December/30 June (<i>Note</i>) | <u><u>(72,998)</u></u> | <u><u>(72,817)</u></u> | <u><u>288</u></u> | <u><u>(124)</u></u> |

Note:

Balances represented by:

| | As at 31 December | | | As at 30 June |
|----------------------|------------------------|------------------------|-------------------|---------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| Taxation recoverable | – | – | 1,043 | 1,059 |
| Taxation payable | <u>(72,998)</u> | <u>(72,817)</u> | <u>(755)</u> | <u>(1,183)</u> |
| | <u><u>(72,998)</u></u> | <u><u>(72,817)</u></u> | <u><u>288</u></u> | <u><u>(124)</u></u> |

22. TRADE PAYABLES

The following is an aging analysis of trade payables at the respective balance sheet dates.

| | As at 31 December | | | As at |
|--------------|-------------------|---------------|---------------|---------------|
| | 2004 | 2005 | 2006 | 30 June |
| | HK\$'000 | HK\$'000 | HK\$'000 | 2007 |
| 0 – 30 days | 37,113 | 67,308 | 53,216 | 43,260 |
| 31 – 60 days | 22,633 | 22,912 | 37,380 | 4,038 |
| Over 60 days | 1,897 | 557 | 445 | 219 |
| | <u>61,643</u> | <u>90,777</u> | <u>91,041</u> | <u>47,517</u> |

23. OTHER PAYABLES AND ACCRUED CHARGES

| | As at 31 December | | | As at |
|---------------------|-------------------|----------------|----------------|---------------|
| | 2004 | 2005 | 2006 | 30 June |
| | HK\$'000 | HK\$'000 | HK\$'000 | 2007 |
| Accrued royalties | 51,633 | 34,031 | 41,922 | 13,963 |
| Accrued advertising | 38,172 | 53,276 | 32,488 | 3,867 |
| Accrued payroll | 23,353 | 9,859 | 9,015 | 4,884 |
| Temporary receipts | 2,187 | 7,770 | 9,723 | 9,472 |
| Others | 13,804 | 27,553 | 29,828 | 25,272 |
| | <u>129,149</u> | <u>132,489</u> | <u>122,976</u> | <u>57,458</u> |

24. BANK LOANS

| | As at 31 December | | | As at |
|---|-------------------|---------------|---------------|----------|
| | 2004 | 2005 | 2006 | 30 June |
| | HK\$'000 | HK\$'000 | HK\$'000 | 2007 |
| Unsecured bank loans payable within one year | <u>19,500</u> | <u>19,000</u> | <u>66,500</u> | <u>–</u> |

As at 30 June 2007, the Group had banking facilities amounting to approximately HK\$255,000,000 (31 December 2004, 2005 and 2006: HK\$255,000,000), of which no facility (31 December 2004: HK\$19,500,000, 31 December 2005: HK\$19,000,000, 31 December 2006: HK\$66,500,000) was utilised.

Current unsecured bank loans as at 31 December 2004, 2005 and 2006 carried interest rates ranging from 1.09% to 1.18% per annum, 5.03% to 5.10% per annum and 4.92% to 5.09% per annum respectively.

25. PROVISIONS

The Group continually assesses potential exposures to customer and supplier claims and, where necessary, establishes provisions for any such exposures as described as below:

Consumer Returns

The Group uses agreed customer allowances based on a percentage of sales and information on actual consumer returns of defective goods to estimate return percentages. The provision is calculated based on these factors and is adjusted for any fluctuations in the returns expected by management as of each period end.

Most of the Group's retail customers receive a fixed percentage of sales as their allowance. Some of these customers receive a higher percentage rate on certain electronic products. The allowance for each retail customer is agreed and documented in the terms of trade. Certain customers receive an allowance based on their actual consumer return experience.

In evaluating the adequacy of the prior year provision, the Group prepares an analysis to determine the reasons for unclaimed deductions. If the analysis determines that some carry forward provision amounts were no longer appropriate based on actual claims experience, the proper adjustments will be made to release the over-accrued portion.

Cooperative Advertising

The Group participates in customer advertising programmes and allows certain customers to take a percentage of sales deduction, which is negotiated on an individual basis. In addition, the Group contributes toward specific expenses of the customers for in-store sales promotions and advertising circulars.

In the case of fixed percentage, the amounts are negotiated and documented in the terms of trade with the respective customer. In the case of all special programs, the program application, limits and amounts are offered on a case by case basis by the Group. A Special Terms and Agreement form is prepared for each program. Some of the programs are set for defined periods of time or limited to a maximum number of units sold, and confirming data is provided by the retailer to finalize the actual program cost.

Claims for cooperative advertising may be received up to two years after the relevant balance sheet date and, in certain cases, later. The Group reviews the provisions periodically and any unutilized amount will be reversed at the year end.

Cancellation Charges

The provision represents the estimated amounts that would be payable to suppliers to settle the cost incurred by them for production orders which have been or are likely to be cancelled. The Group generally settles these amounts in the year after the year that specific product ceases to be actively sold to customers.

In most cases, the vendor may try to mitigate the Group's exposure by utilizing the unused components in its other products. Such arrangement may also reduce the Group's potential cancellation exposure.

At each relevant balance sheet date, the Group will analyze the potential cancellation charge exposure for order cancellations due to commitments for finished goods, work in process items and material authorizations. The Group will also review if any items can be carried over to be produced and sold in the subsequent year. Those items are then deducted from the potential cancellation exposure. Once the exposure is adjusted for the carry over, the remaining exposure is adjusted by a factor representing the historical negotiated discount agreed with the suppliers.

All provisions are established for specific exposures.

Management relies on available contemporary and historical information to evaluate each potential exposure and exercises its best judgment to estimate the amount of provision necessary and sufficient for each potential exposure.

Over- or under-provision for the above exposures, arising from subsequent events and the eventual settlement, are adjusted in that subsequent period where appropriate.

The summary of changes in provisions during the years/period reported is as follows:

| | 2004 | 2005 | 2006 | 2007 |
|-----------------------------------|----------------------|----------------------|----------------------|----------------------|
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| At 1 January | 50,640 | 64,809 | 51,775 | 49,260 |
| Additional provisions made | 55,452 | 53,743 | 52,288 | 14,608 |
| Provisions utilised | (35,147) | (46,257) | (51,670) | (35,413) |
| Reversal of unutilised provisions | <u>(6,136)</u> | <u>(20,520)</u> | <u>(3,133)</u> | <u>(1,675)</u> |
| At 31 December/30 June | <u><u>64,809</u></u> | <u><u>51,775</u></u> | <u><u>49,260</u></u> | <u><u>26,780</u></u> |

26. DEFERRED TAXATION

Deferred taxation is calculated in full on temporary differences under the liability method using taxation rate of 17.5% (31 December 2004, 2005 and 2006: 17.5%) in Hong Kong, and federal and state tax rates of 34% (31 December 2004, 2005 and 2006: 35%) and 8.84% (31 December 2004: 7.57%, 31 December 2005: 7.32% and 31 December 2006: 8.46%) respectively in the United States of America.

The movement on the deferred tax assets/(liabilities) account is as follows:

| | 2004 | 2005 | 2006 | 2007 |
|---|----------------------|----------------------|----------------------|----------------------|
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| At 1 January | 146 | 68,391 | 85,458 | 79,896 |
| Credited/(charged) to income statement | <u>68,245</u> | <u>17,067</u> | <u>(5,562)</u> | <u>(4,981)</u> |
| At 31 December/30 June | <u><u>68,391</u></u> | <u><u>85,458</u></u> | <u><u>79,896</u></u> | <u><u>74,915</u></u> |

The movement in deferred tax assets and liabilities (prior to offsetting of balances within the same taxation jurisdiction) during the year/period is as follows:

Deferred tax liabilities

| | Accelerated tax depreciation (Note 1) | | | |
|---|--|---------------------|--------------------|--------------------|
| | 2004 | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| At 1 January | – | – | (270) | (94) |
| (Charged)/credited to income statement | <u>–</u> | <u>(270)</u> | <u>176</u> | <u>–</u> |
| At 31 December/30 June | <u><u>–</u></u> | <u><u>(270)</u></u> | <u><u>(94)</u></u> | <u><u>(94)</u></u> |

Deferred tax assets

| | Tax losses (Note 2) | | | |
|---|----------------------------|----------------------|----------------------|----------------------|
| | 2004 | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| At 1 January | <u>–</u> | <u>65,948</u> | <u>80,660</u> | <u>72,195</u> |
| Credited/(charged) to income statement: | | | | |
| Recognition of previously unrecognised tax losses | 133,930 | 22,600 | – | – |
| Tax losses recognised | – | – | – | 3,699 |
| Tax benefits on interest and state taxes associate with the tax cases | – | 15,996 | (2,152) | – |
| Utilization of deferred tax assets | <u>(67,982)</u> | <u>(23,884)</u> | <u>(6,313)</u> | <u>(8,680)</u> |
| | <u>65,948</u> | <u>14,712</u> | <u>(8,465)</u> | <u>(4,981)</u> |
| At 31 December/30 June | <u><u>65,948</u></u> | <u><u>80,660</u></u> | <u><u>72,195</u></u> | <u><u>67,214</u></u> |

| | Employees benefits (Note 3) | | | |
|---|------------------------------------|--------------------------------|--------------------------------|--------------------------------|
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| At 1 January | 146 | 2,443 | 5,068 | 7,795 |
| Credited to income statement, net | <u>2,297</u> | <u>2,625</u> | <u>2,727</u> | <u>–</u> |
| At 31 December/30 June | <u><u>2,443</u></u> | <u><u>5,068</u></u> | <u><u>7,795</u></u> | <u><u>7,795</u></u> |
| | Total | | | |
| | 2004 <i>HK\$'000</i> | 2005 <i>HK\$'000</i> | 2006 <i>HK\$'000</i> | 2007 <i>HK\$'000</i> |
| At 1 January | 146 | 68,391 | 85,728 | 79,990 |
| Credited/(charged) to income statement | <u>68,245</u> | <u>17,337</u> | <u>(5,738)</u> | <u>(4,981)</u> |
| At 31 December/30 June | <u><u>68,391</u></u> | <u><u>85,728</u></u> | <u><u>79,990</u></u> | <u><u>75,009</u></u> |

Note:

- (1) Accelerated tax depreciation is taxable temporary difference that will result in taxable amounts in determining taxable profit of future periods when the carrying amount of the asset is recovered. The accelerated tax depreciation is arising from the difference between the carrying amount and tax base of property, plant and equipment and has been recognized as deferred tax liabilities in the Group's financial statements. When the difference between the carrying amount and tax base of property, plant and equipment reduced, deferred tax liabilities is decreased and credited to the Group's income statement.
- (2) Through 31 December 2003, the Group did not recognise its deferred tax assets in respect of the Group's net operating losses in the U.S. ("NOL") due to the then uncertainties concerning its ability to utilise such deferred tax assets.

In 2004, the Group recorded substantial profits and was able to utilise a substantial amount of the NOL. Based on prudent projections the Group would continue to be profitable in 2005 and onwards. Accordingly, the directors were of the opinion that it was appropriate to recognise the deferred tax assets since it became more likely than not that the Group would have the ability to utilise such tax assets. In 2004, previously unrecognized deferred tax assets amounting to HK\$133,930,000 (or approximately US\$17 million) were recognised by capitalising the NOL to the extent that realisation of the related tax benefits was probable through anticipated future taxable profits expected to be generated in 2005 and onwards. HK\$67,982,000 of such deferred tax assets was utilised in 2004.

In 2005, the Group further recognised previously unrecognized deferred tax assets in respect of NOL and tax benefits on interest and state taxes associated with the tax cases as detailed in Note 8 of the Notes to the Financial Information amounting to HK\$38,596,000 (or approximately US\$5 million). HK\$23,884,000 of the such deferred tax assets was utilised in 2005.

As a result of the reversal of provision for tax cases in 2006, the deferred tax credit benefiting on interest and state taxes associate with tax cases reduced by HK\$2,152,000 and charged to income statement accordingly. HK\$6,313,000 of the deferred tax assets in respect of NOL was utilised in 2006. HK\$3,699,000 of the deferred tax assets in respect of the NOL was recognised for period ended 30 June 2007 and HK\$8,680,000 of deferred tax assets was utilised in respect of the NOL offsetting the U.S. tax arising from the capital gain pursuant to the Reorganization in the first half of 2007. Other than the utilisation of deferred tax assets, no gain is recognised in the income statement of the Group.

- (3) Employees benefits are related to the share-based payment transactions for U.S. subsidiaries of the Group. The Group recognized an expense for the consumption of employee services received as consideration for share options granted, in accordance with HKFRS 2 Share-based payment, and did not receive a tax deduction for U.S. subsidiaries of the Group until the share options are exercised. As a result, the difference between the tax base of the employee services received to date and the carrying amount is deductible temporary difference that results in a deferred tax asset for U.S. subsidiaries of the Group. Such deferred tax asset is utilized when the share options are exercised. Net credit to the income statement represents the deferred tax asset on employees benefits recognised upon granting of the share options less the amount utilised upon exercising of the share options during the Relevant Period.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the combined balance sheet:

| | As at 31 December | | | As at 30 June |
|--------------------------|-------------------|-----------------|-----------------|------------------|
| | 2004 | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Deferred tax assets | 68,391 | 85,728 | 80,077 | 75,096 |
| Deferred tax liabilities | — | (270) | (181) | (181) |
| | 68,391 | 85,458 | 79,896 | 74,915 |

27. CAPITAL AND RESERVES

(a) Share Capital

GROUP

For the purpose of the preparation of the combined balance sheets, the share capital at 31 December 2004 represents the aggregate amount of the nominal value of the share capital of the companies comprising the Group.

COMPANY

| | <u>At incorporation</u> | <u>As at 31 December</u> | | <u>As at 30 June</u> |
|---|-----------------------------|--------------------------|-----------------|--------------------------|
| | | 2005 | 2006 | 2007 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Authorised, issued and fully paid: | | | | |
| 12,000 Ordinary shares of US\$1.00 each | <u>93</u> | <u>93</u> | <u>93</u> | <u>93</u> |

The Company was incorporated as an exempted company with limited liability in Bermuda on 11 April 2005 under the Companies Act 1981 of Bermuda.

(b) Reserves

GROUP

Capital reserves represent the aggregate amount of the share capital and share premium of the companies comprising the Group. During the six months ended 30 June 2007, the Group recorded contribution of HK\$35,630,000 made by PIL pursuant to the Reorganization.

COMPANY

The contributed surplus represents the book value of assets contributed by PIL pursuant to the Reorganization.

The application of the contributed surplus is governed by the Companies Act 1981 of Bermuda.

(c) Capital Management

The primary objective of the Group's capital management is to provide a reasonable return for shareholders and benefits for other stakeholders by pricing products and services commensurately with the level of risk, and to safeguard the entity's ability to continue as a going concern.

The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions. In order to maintain or adjust the capital structure, the Group may adjust the amount by issuing new shares or sell assets to reduce debt.

28. EQUITY SETTLED SHARE-BASED TRANSACTIONS

At the special general meetings of PHL, the ultimate holding company of the Company, held on 4 May 1998 and 28 June 2002, a Share Option Plan ("Plan") and a Share Option Scheme ("Scheme") respectively were approved and adopted. A nominal consideration at HK\$10 or US\$1.5 was paid by each option holder for each lot of share option granted. Share options are exercisable in stages in accordance with the terms of the Plan and the Scheme within ten years after the date of grant. Movements in the number of share options held by the Group's directors and employees outstanding during the Relevant Period are as follows:

| | 2004 | | Year ended 31 December 2005 | | 2006 | | Six months ended 30 June 2007 | |
|---------------------------------|--|---------------------------------|--|---------------------------------|--|---------------------------------|--|---------------------------------|
| | Weighted average exercise price HK\$ | Number of options '000 | Weighted average exercise price HK\$ | Number of options '000 | Weighted average exercise price HK\$ | Number of options '000 | Weighted average exercise price HK\$ | Number of options '000 |
| At the beginning | | | | | | | | |
| of the year/period | 0.385 | 35,696 | 0.783 | 53,987 | 0.946 | 64,051 | 0.960 | 70,192 |
| Granted (<i>Note (a)</i>) | 1.305 | 23,822 | 1.206 | 19,902 | 0.914 | 14,628 | - | - |
| Exercised (<i>Note (b)</i>) | 0.401 | (4,519) | 0.384 | (7,444) | 0.384 | (3,138) | 0.686 | (1,088) |
| Lapsed | 0.722 | (1,012) | 1.185 | (2,394) | 1.000 | (5,349) | 1.060 | (681) |
| At the end of the | | | | | | | | |
| year/period (<i>Note (c)</i>) | 0.783 | <u>53,987</u> | 0.946 | <u>64,051</u> | 0.960 | <u>70,192</u> | 0.963 | <u>68,423</u> |

Notes:

- (a) Share options were granted to PHL's and the Group's directors and employees on 9 January 2006 and 4 May 2006 at the exercise price of HK\$1.030 and HK\$0.910 per share respectively (2005: 22 September 2005 at the exercise price of HK\$1.206 per share; 2004: 7 January 2004 and 19 March 2004 at the exercise price of HK\$1.360 and HK\$1.240 per share respectively) and expiring on 8 January 2016 and 3 May 2016 respectively (2005: 21 September 2015; 2004: 6 January 2014 and 18 March 2014 respectively).
- (b) The weighted average closing price per ordinary share of PHL immediately before the dates on which the options were exercised during the year ended 31 December 2006 was HK\$0.906 (2005: HK\$1.364; 2004: HK\$1.189).

The weighted average closing price per ordinary share of PHL immediately before the dates on which the options were exercised during the six months ended 30 June 2007 was HK\$1.140.

- (c) The options outstanding at 31 December 2006 had the exercise prices from HK\$0.199 to HK\$1.360 (2005: from HK\$0.199 to HK\$1.360; 2004: from HK\$0.199 to HK\$1.360) and weighted average remaining contractual life of 7.46 years (2005: 7.84 years; 2004: 7.94 years).

The options outstanding at 30 June 2007 had the exercise prices from HK\$0.199 to HK\$1.360 and weighted average remaining contractual life of 7.22 years.

No share options were cancelled during the 2006 (2005: nil; 2004: nil) and the six months ended 30 June 2007.

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes option pricing model.

Fair value of share options and assumptions:

| | 2004 (weighted average) | 2005 | 2006 (weighted average) |
|---|--|-------------|--|
| Fair value at measurement date | 0.660 | 0.509 | 0.361 |
| Share price | 1.310 | 1.206 | 0.913 |
| Exercise price | 1.310 | 1.206 | 0.913 |
| Expected volatility | 67.37% | 51.63% | 50.33% |
| Expected option life | 5 years | 5 years | 5 years |
| Expected dividend yield | 2.00% | 2.00% | 2.59% |
| Risk-free interest rate (based on Exchange Fund Notes) | 2.73% | 4.17% | 4.35% |

The expected volatility is based on the historic volatility (calculated based on the weighted average life of the share options), adjusted for any expected changes to future volatility due to publicly available information. Expected dividend yield is based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share option grants.

During the years ended 31 December 2004, 2005, 2006 and the six months ended 30 June 2007, the share-based compensation expense of HK\$6,432,000, HK\$7,304,000, HK\$7,701,000 and HK\$1,977,000 had been accounted for in the Group's income statement.

The directors of the Company anticipate that no further option will be granted to them and employees of the Company under the Scheme after listing. The Company will set up its own share option scheme after listing and the directors of the Company will consider such options under its own scheme as may be granted to directors and employees of the Group.

29. NOTES TO THE COMBINED CASH FLOW STATEMENTS

(a) Reconciliation of profit/(loss) before taxation to cash generated from operations

| | Year ended 31 December | | | Six months ended 30 June | |
|---|------------------------|------------------|------------------|-----------------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| | | | | (Unaudited) | |
| Profit/(loss) before taxation | 155,249 | 89,329 | 30,157 | (32,275) | (9,300) |
| Interest income | (739) | (3,002) | (5,131) | (2,406) | (2,421) |
| Interest on bank loans and overdrafts | 1,086 | 565 | 1,337 | 45 | 118 |
| Depreciation | 4,328 | 2,846 | 2,810 | 1,423 | 1,417 |
| Loss on disposal of fixed assets | 507 | 172 | 69 | 39 | 7 |
| Share of loss/(profit) of an associated company | 1,140 | (1,149) | (2,930) | 923 | 485 |
| Operating profit/(loss) before working capital changes | 161,571 | 88,761 | 26,312 | (32,251) | (9,694) |
| (Increase)/decrease in inventories | (7,628) | (20,870) | 8,253 | 3,316 | 436 |
| (Increase)/decrease in trade receivables, other receivables, deposits and prepayments | (72,568) | (47,694) | 2,841 | 232,035 | 224,926 |
| Increase/(decrease) in trade payables, other payables and accrued charges and provisions | 30,169 | 19,440 | (11,764) | (140,428) | (131,522) |
| Increase/ (decrease) in due from/(to) related companies | 8,517 | 5,638 | 5,583 | 4,689 | (11,372) |
| Cash generated from operations | <u>120,061</u> | <u>45,275</u> | <u>31,225</u> | <u>67,361</u> | <u>72,774</u> |

(b) Analysis of cash and cash equivalents

| | As at 31 December | | | As at 30 June | |
|------------------------|-------------------|------------------|------------------|------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| | | | | (Unaudited) | |
| Cash and bank balances | <u>39,391</u> | <u>80,057</u> | <u>90,541</u> | <u>116,447</u> | <u>97,103</u> |

The bank balances bear deposit rates granted by banks for each of the Relevant Periods.

30. COMMITMENTS**Licensing commitments**

In the normal course of business, the Group enters into contractual licensing agreements to secure its rights to design, develop, market and distribute certain toys and toy and family entertainment activity products for future sales. Certain licensing agreements contain financial commitments by the Group to the licensors to be fulfilled during the term of the respective contracts. The amounts of financial commitments contracted but not provided for at the end of the year/period were payable as follows:

| | As at 31 December | | | As at |
|---|--------------------------|----------------------|----------------------|----------------------|
| | 2004 | 2005 | 2006 | 30 June |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Within one year | 17,470 | 31,220 | 24,469 | 38,083 |
| In the second to fifth years inclusive | <u>15,990</u> | <u>20,475</u> | <u>19,188</u> | <u>22,698</u> |
| | <u><u>33,460</u></u> | <u><u>51,695</u></u> | <u><u>43,657</u></u> | <u><u>60,781</u></u> |

The Company did not have any commitments at 30 June 2007 (31 December 2005 and 2006: HK\$ Nil).

31. OPERATING LEASE ARRANGEMENTS

The Group acts as lessee under operating leases for its office and warehouse locations. Details of the Group's commitments under non-cancellable operating leases are set out as follows:

At the balance sheet dates, the future aggregate minimum lease payments under non-cancellable operating leases for office and warehouse facilities payable by the Group were as follows:

| | As at 31 December | | | As at |
|---|--------------------------|----------------------|----------------------|----------------------|
| | 2004 | 2005 | 2006 | 30 June |
| | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Within one year | 9,925 | 9,871 | 7,731 | 6,722 |
| In the second to fifth years inclusive | <u>25,282</u> | <u>19,122</u> | <u>11,548</u> | <u>8,999</u> |
| After the fifth year | <u>1,274</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| | <u><u>36,481</u></u> | <u><u>28,993</u></u> | <u><u>19,279</u></u> | <u><u>15,721</u></u> |

32. RELATED PARTY TRANSACTIONS

The Group entered into the following significant transactions with related parties for each of the Relevant Periods:

| | Year ended 31 December | | | Six months ended 30 June | |
|--|------------------------|------------------|------------------|-----------------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| | | | | (Unaudited) | |
| Rent paid to fellow subsidiaries, Belmont Limited and Bagnols Limited | 829 | 574 | 674 | 341 | 185 |
| Management services fee paid to a fellow subsidiary, PIL Finance Limited (<i>Note</i>) | 1,500 | – | – | – | – |
| Share-based compensation in respect of the share options granted by the ultimate holding company | <u>6,432</u> | <u>7,304</u> | <u>7,701</u> | <u>4,719</u> | <u>1,977</u> |

Note: The management services fee paid to a fellow subsidiary for the discretionary bonus paid to Mr. Chan Chun Hoo, Thomas in relation to his contribution to the improved performance of the Group.

Key management compensation

Remuneration for key management personnel, including amounts paid to the Company's executive directors and the five highest paid individuals as disclosed in Note 11, is as follows:

| | Year ended 31 December | | | Six months ended 30 June | |
|--|------------------------|------------------|------------------|-----------------------------|------------------|
| | 2004 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 |
| | | | | (Unaudited) | |
| Salaries, other allowances and benefits in kind | 9,179 | 10,662 | 13,910 | 9,180 | 6,544 |
| Share-based compensation | 4,461 | 5,657 | 4,574 | 3,141 | 1,491 |
| Performance bonus | 9,347 | 3,329 | 1,718 | – | – |
| Employer's contribution to provident fund | <u>307</u> | <u>303</u> | <u>354</u> | <u>276</u> | <u>186</u> |
| | <u>23,294</u> | <u>19,951</u> | <u>20,556</u> | <u>12,597</u> | <u>8,221</u> |

Total remuneration is included in "staff costs" (Note 10).

Corporate guarantees

The ultimate holding company has given guarantees to certain banks for facilities granted to the group entities during the Relevant Periods free of charge.

The directors of the Company have advised that the Company will substitute for PHL as guarantor prior to the listing of the Company's shares on the Stock Exchange.

Other guarantees

The ultimate holding company has guaranteed the due performance of Playmates Toys Inc., a subsidiary of the Company, under the Disney license, which granted in favour of Disney Enterprises Inc, and Disney Fairies License, which granted in favour of Disney Consumer Products.

The directors of the Company have advised that the Company will substitute for PHL as guarantor prior to the listing of the Company's shares on the Stock Exchange.

Trademark

A fellow subsidiary had provided the right for the use of the trademark "Playmates®" by Playmates Toys Inc. at nil consideration during the Relevant Period. Pursuant to the assignment entered into between a subsidiary of PHL and the Group, the trademark will be assigned to the Group for nominal consideration, conditional upon listing.

In the opinion of the directors, the related party transactions were conducted in the ordinary and usual course of business and on normal commercial terms.

The directors of the Company consider that these related party transactions are expected to discontinue after listing, except for the rent paying to fellow subsidiaries. Such rent paying to fellow subsidiaries after listing would not be significant and is considered de minimis.

33. LITIGATION

Three plaintiffs (the "Plaintiffs") filed a complaint against a subsidiary of the Group (the "Subsidiary") in the California Superior Court arising out of a licensing agreement between one of the Plaintiffs and the Subsidiary. The Plaintiffs alleged a number of matters giving rise to numerous claims in relation to the license agreement, including breach of contract, fraud and deceit, trademark infringement, breach of implied covenant of good faith and fair dealing, breach of confidence, unfair competition, accounting and constructive trust, specific performance and declaratory relief. The amount of general damages alleged is approximately HK\$156,000,000, plus exemplary and punitive damages and attorneys' fee and costs.

In May 2007, the parties agreed to arbitrate both actions. The Subsidiary has filed counterclaims against the Plaintiffs relating to the same licensing agreement and to a consulting agreement between the parties. An initial arbitration hearing date has been set for 12 December 2007. The directors considered the fact that the Group has valid defences to these allegations and claims and the Group intends to defend ourselves vigorously against these claims. The Group reached a settlement with the Plaintiffs in respect of which a settlement agreement was signed on in December 2007, upon the execution of which all of the claims in the litigation was dismissed and all parties were released against all claims against each other. The directors do not believe the litigation will have a material adverse effect on the Group's results of operations and financial position.

34. FINANCIAL RISK MANAGEMENT

Exposure to credit, liquidity, interest rate and currency risks arises in the normal course of business. The risks are minimised by the financial management policies and practices described below.

(a) Credit Risk

Financial instruments that subject the Group to credit risk include cash equivalents and trade receivables. Cash equivalents consist principally of deposits and short-term money market funds placed with major financial institutions. These instruments are short-term in nature and bear minimal risk. To date, the Group has not experienced any losses on cash equivalents.

The Group sells its products primarily to national and regional mass-market retailers in the United States and to third party independent distributors outside the United States. Credit is extended to United States customers for domestic sales based on an evaluation of the customers' financial condition and generally collateral is not required. The Group assigns the majority of its trade receivables to factoring and receivable processing agencies. It is a common industrial practice in the United States. The factoring and receivable processing agent would perform credit analysis of our customers, credit approval and collection processing of the receivables. These agreements transfer the credit risk due to a customer's inability to pay to the factoring and receivable processing agent so as to mitigate credit exposure of the Group. All direct shipments to customers who are located either in the United States or outside of the United States are secured by letters of credit.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

(b) Concentrations of Credit Risk

The Group places its cash investments in short term deposits at highly rated financial institutions which limits the amount of credit exposure to any one financial institution.

The Group markets a substantial portion of its products to customers in the retail industry. The Group continually evaluates the credit risk of these customers.

(c) Interest Rate Risk

The Group maintains revolving credit facility with commercial banks that is used as the primary source of financing for the short term seasonal working capital requirement. As such, risk of changes in interest rate is not significant.

(d) Foreign Currencies

The Group is exposed to foreign currency risk primarily through sales that are denominated in a currency other than the functional currency of the operations of certain subsidiaries to which they relate. The currency giving rise to this risk is United States dollars. The Group does not hedge its foreign currency risks, as the rate of exchange between Hong Kong dollars and the United States dollars is controlled within a tight range. Permanent changes in foreign exchange rates would have an impact on combined earnings.

(e) **Fair Values**

All financial instruments are carried at amounts not materially different from their fair values as at each balance sheet date of the Relevant Periods.

The Group has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to shareholders.

35. SUBSEQUENT EVENTS

Save as disclosed in notes 8 and 33 to the Financial Information, the Group had the following significant subsequent events:

- (a) Pursuant to the written resolutions of sole shareholder of the Company passed on dated 17 December 2007, the shareholder of the Company has resolved to pay a dividend of HK\$4,856,000 to PIL Toys Limited by issuing 485,640,000 shares of HK\$0.01 each in the share capital of the Company.
- (b) On 17 December 2007, the Company's share option scheme was conditionally approved by the sole shareholder of the Company and adopted by the Board of Directors. Subject to the fulfillment of certain conditions, the Board of Directors may, pursuant to the terms and conditions of the share option scheme, grant options to employees, directors or non-executive directors of the Group. No options have been granted up to the date of this report.
- (c) Pursuant to a sale and purchase agreement dated 27 December 2007 between a subsidiary of PHL and the Group, 49% interest in the issued share capital of Unimax Holdings Limited has been transferred to the Group for a consideration of HK\$1.00.
- (d) On 27 December 2007, a fellow subsidiary of PHL entered into a trade mark assignment agreement with the Group to assign trademarks to the Group.

VII. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Group, the Company or any of the companies now comprising the Group in respect of any period subsequent to 30 June 2007.

Yours faithfully,

Moores Rowland
Chartered Accountants
Certified Public Accountants
Hong Kong

The following is the text of a letter, summary of values and valuation certificates received from Savills Valuation and Professional Services Limited, prepared for the purpose of incorporation in this listing document, in connection with its valuation as at 30 November 2007 for the property interests of the Group.



The Directors
Playmates Toys Limited
21st Floor
The Toy House
100 Canton Road
Tsim Sha Tsui
Kowloon

T: (852) 2801 6100
F: (852) 2530 0756

23/F Two Exchange Square
Central, Hong Kong

EA Licence: C-023750
savills.com

31 December 2007

Dear Sirs

RE: VALUATION OF VARIOUS PROPERTY INTERESTS IN HONG KONG, THE PEOPLE'S REPUBLIC OF CHINA ("THE PRC") AND UNITED STATES OF AMERICA ("USA")

In accordance with your instructions for us to value the various property interests held by Playmates Toys Limited (referred to as the "Company") and its subsidiaries (hereinafter together referred to as the "Group") located in Hong Kong, the PRC and USA, we confirm that we have carried out inspections, made relevant enquiries and carried out searches and obtained such further information as we consider necessary for the purpose of providing you with our opinion of values of these property interests as at 30 November 2007 for the purpose of incorporation of the listing document.

Our valuation of each of the property interests is our opinion of its market value which we would define as intended to mean "the estimated amount for which a Property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion".

The market value is the best price reasonably obtainable in the market by the seller and the most advantageous price reasonably obtainable in the market by the buyer. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, joint ventures, management agreements, special considerations or concessions granted by anyone associated with the sale, or any element of special value. The market value of a property interest is also estimated without regard to costs of sale and purchase, and without offset for any associated taxes.

Our valuation is prepared in accordance with The RICS Appraisal and Valuation Standards (5th Edition May 2003) published by the Royal Institution of Chartered Surveyors and The HKIS Valuation Standards on Properties (1st Edition 2005) published by The Hong Kong Institute of Surveyors and in compliance with the requirements of Chapter 5 and Practice Note 12 of Listing Rules published by the Stock Exchange of Hong Kong Limited.

In valuing the property interests in Group I, II and III which are rented by the Group in Hong Kong, the PRC and USA respectively under tenancy/licence agreements or leases, we are of the opinion that they have no commercial value mainly due to the short term nature of the property interests, the prohibition against assignment or sub-letting in the agreements or leases or otherwise, due to the lack of substantial profit rent.

For the property interests in Hong Kong, the PRC and USA, we have been provided with copies of relevant tenancy/licence agreements and leases. We have not, however, inspected the original documents to verify ownership or to ascertain the existence of any amendment which does not appear on the copies provided to us. We have relied on the advice given by the Group and its legal advisers, Sincere Partners & Attorneys, on PRC laws, regarding the title to the property interest in the PRC.

We have relied to a very considerable extent on information given by the Group and have accepted advice given to us on such matters as planning approvals or statutory notices, easements, tenure, particulars of occupancy, floor areas and all other relevant matters. Dimensions, measurements and areas included in the valuation certificate are based on information contained in the documents provided to us and are therefore only approximations. No on-site measurements have been taken. We have no reason to doubt the truth and accuracy of the information provided to us. We have also been advised by the Group that no material facts have been omitted from the information provided.

We have inspected the exterior of the properties valued and, where possible, we have also inspected the interior of the properties. However, no structural survey has been made, but in the course of our inspection, we did not note any serious defect. We are not, however, able to report whether the properties are free from rot, infestation or any other structural defect. No tests were carried out on any of the services.

No allowance has been made in our valuation for any charges, mortgages or amounts owing on the property interests nor for any expenses or taxation which may be incurred in effecting a sale. Unless otherwise stated, it is assumed that the property interests are free from encumbrances, restrictions, and outgoings of an onerous nature which could affect their values.

We enclose herewith our summary of values and valuation certificate.

Yours faithfully,
For and on behalf of
Savills Valuation and Professional Services Limited
Charles C K Chan
MSc FRICS FHKIS MCI Arb RPS (GP)
Managing Director

Note: Mr Charles C K Chan, chartered estate surveyor, *MSc, FRICS, FHKIS, MCI Arb, RPS(GP)*, has been a qualified valuer since June 1987 and has about 23 years experience in the valuation of properties in Hong Kong and about 17 years experiences in the valuation at properties in the PRC and extensive experience in the valuation of properties in USA.

SUMMARY OF VALUES

| Property | Capital value in existing state as at 30 November 2007 |
|---|---|
| Group I – Property interests rented by the Group in Hong Kong | |
| 1. Portions of 21st Floor, 100 Canton Road, Tsim Sha Tsui, Kowloon, Hong Kong | No commercial value |
| 2. 1A and 1B, 1st Floor of Phase I, Playmates Factory Building, 1 Tin Hau Road, Tuen Mun, New Territories, Hong Kong | No commercial value |
| 3. Unit A, Ground Floor of Phase II, Playmates Factory Building, 1 Tin Hau Road, Tuen Mun, New Territories, Hong Kong | No commercial value |
| 4. Units 405, 406A and 406B on the 4th Floor of InnoCentre, 72 Tat Chee Avenue, Kowloon Tong, Kowloon, Hong Kong | No commercial value |
| Group II – Property interest rented by the Group in the PRC | |
| 5. Rooms 2501 and 2502, Zheng Quan Building, 5020 Bin He Da Dao, Shenzhen, Guangdong Province, PRC | No commercial value |
| Group III – Property interests rented by the Group in USA | |
| 6. Building “Q-1”, Golden Springs Business Park, 12995 Marquardt, Santa Fe Springs, California, USA | No commercial value |
| 7. Portion of 6th Floor and Suite 600, 6th Floor, Comerica Bank, 611 Anton Boulevard, Costa Mesa, California, USA | No commercial value |

VALUATION CERTIFICATE

Group I – Property interests rented by the Group in Hong Kong

| Property | Description and tenancy particulars | Particulars of occupancy | Capital value in existing state as at 30 November 2007 |
|---|--|---|--|
| 1. Portions of 21st Floor, 100 Canton Road, Tsim Sha Tsui, Kowloon, Hong Kong | <p>100 Canton Road comprises a 25-storey (including a basement level and 2 service floors) commercial building completed in about 1994.</p> <p>The property comprises 2 partitioned offices on 21st Floor with a total saleable area of approximately 15.33 sq m (165 sq ft).</p> <p>By a tenancy agreement made between Belmont Limited, a related company of the Group, as the landlord and PIL Finance Limited, a related company of the Group, as the tenant, 21st Floor of the subject building was leased to the tenant from 1 January 2005 and expiring on 31 December 2007 whilst the tenancy has been renewed for a further term from 1 January 2008 to 31 December 2009.</p> <p>By a licence agreement dated 27 December 2007 made between PIL Finance Limited, a related company of the Group, as the licensor and Playmates Toys Limited, as the licensee, the Company was granted a right to occupy and use the property on a monthly basis from 31 December 2007 and expiring upon 3 months notice by either party or the termination of the licensor's tenancy agreement with the landlord at a monthly licence fee of HK\$8,000 inclusive of management fee, rates and government rent. The monthly licence fee will be reviewed annually.</p> | The property is occupied by the Group as offices. | No commercial value |

Notes:

- (1) According to the Approved Tsim Sha Tsui Outline Zoning Plan No. S/K1/22, the property falls within an area zoned "Commercial".
- (2) The current use of the property complies with the permitted use as stipulated in the licence agreement.

VALUATION CERTIFICATE

| Property | Description and tenancy particulars | Particulars of occupancy | Capital value in existing state as at 30 November 2007 |
|--|--|--|--|
| 2. 1A and 1B, 1st Floor of Phase I, Playmates Factory Building, 1 Tin Hau Road, Tuen Mun, New Territories, Hong Kong | <p>Phase I of Playmates Factory Building is a 10-storey industrial building completed in two phases. The Ground to 3rd Floors were completed in 1973 whilst the 4th to 9th Floors were completed in 1977.</p> <p>The property comprises 2 industrial units on 1st Floor of the building with a saleable area of approximately 209.03 sq.m. (2,250 sq.ft.).</p> <p>By a licence agreement and a supplemental licence agreement dated 27 February 2007 and 30 August 2007 respectively made between Bagnols Limited, a fellow subsidiary of the Group, as the licensor and Playmates Asia Services Limited, in which the Company has a 100% interest, as the licensee, the Group was granted a non-exclusive right to use the property for a term of twelve months from 1 January 2007 and expiring on 31 December 2007 at a monthly licence fee of HK\$7,227.90 exclusive of management fee, rates and government rent.</p> | The property is occupied by the Group as warehouses. | No commercial value |

Notes:

- (1) According to the Draft Tuen Mun Outline Zoning Plan No. S/TM/23, the property falls within an area zoned "Industrial".
- (2) The current use of the property complies with the permitted use as stipulated in the licence agreement.

VALUATION CERTIFICATE

| Property | Description and tenancy particulars | Particulars of occupancy | Capital value in existing state as at 30 November 2007 |
|---|---|---|--|
| 3. Unit A, Ground Floor of Phase II, Playmates Factory Building, 1 Tin Hau Road, Tuen Mun, New Territories, Hong Kong | <p>Phase II of Playmates Factory Building is an 18-storey industrial building completed about 1981.</p> <p>The property comprises an industrial unit on Ground Floor with a saleable area of approximately 165.27 sq.m. (1,779 sq.ft.).</p> <p>By a tenancy agreement and a supplemental tenancy agreement dated 27 February 2007 and 30 August 2007 respectively made between Bagnols Limited, a fellow subsidiary of the Group, as landlord and Playmates Asia Services Limited, in which the Company has a 100% interest, as tenant, the property was leased to the Group for a term of two years from 1 January 2007 and expiring on 31 December 2008 at a monthly rent of HK\$13,303.8 exclusive of management fee, rates and government rent.</p> | The property is occupied by the Group as a warehouse. | No commercial value |

Notes:

- (1) According to the Draft Tuen Mun Outline Zoning Plan No. S/TM/23, the property falls within an area zoned "Industrial".
- (2) The current use of the property complies with the permitted use as stipulated in the tenancy agreement.

VALUATION CERTIFICATE

| Property | Description and tenancy particulars | Particulars of occupancy | Capital value in existing state as at 30 November 2007 |
|--|---|---|--|
| 4. Units 405, 406A and 406B on the 4th Floor of InnoCentre, 72 Tat Chee Avenue, Kowloon Tong, Kowloon, Hong Kong | <p>InnoCentre is a 9-storey (including two car parking floors) commercial building completed in about 1994.</p> <p>The property comprises 3 units on 4th Floor with a total gross area of approximately 572.74 sq.m. (6,165 sq.ft.).</p> <p>By a tenancy agreement dated 19 September 2007 made between Hong Kong Science And Technology Parks Corporation, an independent third party, as landlord and Playmates Toys Asia Limited, in which the Company has a 100% interest, as the tenant, the property was leased to the Group for a term of three years from 20 September 2007 and expiring on 19 September 2010 at a monthly rent of \$92,475 inclusive of management fee but exclusive of rates and government rent.</p> | The property is occupied by the Group as offices. | No commercial value |

Notes:

- (1) According to the Approved Shek Kip Mei Outline Zoning Plan No. S/K4/21, the property falls within an area zoned "Government / Institution / Community (3)".
- (2) The current use of the property complies with the permitted use as stipulated in the tenancy agreement.

VALUATION CERTIFICATE

Group II – Property interest rented by the Group in PRC

| Property | Description and tenancy particulars | Particulars of occupancy | Capital value in existing state as at 30 November 2007 |
|--|--|---|--|
| 5. Rooms 2501 and 2502, Zheng Quan Building, 5020 Bin He Da Dao, Shenzhen, Guangdong Province, PRC | <p>Zheng Quang Building is a 28-storey (including two basements) commercial building completed in about 1998.</p> <p>The property comprises two office units with a total gross floor area of approximately 365 sq.m. (3,929 sq.ft.).</p> <p>By two tenancy agreements and two supplemental agreements dated 5 August 2007 and 12 September 2007 respectively, the property is leased from Shenzhen SDG Property Management Co. Ltd, as an agent to the landlord (Jutian Securities Co., Ltd), an independent third party, to the Group, as the tenant, for a term commencing on 10 September 2007 and expiring on 10 September 2009 at a total monthly rent of RMB24,090.</p> | The property is occupied by the Group as offices. | No commercial value |

Notes:

- (1) Room 2501 is leased to Playmates Asia Services Limited Shenzhen Representative Office in which the Company has a 100% interest.
- (2) Room 2502 is leased to Playmates China Holdings Limited in which the Company has a 100% interest.
- (3) We have been provided with a copy of legal opinion on the legality of the tenancy agreements to the property issued by the Group's PRC legal adviser, which contains, inter-alia, the following information:
 - (i) the owner of the property is Jutian Securities Co., Ltd;
 - (ii) the tenancy agreements are valid and the agent, Shenzhen SDG Property Management Co., Ltd., is vested with full power to sign the tenancy agreements on behalf of Jutian Securities Co., Ltd.; and
 - (iii) the tenancy agreements and the supplemental rental agreements have been registered.
- (4) The current use of the property complies with the permitted use as stipulated in the tenancy agreements.

VALUATION CERTIFICATE

Group III – Property interest rented by the Group in USA

| Property | Description and tenancy particulars | Particulars of occupancy | Capital value in existing state as at 30 November 2007 |
|---|--|---|--|
| 6. Building “Q-1” of Golden Springs Business Park, 12995 Marquardt, Santa Fe Springs, California, USA | <p data-bbox="504 529 815 683">Building “Q-1” of Golden Springs Business Park is a single storey warehouse building completed in about 2005.</p> <p data-bbox="504 725 815 878">The property comprises the whole block of Building “Q-1” with a lettable area of approximately 9,578.97 sq.m. (103,108 sq.ft.).</p> <p data-bbox="504 921 815 1517">By a lease and its subsequent amendments made between Golden Springs Development Company, LLC, an independent third party, as landlord and Playmates Toys Inc., in which the Company has a 100% interest, as lessee, the property was leased to the Group for a term of five years from 21 February 2005 and expiring on 28 February 2010 at a monthly rent of US\$50,523 from the 1st-30th months and at a monthly rent of US\$54,451 from the 31st-60th months with an option to extend for five years at market rent.</p> | The property is occupied by the Group as a warehouse. | No commercial value |

Notes:

- (1) According to the Zoning Map of City of Santa Fe Springs, the property falls within an area zoned “Heavy Manufacturing”.
- (2) The current use of the property complies with the permitted use as stipulated in the lease.

VALUATION CERTIFICATE

| Property | Description and tenancy particulars | Particulars of occupancy | Capital value in existing state as at 30 November 2007 |
|---|--|---|--|
| 7. Portion of 6th Floor and Suite 600, 6th Floor, Comerica Bank, 611 Anton Boulevard, Costa Mesa, California, USA | <p>Comercia Bank is a 15-storey office building completed in about 1981.</p> <p>The property comprises a portion of 6th Floor and Suite 600 with a lettable area of approximately 1,159.05 sq.m. (12,476 sq.ft.).</p> <p>By a lease and its subsequent amendments made among Two Town Center Associates and The Prudential Insurance Company of America, independent third parties, as landlord and Playmates Toys Inc., in which the Company has a 100% interest, as tenant, the property was leased to the Group for a term of 4 years commencing from 15 January 2004 and expiring on 14 January 2008 at a rent of US\$17,466.4 per month with an option to extend for five years at market rent.</p> | The property is occupied by the Group as office | No commercial value |

Notes:

- (1) According to the Zoning Map of City of Costa Mesa, the property falls within an area zoned "Town Center"
- (2) The current use of the property complies with the permitted use as stipulated in the lease.

Set out below is a summary of certain provisions of the Memorandum of Association and Bye-laws and of certain aspects of Bermuda company law.

1. MEMORANDUM OF ASSOCIATION

The Memorandum of Association states, inter alia, that the liability of members of the Company is limited to the amount, if any, for the time being unpaid on the Shares respectively held by them and that the Company is an exempted company as defined in the Companies Act. The Memorandum of Association also sets out the objects for which the Company was formed which are unrestricted and that the Company has the capacity, rights, powers and privileges of a natural person. As an exempted company, the Company will be carrying on business outside Bermuda from a place of business within Bermuda.

In accordance with and subject to section 42A of the Companies Act, the Memorandum of Association empowers the Company to purchase its own Shares and pursuant to its Bye-laws, this power is exercisable by the Board upon such terms and subject to such conditions as it thinks fit.

2. BYE-LAWS

The Bye-laws were adopted on 17 December 2007. The following is a summary of certain provisions of the Bye-laws:

(a) Directors

(i) Power to allot and issue Shares and warrants

Subject to any special rights conferred on the holders of any Shares or class of Shares, any Share may be issued with or have attached thereto such rights, or such restrictions, whether with regard to dividend, voting, return of capital, or otherwise, as the Company may by ordinary resolution determine (or, in the absence of any such determination or so far as the same shall not make specific provision, as the Board may determine). Subject to the Companies Act, these Bye-laws, and to any special rights conferred on the holders of any Shares or attaching to any class of Shares, any preference Shares may be issued or converted into Shares that are liable to be redeemed, at a determinable date or at the option of the Company or, if so authorised by the Memorandum of Association, at the option of the holder, on such terms and in such manner as the Company before the issue or conversion may by ordinary resolution determine. The Board may issue options, warrants or convertible securities or securities of similar nature conferring the right upon the holders thereof to subscribe for, purchase or receive any class of Shares or securities in the capital of the Company on such terms as it may from time to time determine.

Subject to the provisions of the Companies Act, the Bye-laws, any direction that may be given by the Company in general meeting and, where applicable, the rules of any Designated Stock Exchange (as defined in the Bye-laws) and without prejudice to any special rights or restrictions for the time being attached to any Shares or any class of Shares, all unissued Shares in the Company (whether forming part of the original or any increased capital) shall be at the disposal of the board, which may offer, allot, grant options over or otherwise dispose of them to such persons, at such times, for such consideration and on such terms and conditions as it in its absolute discretion thinks fit, but so that no Shares shall be issued at a discount.

Neither the Company nor the board shall be obliged, when making or granting any allotment of, offer of, option over or disposal of Shares, to make, or make available, any such allotment, offer, option or Shares to members or others with registered addresses in any particular territory or territories being a territory or territories where, in the absence of a registration statement or other special formalities, this would or might, in the opinion of the board, be unlawful or impracticable. Members affected as a result of the foregoing sentence shall not be, or be deemed to be, a separate class of members for any purpose whatsoever.

(ii) Power to dispose of the assets of the Company or any of its subsidiaries

There are no specific provisions in the Bye-laws relating to the disposal of the assets of the Company or any of its subsidiaries.

Note: The Directors may, however, exercise all powers and do all acts and things which may be exercised or done or approved by the Company and which are not required by the Bye-laws or the Companies Act to be exercised or done by the Company in general meeting.

(iii) Compensation or payments for loss of office

Payments to any Director or past Director of any sum by way of compensation for loss of office or as consideration for or in connection with his retirement from office (not being a payment to which the Director is contractually entitled) must be approved by the Company in general meeting.

(iv) Loans and provision of security for loans to Directors

There are no provisions in the Bye-laws relating to the making of loans to Directors. However, the Companies Act contains restrictions on companies making loans or providing security for loans to their directors, the relevant provisions of which are summarised in the paragraph headed "BERMUDA COMPANY LAW" in this Appendix.

(v) *Financial assistance to purchase Shares*

Neither the Company nor any of its subsidiaries shall directly or indirectly give financial assistance to a person who is acquiring or proposing to acquire shares in the Company for the purpose of that acquisition whether before or at the same time as the acquisition takes place or afterwards, provided that the Bye-laws shall not prohibit transactions permitted under the Companies Act.

(vi) *Disclosure of interests in contracts with the Company or any of its subsidiaries*

A Director may hold any other office or place of profit with the Company (except that of auditor of the Company) in conjunction with his office of Director for such period and, subject to the Companies Act, upon such terms as the board may determine, and may be paid such extra remuneration (whether by way of salary, commission, participation in profits or otherwise) in addition to any remuneration provided for by or pursuant to any other Bye-laws. A Director may be or become a director or other officer of, or a member of, any company promoted by the Company or any other company in which the Company may be interested, and shall not be liable to account to the Company or the members for any remuneration, profits or other benefits received by him as a director, officer or member of, or from his interest in, such other company. Subject as otherwise provided by the Bye-laws, the Directors may also cause the voting power conferred by the shares in any other company held or owned by the Company to be exercised in such manner in all respects as they think fit, including the exercise thereof in favour of any resolution appointing the Directors or any of them to be directors or officers of such other company, or voting or providing for the payment of remuneration to the directors or officers of such other company.

Subject to the Companies Act and to the Bye-laws, no Director or proposed or intending Director shall be disqualified by his office from contracting with the Company, either with regard to his tenure of any office or place of profit or as vendor, purchaser or in any other manner whatsoever, nor shall any such contract or any other contract or arrangement in which any Director is in any way interested be liable to be avoided, nor shall any Director so contracting or being so interested be liable to account to the Company or the members for any remuneration, profit or other benefits realised by any such contract or arrangement by reason of such Director holding that office or the fiduciary relationship thereby established. A Director who to his knowledge is in any way, whether directly or indirectly, interested in a contract or arrangement or proposed contract or arrangement with the Company shall declare the nature of his interest at the meeting of the board at which the question of entering into the contract or arrangement is first taken into consideration, if he knows his interest then exists, or in any other case, at the first meeting of the board after he knows that he is or has become so interested.

A Director shall not vote (nor be counted in the quorum) on any resolution of the board approving any contract or arrangement or other proposal in which he or any of his associates is materially interested but this prohibition shall not apply to any of the following matters, namely:

- (aa) any contract or arrangement for giving to such Director or his associate(s) any security or indemnity in respect of money lent by him or any of his associates or obligations incurred or undertaken by him or any of his associates at the request of or for the benefit of the Company or any of its subsidiaries;
- (bb) any contract or arrangement for the giving of any security or indemnity to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which the Director or his associate(s) has himself/themselves assumed responsibility in whole or in part whether alone or jointly under a guarantee or indemnity or by the giving of security;
- (cc) any contract or arrangement concerning an offer of shares or debentures or other securities of or by the Company or any other company which the Company may promote or be interested in for subscription or purchase, where the Director or his associate(s) is/are or is/are to be interested as a participant in the underwriting or sub-underwriting of the offer;
- (dd) any contract or arrangement in which the Director or his associate(s) is/are interested in the same manner as other holders of Shares or debentures or other securities of the Company by virtue only of his/their interest in Shares or debentures or other securities of the Company;
- (ee) any contract or arrangement concerning any other company in which the Director or his associate(s) is/are interested only, whether directly or indirectly, as an officer or executive or a shareholder or in which the Director and any of his associates are not in aggregate beneficially interested in 5 percent. or more of the issued shares or of the voting rights of any class of shares of such company (or of any third company through which his interest or that of any of his associates is derived); or
- (ff) any proposal or arrangement concerning the adoption, modification or operation of a share option scheme, a pension fund or retirement, death, or disability benefits scheme or other arrangement which relates both to Directors, his associates and employees of the Company or of any of its subsidiaries and does not provide in respect of any Director, or his associate(s), as such any privilege or advantage not accorded generally to the class of persons to which such scheme or fund relates.

(vii) Remuneration

The Directors shall be entitled to receive by way of remuneration for their services as Directors such sum as shall from time to time be determined by the board, such sum to be divided amongst the Directors in such proportions and in such manner as the board may agree or, failing agreement, equally, except that in such event any Director holding office for less than the whole of the relevant period in respect of which the remuneration is paid shall only rank in such division in proportion to the time during such period for which he held office. The foregoing provisions shall not apply to a Director who holds any salaried employment or office in the Company except in the case of sums paid in respect of Directors' fees. The Directors shall also be entitled to be prepaid or repaid all travelling, hotel and incidental expenses reasonably incurred or expected to be incurred by them in attending any board meetings, committee meetings or general meetings or separate meetings of any class of shares or of debentures of the Company or otherwise in connection with the discharge of their duties as Directors.

Any Director who, by request, goes or resides abroad for any purpose of the Company or who performs services which in the opinion of the board go beyond the ordinary duties of a Director may be paid such extra remuneration (whether by way of salary, commission, participation in profits or otherwise) as the board may determine and such extra remuneration shall be in addition to or in substitution for any ordinary remuneration provided for by or pursuant to any other Bye-law. An executive Director appointed to be a managing director, joint managing director, deputy managing director or other executive officer shall receive such remuneration (whether by way of salary, bonus, commission, participation in profits, compensation or otherwise or by all or any of those modes) and such other benefits (whether by way of pension, share options and/or gratuity and/or other benefits on retirement or otherwise) and allowances as the board may from time to time decide. Such remuneration may be either in addition to or in lieu of his remuneration as a Director.

The board may establish or concur or join with other companies (being subsidiary companies of the Company or companies with which it is associated in business) in establishing and making contributions out of the Company's monies to any schemes or funds for providing pensions, sickness or compassionate allowances, life assurance or other benefits for employees (which expression as used in this and the following paragraph shall include any Director or ex Director who may hold or have held any executive office or any office of profit with the Company or any of its subsidiaries) and ex-employees of the Company and their dependants or any class or classes of such persons.

The board may pay, enter into agreements to pay or make grants of revocable or irrevocable, and either subject or not subject to any terms or conditions, pensions or other benefits to employees and ex-employees and their dependants, or to any of such persons, including pensions or benefits additional to those, if any, to which such employees or ex-employees or their dependants are or may become entitled under any such scheme or fund as is mentioned in the previous paragraph. Any such pension or benefit may, as the board considers desirable, be granted to an employee either before and in anticipation of, or upon or at any time after, his actual retirement.

(viii) Retirement, appointment and removal

Notwithstanding any other provisions in the Bye-laws, at each annual general meeting, at least one-third of the Directors for the time being (or if their number is not a multiple of three, then the number nearest to but not less than one-third) will retire from office by rotation provided that every Director shall be subject to retirement in accordance with the rules of the Designated Stock Exchange (as defined in the Bye-laws). A retiring Director shall be eligible for re-election and shall continue to act as a Director throughout the meeting at which he retires. The Directors to retire by rotation shall include (so far as necessary to ascertain the number of directors to retire by rotation) any Director who wishes to retire and not to offer himself for re-election. Any further Directors so to retire will be those who have been longest in office since their last re-election or appointment but as between persons who became or were last re-elected Directors on the same day those to retire will (unless they otherwise agree among themselves) be determined by lot.

Note: There are no provisions relating to retirement of Directors upon reaching any age limit.

The Directors shall have the power from time to time and at any time to appoint any person as a Director either to fill a casual vacancy on the board or, subject to authorisation by the members in general meeting, as an addition to the existing board but so that the number of Directors so appointed shall not exceed any maximum number determined from time to time by the members in general meeting. Any Director so appointed shall hold office only until the next following annual general meeting of the Company and shall then be eligible for re-election at the meeting. Neither a Director nor an alternate Director is required to hold any shares in the Company by way of qualification.

A Director may be removed by ordinary resolution of the Company before the expiration of his period of office (but without prejudice to any claim which such Director may have for damages for any breach of any contract between him and the Company) provided that the notice of any such meeting convened for the purpose of removing a Director shall contain a statement of the intention to do so and be served on such Director 14 days before the meeting and, at such meeting, such Director shall be entitled to be heard on the motion for his removal. Unless otherwise determined by the Company in general meeting, the number of Directors shall not be less than two. There is no maximum number of Directors unless otherwise determined from time to time by members of the Company.

The board may from time to time appoint one or more of its body to be managing director, joint managing director, or deputy managing director or to hold any other employment or executive office with the Company for such period (subject to their continuance as Directors) and upon such terms as the board may determine and the board may revoke or terminate any of such appointments (but without prejudice to any claim for damages that such Director may have against the Company or vice versa). The board may delegate any of its powers, authorities and discretions to committees consisting of such Director or Directors and other persons as the board thinks fit, and it may from time to time revoke such delegation or revoke the appointment of and discharge any such committees either wholly or in part, and either as to persons or purposes, but every committee so formed shall, in the exercise of the powers, authorities and discretions so delegated, conform to any regulations that may from time to time be imposed upon it by the board.

(ix) Borrowing powers

The board may exercise all the powers of the Company to raise or borrow money, to mortgage or charge all or any part of the undertaking, property and assets (present and future) and uncalled capital of the Company and, subject to the Companies Act, to issue debentures, bonds and other securities of the Company, whether outright or as collateral security for any debt, liability or obligation of the Company or of any third party.

Note: These provisions, in common with the Bye-laws in general, can be varied with the sanction of a special resolution of the Company.

(b) Alterations to constitutional documents

The Bye-laws may be rescinded, altered or amended by the Directors subject to the confirmation by a special resolution of the members. The Bye-laws state that a special resolution shall be required to alter the provisions of the Memorandum of Association, to confirm any such rescission, alteration or amendment to the Bye-laws or to change the name of the Company.

(c) Alteration of capital

The Company may from time to time by ordinary resolution in accordance with the relevant provisions of the Companies Act:

- (i) increase its capital by such sum, to be divided into Shares of such amounts as the resolution shall prescribe;
- (ii) consolidate and divide all or any of its capital into Shares of larger amount than its existing Shares;

- (iii) divide its Shares into several classes and without prejudice to any special rights previously conferred on the holders of existing Shares as the Directors may determine;
- (iv) sub-divide its Shares or any of them into Shares of smaller amount than is fixed by the Memorandum of Association;
- (v) change the currency denomination of its Share capital;
- (vi) make provision for the issue and allotment of Shares which do not carry any voting rights; and
- (vii) cancel any Shares which, at the date of the passing of the resolution, have not been taken, or agreed to be taken, by any person, and diminish the amount of its capital by the amount of the Shares so cancelled.

The Company may, by special resolution, subject to any confirmation or consent required by law, reduce its authorised or issued share capital or, save for the use of share premium as expressly permitted by the Companies Act, any share premium account or other undistributable reserve.

(d) Variation of rights of existing Shares or classes of Shares

Subject to the Companies Act, all or any of the special rights attached to the Shares or any class of Shares may (unless otherwise provided for by the terms of issue of the Shares of that class) from time to time (whether or not the Company is being wound up) be varied, modified or abrogated either with the consent in writing of the holders of not less than three-fourths of the issued Shares of that class or with the sanction of a special resolution passed at a separate general meeting of the holders of the Shares of that class. To every such separate general meeting all the provisions of the Bye-laws relating to general meetings will mutatis mutandis apply, but so that the necessary quorum (other than at an adjourned meeting) shall be two persons (or in the case of a member being a corporation, its duly authorised representative) holding or representing by proxy not less than one-third in nominal value of the issued Shares of that class and at any adjourned meeting two holders present in person (or in the case of a member being a corporation, its duly authorised representative) or by proxy whatever the number of Shares held by them shall be a quorum. Every holder of Shares of the class shall be entitled on a poll to one vote for every such share held by him, and any holder of Shares of the class present in person or by proxy may demand a poll.

(e) Special resolution majority required

A special resolution of the Company must be passed by a majority of not less than three-fourths of the votes cast by such members as, being entitled so to do, vote in person or, in the case of such members as are corporations, by their duly authorised representatives or, where proxies are allowed, by proxy at a general meeting of which not less than 21 clear days' notice, specifying the intention to propose the resolution as a special resolution, has been duly given. Provided that, except in the case of an annual general meeting, if it is so agreed by a majority in number of the members having a right to attend and vote at such meeting, being a majority together holding not less than 95 per cent. in nominal value of the shares giving that right and, in the case of an annual general meeting, if so agreed by all members entitled to attend and vote thereat, a resolution may be proposed and passed as a special resolution at a meeting of which less than 21 clear days' notice has been given.

(f) Voting rights (generally and on a poll) and rights to demand a poll

Subject to any special rights or restrictions as to voting for the time being attached to any Shares by or in accordance with the Bye-laws, at any general meeting on a show of hands, every member who is present in person or by proxy or being a corporation is present by its duly authorised representative shall have one vote and on a poll every member present in person or in the case of a member being a corporation by its duly authorised representative or by proxy shall have one vote for every fully paid Share of which he is the holder but so that no amount paid up or credited as paid up on a share in advance of calls or installments is treated for the foregoing purposes as paid up on the Share.

Notwithstanding anything contained in the Bye-laws, where more than one proxy is appointed by a member which is a clearing house (as defined in the Bye-laws) (or its nominee(s)), each such proxy shall have one vote on a show of hands. On a poll, a member entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way.

At any general meeting a resolution put to the vote of the meeting is to be decided on a show of hands unless voting by way of a poll is required by the rules of the Designated Stock Exchange (as defined in the Bye-laws) or (before or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll) a poll is demanded by (i) the chairman of the meeting or (ii) at least three members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy for the time being entitled to vote at the meeting or (iii) any member or members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy and representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting or (iv) a member or members present in person or, in the case of a member being a corporation, by its duly authorised 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 or (v) if required by the rules of the Designated Stock Exchange, by the chairman of such meeting and/or Directors who, individually or collectively, hold proxies in respect of Shares representing five per cent. (5%) or more of the total voting rights at such meeting.

If a recognised clearing house (or its nominee(s)) is a member of the Company it may authorise such persons as it thinks fit to act as its representative(s) at any meeting of the Company or at any meeting of any class of members of the Company provided that the authorisation shall specify the number and class of Shares in respect of which each such representative is so authorised. A person authorised pursuant to this provision shall be deemed to have been duly authorised without further evidence of the facts and be entitled to exercise the same powers on behalf of the recognised clearing house (or its nominee(s)) as if such person was the registered holder of the Shares held by that clearing house (or its nominee(s)) in respect of the number and class of Shares specified in the relevant authorisation including the right to vote individually on a show of hands.

Where the Company has knowledge that any shareholder is, under the rules of the Designated Stock Exchange (as defined in the Bye-laws), required to abstain from voting on any particular resolution of the Company or restricted to voting only for or only against any particular resolution of the Company, any votes cast by or on behalf of such shareholder in contravention of such requirement or restriction shall not be counted.

(g) Requirements for annual general meetings

An annual general meeting of the Company shall be held in each year other than the year in which its statutory meeting is convened at such time (within a period of not more than 15 months after the holding of the last preceding annual general meeting unless a longer period would not infringe the rules of any Designated Stock Exchange (as defined in the Bye-laws)) and place as may be determined by the board.

(h) Accounts and audit

The board shall cause true accounts to be kept of the sums of money received and expended by the Company, and the matters in respect of which such receipt and expenditure take place, and of the property, assets, credits and liabilities of the Company and of all other matters required by the provisions of the Companies Act or necessary to give a true and fair view of the Company's affairs and to explain its transactions.

The accounting records shall be kept at the registered office or, subject to the Companies Act, at such other place or places as the board decides and shall always be open to inspection by any Director. No member (other than a Director) shall have any right of inspecting any accounting record or book or document of the Company except as conferred by law or authorised by the board or the Company in general meeting.

Subject to the Companies Act, a printed copy of the Directors' report, accompanied by the balance sheet and profit and loss account, including every document required by law to be annexed thereto, made up to the end of the applicable financial year and containing a summary of the assets and liabilities of the Company under convenient heads and a statement of income and expenditure, together with a copy of the auditors' report, shall be sent to each person entitled thereto at least 21 days before the date of the general meeting and laid before the Company in general meeting in accordance with the requirements of the Companies Act provided that this provision shall not require a copy of those documents to be sent to any person whose address the Company is not aware of or to more than one of the joint holders of any shares or debentures; however, to the extent permitted by and subject to due compliance with all applicable laws, including the rules of the Designated Stock Exchange (as defined in the Bye-laws), the Company may send to such persons a summary financial statement derived from the Company's annual accounts and the Directors' report instead provided that any such person may by notice in writing served on the Company, demand that the Company sends to him, in addition to a summary financial statement, a complete printed copy of the Company's annual financial statement and the Directors' report thereon.

Subject to the Companies Act, at the annual general meeting or at a subsequent special general meeting in each year, the members shall appoint an auditor to audit the accounts of the Company and such auditor shall hold office until the members appoint another auditor. Such auditor may be a member but no Director or officer or employee of the Company shall, during his continuance in office, be eligible to act as an auditor of the Company. The remuneration of the auditor shall be fixed by the board.

If the office of auditor becomes vacant by the resignation or death of the auditor, or by his becoming incapable of acting by reason of illness or other disability at a time when his services are required, the Directors shall fill the vacancy and fix the remuneration of the auditor so appointed.

The financial statements of the Company shall be audited by the auditor in accordance with generally accepted auditing standards. The auditor shall make a written report thereon in accordance with generally accepted auditing standards and the report of the auditor shall be submitted to the members in general meeting. The generally accepted auditing standards referred to herein may be those of a country or jurisdiction other than Bermuda. If the auditing standards of a country or jurisdiction other than Bermuda are used, the financial statements and the report of the auditor should disclose this fact and name such country and jurisdiction.

(i) Notices of meetings and business to be conducted thereat

An annual general meeting and any special general meeting at which it is proposed to pass a special resolution shall (save as set out in sub paragraph (e) above) be called by at least 21 clear days' notice in writing, and any other special general meeting shall be called by at least 14 clear days' notice (in each case exclusive of the day on which the notice is given or deemed to be given and of the day for which it is given or on which it is to take effect). The period of notice shall be exclusive of the day on which it is served or deemed to be served and exclusive of the day on which the meeting is to be held, and the notice shall specify the time and place of the meeting and, in the case of special business, the general nature of that business. The notice convening an annual general meeting shall specify the meeting as such.

(j) Transfer of Shares

All transfers of Shares may be effected by an instrument of transfer in the usual or common form or in a form prescribed by the Designated Stock Exchange or in such other form as the board may approve and which may be under hand or, if the transferor or transferee is a clearing house or its nominee(s), by hand or by machine imprinted signature or by such other manner of execution as the board may approve from time to time. The instrument of transfer shall be executed by or on behalf of the transferor and the transferee provided that the board may dispense with the execution of the instrument of transfer by the transferee in any case in which it thinks fit, in its discretion, to do so and the transferor shall be deemed to remain the holder of the share until the name of the transferee is entered in the register of members in respect thereof. The board may also resolve either generally or in any particular case, upon request by either the transferor or the transferee, to accept mechanically executed transfers.

The board in so far as permitted by any applicable law may, in its absolute discretion, at any time and from time to time transfer any Share upon the principal register to any branch register or any Share on any branch register to the principal register or any other branch register.

Unless the board otherwise agrees (which agreement may be on such terms and subject to such conditions as the Board in its absolute discretion may from time to time determine, and which agreement the Board shall without giving any reason therefor, be entitled in its absolute discretion to give or withhold), no Shares on the principal register shall be transferred to any branch register nor shall Shares on any branch register be transferred to the principal register or any other branch register. All transfers and other documents of title shall be lodged for registration and registered, in the case of Shares on a branch register, at the relevant registration office and, in the case of Shares on the principal register, at the registered office in Bermuda or such other place in Bermuda at which the principal register is kept in accordance with the Companies Act.

Notwithstanding anything contained in the Bye-laws, the Company shall as soon as practicable and on a regular basis record in the principal register all transfers of shares effected on any branch register and shall at all times maintain the principal register in all respects in accordance with the Companies Act.

The board may, in its absolute discretion, and without assigning any reason, refuse to register a transfer of any Share (not being a fully paid up share) to a person of whom it does not approve or any Share issued under any share incentive scheme for employees upon which a restriction on transfer imposed thereby still subsists, and it may also refuse to register any transfer of any Share to more than four joint holders or any transfer of any Share (not being a fully paid up share) on which the Company has a lien.

The board may decline to recognise any instrument of transfer unless a fee of such maximum sum as any Designated Stock Exchange (as defined in the Bye-laws) may determine to be payable or such lesser sum as the Directors may from time to time require is paid to the Company in respect thereof, the instrument of transfer, if applicable, is properly stamped, is in respect of only one class of Share and is lodged at the relevant registration office or registered office or such other place at which the principal register is kept accompanied by the relevant share certificate(s) and such other evidence as the board may reasonably require to show the right of the transferor to make the transfer (and if the instrument of transfer is executed by some other person on his behalf, the authority of that person so to do).

The registration of transfers may be suspended and the register closed on giving notice by advertisement in an appointed newspaper and, where applicable, any other newspapers in accordance with the requirements of any Designated Stock Exchange (as defined in the Bye-laws) or by any means in such manner as may be accepted by the Designated Stock Exchange, at such times and for such periods as the board may determine and either generally or in respect of any class of Shares. The register of members shall not be closed for periods exceeding in the whole 30 days in any year.

(k) Power for the Company to purchase its own Shares

The Bye-laws supplement the Company's Memorandum of Association (which gives the Company the power to purchase its own shares) by providing that the power is exercisable by the board upon such terms and conditions as it thinks fit.

(l) Power for any subsidiary of the Company to own Shares in the Company

There are no provisions in the Bye-laws relating to ownership of Shares in the Company by a subsidiary.

(m) Dividends and other methods of distribution

Subject to the Companies Act, the Company in general meeting may declare dividends in any currency to be paid to the members but no dividend shall be declared in excess of the amount recommended by the board. The Company in general meeting may also make a distribution to its members out of contributed surplus (as ascertained in accordance with the Companies Act). No dividend shall be declared or paid and no distribution of contributed surplus shall be made otherwise than in accordance with the Statutes (as defined in the Bye-laws). No dividend shall be paid otherwise than out of the profits of the Company available for distribution.

Except in so far as the rights attaching to, or the terms of issue of, any Share may otherwise provide, all dividends shall be declared and paid according to the amounts paid up on the shares in respect whereof the dividend is paid but no amount paid up on a share in advance of calls shall for this purpose be treated as paid up on the Share. The board may deduct from any dividend or other monies payable to a member by the Company on or in respect of any Shares all sums of money (if any) presently payable by him to the Company on account of calls or otherwise.

Whenever the board or the Company in general meeting has resolved that a dividend be paid or declared on the share capital of the Company, the board may further resolve either (a) that such dividend be satisfied wholly or in part in the form of an allotment of Shares credited as fully paid up, provided that the shareholders entitled thereto shall be entitled to elect to receive such dividend (or part thereof) in cash in lieu of such allotment, or (b) that shareholders entitled to such dividend shall be entitled to elect to receive an allotment of Shares credited as fully paid up in lieu of the whole or such part of the dividend as the board may think fit. The Company may also upon the recommendation of the board by an ordinary resolution resolve in respect of any one particular dividend of the Company that it may be satisfied wholly in the form of an allotment of Shares credited as fully paid up without offering any right to shareholders to elect to receive such dividend in cash in lieu of such allotment.

Whenever the board or the Company in general meeting has resolved that a dividend be paid or declared the board may further resolve that such dividend be satisfied wholly or in part by the distribution of specific assets of any kind.

All dividends or bonuses unclaimed for one year after having been declared may be invested or otherwise made use of by the board for the benefit of the Company until claimed and the Company shall not be constituted a trustee in respect thereof. All dividends or bonuses unclaimed for six years after having been declared may be forfeited by the board and shall revert to the Company.

(n) Proxies

Any member of the Company entitled to attend and vote at a meeting of the Company is entitled to appoint another person as his proxy to attend and vote instead of him. A member who is the holder of two or more shares may appoint more than one proxy to represent him and vote on his behalf at a general meeting of the Company or at a class meeting. A proxy need not be a member of the Company. In addition, a proxy or proxies representing either a member who is an individual or a member which is a corporation shall be entitled to exercise the same powers on behalf of the member which he or they represent as such member could exercise.

(o) Call on Shares and forfeiture of Shares

Subject to the Bye-laws and to the terms of allotment, the board may from time to time make such calls upon the members in respect of any monies unpaid on the Shares held by them respectively (whether on account of the nominal value of the Shares or by way of premium). A call may be made payable either in one lump sum or by installments. If the sum payable in respect of any call or instalment is not paid on or before the day appointed for payment thereof, the person or persons from whom the sum is due shall pay interest on the same at such rate not exceeding 20 per cent. per annum as the board may agree to accept from the day appointed for the payment thereof to the time of actual payment, but the board may waive payment of such interest wholly or in part. The board may, if it thinks fit, receive from any member willing to advance the same, either in money or money's worth, all or any part of the monies uncalled and unpaid or installments payable upon any Shares held by him, and upon all or any of the monies so advanced the Company may pay interest at such rate (if any) as the board may decide.

If a member fails to pay any call on the day appointed for payment thereof, the board may serve not less than 14 clear days' notice on him requiring payment of so much of the call as is unpaid, together with any interest which may have accrued and which may still accrue up to the date of actual payment and stating that, in the event of non-payment at or before the time appointed, the Shares in respect of which the call was made will be liable to be forfeited.

If the requirements of any such notice are not complied with, any Share in respect of which the notice has been given may at any time thereafter, before the payment required by the notice has been made, be forfeited by a resolution of the board to that effect.

Such forfeiture shall include all dividends and bonuses declared in respect of the forfeited Share and not actually paid before the forfeiture.

A person whose Shares have been forfeited shall cease to be a member in respect of the forfeited Shares but shall, notwithstanding, remain liable to pay to the Company all monies which, at the date of forfeiture, were payable by him to the Company in respect of the Shares, together with (if the board shall in its discretion so require) interest thereon from the date of forfeiture until the date of actual payment at such rate not exceeding 20 per cent. per annum as the board determines.

(p) Inspection of register of members

The register and branch register of members shall be open to inspection between 10:00 a.m. and 12:00 noon on every business day by members of the public without charge at the registered office or such other place in Bermuda at which the register is kept in accordance with the Companies Act, unless the register is closed in accordance with the Companies Act.

(q) Quorum for meetings and separate class meetings

For all purposes the quorum for a general meeting shall be two members present in person or by proxy or (in the case of a member being a corporation) by its duly authorised representative and entitled to vote. In respect of a separate class meeting (other than an adjourned meeting) convened to sanction the modification of class rights the necessary quorum shall be two persons holding or representing by proxy not less than one-third in nominal value of the issued shares of that class.

(r) Rights of the minorities in relation to fraud or oppression

There are no provisions in the Bye-laws relating to rights of minority shareholders in relation to fraud or oppression. However, certain remedies are available to shareholders of the Company under Bermuda law, as summarised in paragraph 4(e) of this Appendix.

(s) Procedures on liquidation

A resolution that the Company be wound up by the court or be wound up voluntarily shall be a special resolution.

If the Company shall be wound up (whether the liquidation is voluntary or by the court) the liquidator may, with the authority of a special resolution and any other sanction required by the Companies Act, divide among the members in specie or kind the whole or any part of the assets of the Company whether or not the assets shall consist of property of one kind or shall consist of properties of different kinds and the liquidator may, for such purpose, set such value as he deems fair upon any one or more class or classes of property to be divided as aforesaid and may determine how such division shall be carried out as between the members or different classes of members. The liquidator may, with the like authority, vest any part of the assets in trustees upon such trusts for the benefit of members as the liquidator, with the like authority, shall think fit, but so that no contributory shall be compelled to accept any Shares or other property in respect of which there is a liability.

(t) Untraceable members

The Company may sell any of the shares of a member who is untraceable if (i) all cheques or warrants (being not less than three in total number) for any sum payable in cash to the holder of such Shares have remained uncashed for a period of 12 years; (ii) upon the expiry of the 12 year period, the Company has not during that time received any indication of the existence of the member; and (iii) the Company has caused an advertisement to be published in accordance with the rules of the Designated Stock Exchange (as defined in the Bye-laws) giving notice of its intention to sell such shares and a period of three months, or such shorter period as may be permitted by the Designated Stock Exchange (as defined in the Bye-laws), has elapsed since such advertisement and the Designated Stock Exchange (as defined in the Bye-laws) has been notified of such intention. The net proceeds of any such sale shall belong to the Company and upon receipt by the Company of such net proceeds, it shall become indebted to the former member of the Company for an amount equal to such net proceeds.

(u) Other provisions

The Bye-laws provide that to the extent that it is not prohibited by and is in compliance with the Companies Act, if warrants to subscribe for shares have been issued by the Company and the Company does any act or engages in any transaction which would result in the subscription price of such warrants being reduced below the par value of a Share, a subscription rights reserve shall be established and applied in paying up the difference between the subscription price and the par value of a share on any exercise of the warrants.

The Bye-laws also provide that the Company is required to maintain at its registered office a register of directors and officers in accordance with the provisions of the Companies Act and such register is open to inspection by members of the public without charge between 10:00 a.m. and 12:00 noon on every business day.

3. VARIATION OF MEMORANDUM OF ASSOCIATION AND BYE LAWS

The Memorandum of Association may be altered by the Company in general meeting. The Bye-laws may be amended by the Directors subject to the confirmation of the Company in general meeting. The Bye-laws state that a special resolution shall be required to alter the provisions of the Memorandum of Association or to confirm any amendment to the Bye-laws or to change the name of the Company. For these purposes, a resolution is a special resolution if it has been passed by a majority of not less than three fourths of the votes cast by such members of the Company as, being entitled to do so, vote in person or, in the case of such members as are corporations, by their respective duly authorised representatives or, where proxies are allowed, by proxy at a general meeting of which not less than 21 clear days' notice specifying the intention to propose the resolution as a special resolution has been duly given. Except in the case of an annual general meeting, the requirement of 21 clear days' notice may be waived by a majority in number of the members having the right to attend and vote at the relevant meeting, being a majority together holding not less than 95 percent in nominal value of the shares giving that right.

4. BERMUDA COMPANY LAW

The Company is incorporated in Bermuda and, therefore, operates subject to Bermuda law. Set out below is a summary of certain provisions of Bermuda company law, although this does not purport to contain all applicable qualifications and exceptions or to be a complete review of all matters of Bermuda company law and taxation, which may differ from equivalent provisions in jurisdictions with which interested parties may be more familiar:

(a) Share capital

The Companies Act provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called the “share premium account”, to which the provisions of the Companies Act relating to a reduction of share capital of a company shall apply as if the share premium account were paid up share capital of the company except that the share premium account may be applied by the company:

- (i) in paying up unissued shares to be issued to members of the company as fully paid bonus shares; or
- (ii) in writing off:
 - (aa) the preliminary expenses of the company; or
 - (bb) the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or
- (iii) in providing for the premiums payable on redemption of any shares or of any debentures of the company.

In the case of an exchange of shares the excess value of the shares acquired over the nominal value of the shares being issued may be credited to a contributed surplus account of the issuing company.

The Companies Act permits a company to issue preference shares and subject to the conditions stipulated therein to convert those preference shares into redeemable preference shares.

The Companies Act includes certain protections for holders of special classes of shares, requiring their consent to be obtained before their rights may be varied. Where provision is made by the memorandum of association or bye-laws for authorising the variation of rights attached to any class of shares in the company, the consent of the specified proportions of the holders of the issued shares of that class or the sanction of a resolution passed at a separate meeting of the holders of those shares is required, and where no provision for varying such rights is made in the memorandum of association or bye-laws and nothing therein precludes a variation of such rights, the written consent of the holders of three fourths of the issued shares of that class or the sanction of a resolution passed as aforesaid is required.

(b) Financial assistance to purchase shares of a company or its holding company

A company is prohibited from providing financial assistance for the purpose of an acquisition of its own or its holding company's shares unless there are reasonable grounds for believing that the company is, and would after the giving of such financial assistance be, able to pay its liabilities as they become due. In certain circumstances, the prohibition from giving financial assistance may be excluded such as where the assistance is only an incidental part of a larger purpose or the assistance is of an insignificant amount such as the payment of minor costs.

(c) Purchase of shares and warrants by a company and its subsidiaries

A company may, if authorised by its memorandum of association or bye-laws, purchase its own shares. Such purchases may only be effected out of the capital paid up on the purchased shares or out of the funds of the company otherwise available for dividend or distribution or out of the proceeds of a fresh issue of shares made for the purpose. Any premium payable on a purchase over the par value of the shares to be purchased must be provided for out of funds of the company otherwise available for dividend or distribution or out of the company's share premium account. Any amount due to a shareholder on a purchase by a company of its own shares may (i) be paid in cash; (ii) be satisfied by the transfer of any part of the undertaking or property of the company having the same value; or (iii) be satisfied partly under (i) and partly under (ii). Any purchase by a company of its own shares may be authorised by its board of directors or otherwise by or in accordance with the provisions of its bye-laws. Such purchase may not be made if, on the date on which the purchase is to be effected, there are reasonable grounds for believing that the company is, or after the purchase would be, unable to pay its liabilities as they become due. The shares so purchased may either be cancelled or held as treasury shares. Any purchased shares that are cancelled will, in effect, revert to the status of authorised but unissued shares. If shares are held as treasury shares, the company is prohibited to exercise any rights in respect of those shares, including any right to attend and vote at meetings, including a meeting under a scheme of arrangement, and any purported exercise of such a right is void. No dividend shall be paid to the company in respect of shares held by the company as treasury shares; and no other distribution (whether in cash or otherwise) of the company's assets (including any distribution of assets to members on a winding up) shall be made to the company in respect of shares held by the company as treasury shares. Any shares allotted by the company as fully paid bonus shares in respect of shares held by the company as treasury shares shall be treated for the purposes of the Companies Act as if they had been acquired by the company at the time they were allotted.

A company is not prohibited from purchasing and may purchase its own warrants subject to and in accordance with the terms and conditions of the relevant warrant instrument or certificate. There is no requirement under Bermuda law that a company's memorandum of association or its bye-laws contain a specific provision enabling such purchases.

Under Bermuda law, a subsidiary may hold shares in its holding company and in certain circumstances, may acquire such shares. The holding company is, however, prohibited from giving financial assistance for the purpose of the acquisition, subject to certain circumstances provided by the Companies Act. A company, whether a subsidiary or a holding company, may only purchase its own shares if it is authorised to do so in its memorandum of association or bye laws pursuant to section 42A of the Companies Act.

(d) Dividends and distributions

A company may not declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that (i) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (ii) the realisable value of the company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. Contributed surplus is defined for purposes of section 54 of the Companies Act to include the proceeds arising from donated shares, credits resulting from the redemption or conversion of shares at less than the amount set up as nominal capital and donations of cash and other assets to the company.

(e) Protection of minorities

Class actions and derivative actions are generally not available to shareholders under the laws of Bermuda. The Bermuda courts, however, would ordinarily be expected to permit a shareholder to commence an action in the name of a company to remedy a wrong done to the company where the act complained of is alleged to be beyond the corporate power of the company or is illegal or would result in the violation of the company's memorandum of association and bye laws. Furthermore, consideration would be given by the court to acts that are alleged to constitute a fraud against the minority shareholders or, for instance, where an act requires the approval of a greater percentage of the company's shareholders than actually approved it.

Any member of a company who complains that the affairs of the company are being conducted or have been conducted in a manner oppressive or prejudicial to the interests of some part of the members, including himself, may petition the court which may, if it is of the opinion that to wind up the company would unfairly prejudice that part of the members but that otherwise the facts would justify the making of a winding up order on just and equitable grounds, make such order as it thinks fit, whether for regulating the conduct of the company's affairs in future or for the purchase of shares of any members of the company by other members of the company or by the company itself and in the case of a purchase by the company itself, for the reduction accordingly of the company's capital, or otherwise. Bermuda law also provides that the company may be wound up by the Bermuda court, if the court is of the opinion that it is just and equitable to do so. Both these provisions are available to minority shareholders seeking relief from the oppressive conduct of the majority, and the court has wide discretion to make such orders as it thinks fit.

Except as mentioned above, claims against a company by its shareholders must be based on the general laws of contract or tort applicable in Bermuda.

A statutory right of action is conferred on subscribers of shares in a company against persons, including directors and officers, responsible for the issue of a prospectus in respect of damage suffered by reason of an untrue statement therein, but this confers no right of action against the company itself. In addition, such company, as opposed to its shareholders, may take action against its officers including directors, for breach of their statutory and fiduciary duty to act honestly and in good faith with a view to the best interests of the company.

(f) Management

The Companies Act contains no specific restrictions on the power of directors to dispose of assets of a company, although it specifically requires that every officer of a company, which includes a director, managing director and secretary, in exercising his powers and discharging his duties must do so honestly and in good faith with a view to the best interests of the company and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Furthermore, the Companies Act requires that every officer should comply with the Companies Act, regulations passed pursuant to the Companies Act and the bye laws of the company. The directors of a company may, subject to the bye-laws of the company, exercise all the powers of the company except those powers that are required by the Companies Act or the bye-laws to be exercised by the members of the company.

(g) Accounting and auditing requirements

The Companies Act requires a company to cause proper records of accounts to be kept with respect to (i) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place; (ii) all sales and purchases of goods by the company and (iii) the assets and liabilities of the company.

Furthermore, it requires that a company keeps its records of account at the registered office of the company or at such other place as the directors think fit and that such records shall at all times be open to inspection by the directors or the resident representative of the company. If the records of account are kept at some place outside Bermuda, there shall be kept at the office of the company in Bermuda such records as will enable the directors or the resident representative of the company to ascertain with reasonable accuracy the financial position of the company at the end of each three month period, except that where the company is listed on an appointed stock exchange, there shall be kept such records as will enable the directors or the resident representative of the company to ascertain with reasonable accuracy the financial position of the company at the end of each six month period.

The Companies Act requires that the directors of the company must, at least once a year, lay before the company in general meeting financial statements for the relevant accounting period. Further, the company's auditor must audit the financial statements so as to enable him to report to the members. Based on the results of his audit, which must be made in accordance with generally accepted auditing standards, the auditor must then make a report to the members. The generally accepted auditing standards may be those of a country or jurisdiction other than Bermuda or such other generally accepted auditing standards as may be appointed by the Minister of Finance of Bermuda under the Companies Act; and where the generally accepted auditing standards used are other than those of Bermuda, the report of the auditor shall identify the generally accepted auditing standards used. All members of the company are entitled to receive a copy of every financial statement prepared in accordance with these requirements, at least five days before the general meeting of the company at which the financial statements are to be tabled. A company the shares of which are listed on an appointed stock exchange may send to its members summarized financial statements instead. The summarized financial statements must be derived from the company's financial statements for the relevant period and contain the information set out in the Companies Act. The summarized financial statements sent to the company's members must be accompanied by an auditor's report on the summarized financial statements and a notice stating how a member may notify the company of his election to receive financial statements for the relevant period and/or for subsequent periods.

The summarized financial statements together with the auditor's report thereon and the accompanied notice must be sent to the members of the company not less than 21 days before the general meeting at which the financial statements are laid. Copies of the financial statements must be sent to a member who elects to receive the same within 7 days of receipt by the company of the member's notice of election.

(h) Auditors

At each annual general meeting, a company must appoint an auditor to hold office until the close of the next annual general meeting; however, this requirement may be waived if all of the shareholders and all of the directors, either in writing or at the general meeting, agree that there shall be no auditor.

A person, other than an incumbent auditor, shall not be capable of being appointed auditor at an annual general meeting unless notice in writing of an intention to nominate that person to the office of auditor has been given not less than 21 days before the annual general meeting. The company must send a copy of such notice to the incumbent auditor and give notice thereof to the members not less than 7 days before the annual general meeting. An incumbent auditor may, however, by notice in writing to the secretary of the company waive the requirements of the foregoing.

Where an auditor is appointed to replace another auditor, the new auditor must seek from the replaced auditor a written statement as to the circumstances of the latter's replacement. If the replaced auditor does not respond within 15 days, the new auditor may act in any event. An appointment as auditor of a person who has not requested a written statement from the replaced auditor is voidable by a resolution of the shareholders at a general meeting. An auditor who has resigned, been removed or whose term of office has expired or is about to expire, or who has vacated office is entitled to attend the general meeting of the company at which he is to be removed or his successor is to be appointed; to receive all notices of, and other communications relating to, that meeting which a member is entitled to receive; and to be heard at that meeting on any part of the business of the meeting that relates to his duties as auditor or former auditor.

(i) Exchange control

An exempted company is usually designated as "non resident" for Bermuda exchange control purposes by the Bermuda Monetary Authority. Where a company is so designated, it is free to deal in currencies of countries outside the Bermuda exchange control area which are freely convertible into currencies of any other country. The permission of the Bermuda Monetary Authority is required for the issue of shares and securities by the company and the subsequent transfer of such shares and securities. In granting such permission, the Bermuda Monetary Authority accepts no responsibility for the financial soundness of any proposals or for the correctness of any statements made or opinions expressed in any document with regard to such issue. Before the company can issue or transfer any further shares and securities in excess of the amounts already approved, it must obtain the prior consent of the Bermuda Monetary Authority.

The Bermuda Monetary Authority has granted general permission for the issue and transfer of shares and securities to and between persons regarded as resident outside Bermuda for exchange control purposes without specific consent for so long as any equity securities, including shares, are listed on an appointed stock exchange (as defined in the Companies Act). Issues to and transfers involving persons regarded as "resident" for exchange control purposes in Bermuda will be subject to specific exchange control authorisation.

(j) Taxation

Under present Bermuda law, no Bermuda withholding tax on dividends or other distributions, nor any Bermuda tax computed on profits or income or on any capital asset, gain or appreciation will be payable by an exempted company or its operations, nor is there any Bermuda tax in the nature of estate duty or inheritance tax applicable to shares, debentures or other obligations of the company held by non residents of Bermuda. Furthermore, a company may apply to the Minister of Finance of Bermuda for an assurance, under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, that no such taxes shall be so applicable until 28th March 2016, although this assurance will not prevent the imposition of any Bermuda tax payable in relation to any land in Bermuda leased or let to the company or to persons ordinarily resident in Bermuda.

(k) Stamp duty

An exempted company is exempt from all stamp duties except on transactions involving “Bermuda property”. This term relates, essentially, to real and personal property physically situated in Bermuda, including shares in local companies (as opposed to exempted companies). Transfers of shares and warrants in all exempted companies are exempt from Bermuda stamp duty.

(l) Loans to directors

Bermuda law prohibits the making of loans by a company to any of its directors or to their families or companies in which they hold more than a 20 per cent. interest, without the consent of any member or members holding in aggregate not less than nine tenths of the total voting rights of all members having the right to vote at any meeting of the members of the company. These prohibitions do not apply to (a) anything done to provide a director with funds to meet the expenditure incurred or to be incurred by him for the purposes of the company, provided that the company gives its prior approval at a general meeting or, if not, the loan is made on condition that it will be repaid within six months of the next following annual general meeting if the loan is not approved at or before such meeting, (b) in the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other persons, anything done by the company in the ordinary course of that business, or (c) any advance of moneys by the company to any officer or auditor under Section 98(2)(c) of the Companies Act which allows the company to advance moneys to an officer or auditor of the company for the costs incurred in defending any civil or criminal proceedings against them, on condition that the officer or auditor shall repay the advance if any allegation of fraud or dishonesty is proved against them. If the approval of the company is not given for a loan, the directors who authorised it will be jointly and severally liable for any loss arising therefrom.

(m) Inspection of corporate records

Members of the general public have the right to inspect the public documents of a company available at the office of the Registrar of Companies in Bermuda which will include the company’s certificate of incorporation, its memorandum of association (including its objects and powers) and any alteration to the company’s memorandum of association. The members of the company have the additional right to inspect the bye laws of a company, minutes of general meetings and the company’s audited financial statements, which must be presented to the annual general meeting. Minutes of general meetings of a company are also open for inspection by directors of the company without charge for not less than two hours during business hours each day. The register of members of a company is open for inspection by members of the public without charge. The company is required to maintain its share register in Bermuda but may, subject to the provisions of the Companies Act, establish a branch register outside Bermuda. Any branch register of members established by the company is subject to the same rights of

inspection as the principal register of members of the company in Bermuda. Any person may on payment of a fee prescribed by the Companies Act require a copy of the register of members or any part thereof which must be provided within fourteen days of a request. Bermuda law does not, however, provide a general right for members to inspect or obtain copies of any other corporate records.

A company is required to maintain a register of directors and officers at its registered office and such register must be made available for inspection for not less than two hours in each day by members of the public without charge. If summarized financial statements are sent by a company to its members pursuant to section 87A of the Companies Act, a copy of the summarized financial statements must be made available for inspection by the public at the registered office of the company in Bermuda.

(n) Winding up

A company may be wound up by the Bermuda court on application presented by the company itself, its creditors or its contributors. The Bermuda court also has authority to order winding up in a number of specified circumstances including where it is, in the opinion of the Bermuda court, just and equitable that such company be wound up.

A company may be wound up voluntarily when the members so resolve in general meeting, or, in the case of a limited duration company, when the period fixed for the duration of the company by its memorandum expires, or the event occurs on the occurrence of which the memorandum provides that the company is to be dissolved. In the case of a voluntary winding up, such company is obliged to cease to carry on its business from the time of passing the resolution for voluntary winding up or upon the expiry of the period or the occurrence of the event referred to above. Upon the appointment of a liquidator, the responsibility for the company's affairs rests entirely in his hands and no future executive action may be carried out without his approval.

Where, on a voluntary winding up, a majority of directors make a statutory declaration of solvency, the winding up will be a members' voluntary winding up. In any case where such declaration has not been made, the winding up will be a creditors' voluntary winding up.

In the case of a members' voluntary winding up of a company, the company in general meeting must appoint one or more liquidators within the period prescribed by the Companies Act for the purpose of winding up the affairs of the company and distributing its assets. If the liquidator at any time forms the opinion that such company will not be able to pay its debts in full, he is obliged to summon a meeting of creditors.

As soon as the affairs of the company are fully wound up, the liquidator must make up an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed of, and thereupon call a general meeting of the company for the purposes of laying before it the account and giving an explanation thereof. This final general meeting requires at least one month's notice published in an appointed newspaper in Bermuda.

In the case of a creditors' voluntary winding up of a company, the company must call a meeting of creditors of the company to be summoned on the day following the day on which the meeting of the members at which the resolution for winding up is to be proposed is held. Notice of such meeting of creditors must be sent at the same time as notice is sent to members. In addition, such company must cause a notice to appear in an appointed newspaper on at least two occasions.

The creditors and the members at their respective meetings may nominate a person to be liquidator for the purposes of winding up the affairs of the company provided that if the creditors nominate a different person, the person nominated by the creditors shall be the liquidator. The creditors at the creditors' meeting may also appoint a committee of inspection consisting of not more than five persons.

If a creditors' winding up continues for more than one year, the liquidator is required to summon a general meeting of the company and a meeting of the creditors at the end of each year to lay before such meetings an account of his acts and dealings and of the conduct of the winding up during the preceding year. As soon as the affairs of the company are fully wound up, the liquidator must make an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed of, and thereupon shall call a general meeting of the company and a meeting of the creditors for the purposes of laying the account before such meetings and giving an explanation thereof.

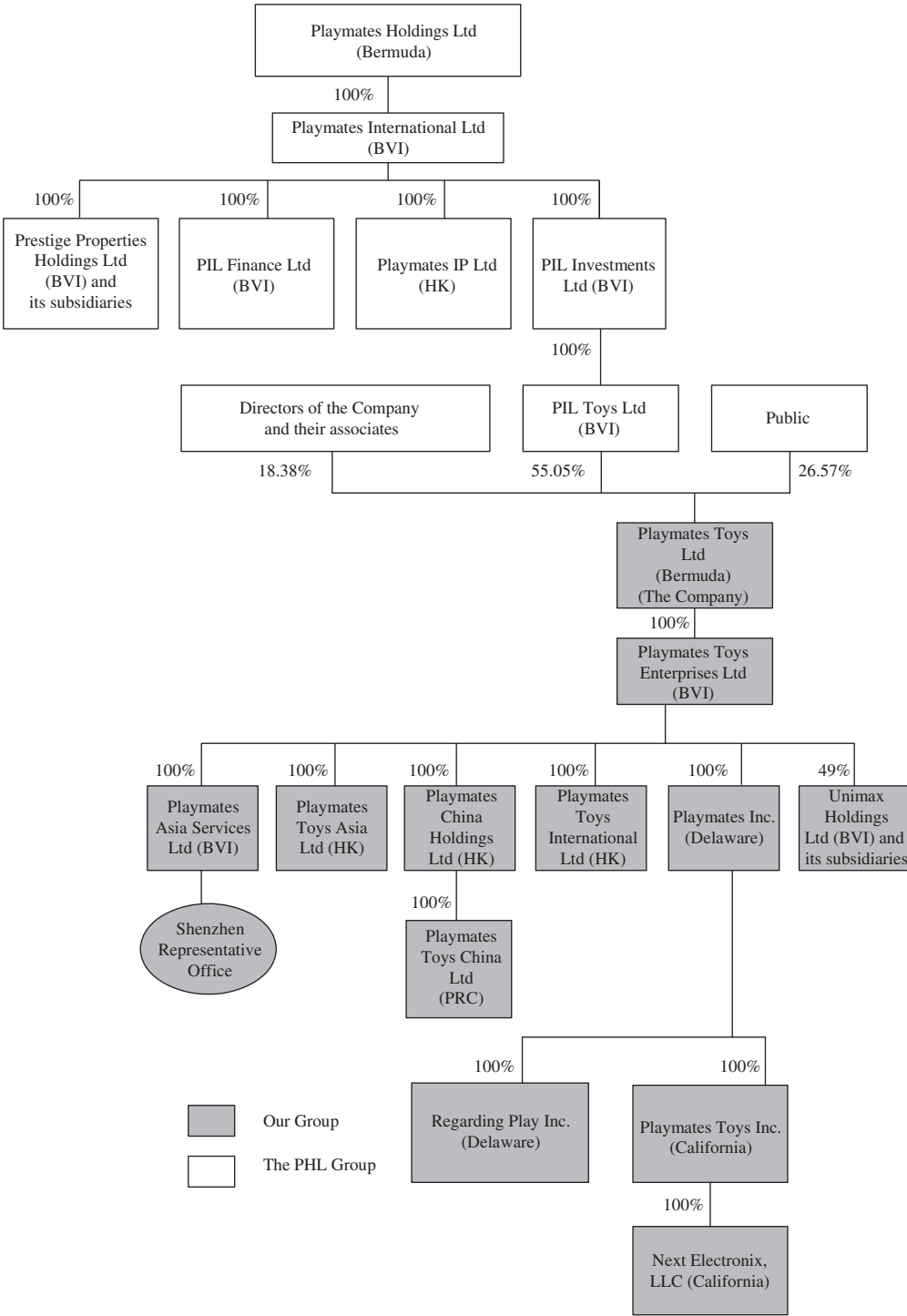
5. GENERAL

Conyers Dill & Pearman, the Company's legal advisers on Bermuda law, have sent to the Company a letter of advice summarising certain aspects of Bermuda company law. This letter, together with a copy of the Companies Act, is available for inspection as referred to in the paragraph headed "DOCUMENTS AVAILABLE FOR INSPECTION" in Appendix V. Any person wishing to have a detailed summary of Bermuda company law or advice on the differences between it and the laws of any jurisdiction with which he is more familiar is recommended to seek independent legal advice.

1. FURTHER INFORMATION ABOUT THE COMPANY AND ITS SUBSIDIARIES

1.1 Our Group Structure and Key Corporate History

Our Group corporate and shareholding structure immediately upon listing is set out in the below diagram:



1.2 Incorporation of the Company

The Company was incorporated in Bermuda under the Companies Act as an exempted company with limited liability on 11 April 2005 as a wholly-owned subsidiary of PIL. The Company has established a place of business in Hong Kong at 21/F, The Toy House, 100 Canton Road, Tsimshatsui, Kowloon, Hong Kong and is registered in Hong Kong under Part XI of the Companies Ordinance, with Mr. Chan Chun Hoo, Thomas being appointed as the authorized representative of the Company to accept service of legal process and notices in Hong Kong on behalf of the Company. The address for service of legal process and notices in Hong Kong is 21/F, The Toy House, 100 Canton Road, Tsimshatsui, Kowloon, Hong Kong. As the Company was incorporated in Bermuda, it operates subject to the Companies Act of Bermuda and to its constitution. Its constitution comprises the Memorandum of Association and Bye-laws. A summary of various parts of its constitution and relevant aspects of the Companies Act is set out in Appendix III to this document. Set out below is a table providing further information in relation to the date of incorporation and the principal business of each of our Company's subsidiaries:

| | Name of company | Date of incorporation | Place of incorporation | Principal activities |
|-----|----------------------------------|------------------------------|-------------------------------|---|
| 1. | Playmates Toys Enterprises Ltd | 17 May 2007 | The British Virgin Islands | Investment holding |
| 2. | Playmates Asia Services Ltd | 5 January 1999 | The British Virgin Islands | Provision of services |
| 3. | Playmates Toys Asia Limited | 25 May 2007 | Hong Kong | Provision of services and trading |
| 4. | Playmates China Holdings Limited | 25 May 2007 | Hong Kong | Investment holding |
| 5. | Playmates Toys China Limited | 26 November 2007 | PRC | Provision of services |
| 6. | Playmates Toys International Ltd | 22 December 2004 | Hong Kong | Toys distribution in non-U.S. markets |
| 7. | Playmates Inc. | 21 October 1996 | Delaware, U.S. | Investment holding |
| 8. | Playmates Toys Inc. | 29 November 1982 | California, U.S. | Toys development, marketing and distribution in U.S. market |
| 9. | Regarding Play Inc. | 23 June 1999 | Delaware, U.S. | Inactive |
| 10. | Next Electronix, LLC. | 1 September 2004 | California, U.S. | Inactive |

1.3 Changes in Share Capital of the Company

The following changes in the share capital of the Company have taken place since the date of its incorporation up to the date of this document:

- (a) As at the date of incorporation of the Company on 11 April 2005, its authorized share capital was US\$12,000.00 (or approximately HK\$93,600) divided into 12,000 shares of US\$1.00 (or approximately HK\$7.8) each;
- (b) On 3 May 2005, 12,000 shares of US\$1.00 (or approximately HK\$7.8) each were issued to and fully paid by PIL;
- (c) On 31 May 2007, PIL transferred the 12,000 shares of US\$1.00 (or approximately HK\$7.8) each in the Company to PIL Toys as a contribution of capital in accordance with the terms and conditions of a contribution and assignment agreement;
- (d) Pursuant to written resolutions of the sole shareholder of the Company passed on 17 December 2007, the following matters were approved:
 - (i) the currency denomination of the Company was changed from U.S. dollar to Hong Kong dollar by adopting an exchange rate of US\$1.00 to HK\$7.80, such that the authorised and issued share capital of the Company became HK\$93,600 divided into 12,000 shares of HK\$7.80 each;
 - (ii) each and every share of HK\$7.80 in the capital of the Company was subdivided into 780 shares of HK\$0.01 each, such that the authorised and issued share capital of the Company became HK\$93,600 divided into 9,360,000 shares of HK\$0.01 each;
 - (iii) the authorised share capital of the Company was increased from HK\$93,600 divided into 9,360,000 shares of HK\$0.01 each to HK\$30,000,000 divided into 3,000,000,000 shares of HK\$0.01 each by the creation of an additional 2,990,640,000 Shares to rank pari passu in all respects with the Shares then in issue;
- (e) Pursuant to written resolutions of the sole shareholder of the Company passed on 17 December 2007, it was approved that the Company will issue 485,640,000 Shares by way of dividend of HK\$4,856,400 to PIL Toys;
- (f) PHL shall effect the Distribution by carrying out the following steps on the date of the PHL SGM (see also "HISTORY AND REORGANIZATION – THE DISTRIBUTION"):
 - (i) PIL Toys will distribute approximately 222,523,256 Shares (constituting approximately 45% of the issued share capital of the Company as at the Latest Practicable Date) to PIL Investments Limited;
 - (ii) PIL Investments Limited will distribute approximately 222,523,256 Shares to PIL;

- (iii) PIL will distribute approximately 222,523,256 Shares to PHL; and
- (iv) PHL will distribute approximately 222,523,256 Shares to its shareholders whose names appear on PHL's register of members at 4:00 p.m. on the Distribution Record Date.

1.4 Shareholders Resolutions

On 17 December 2007, written resolutions of the sole shareholder of the Company were passed to approve the following:

THAT, conditional upon (i) the Listing Committee of the Stock Exchange granting listing of, and permission to deal in, the Shares in issue and any Shares which may be issued pursuant to the exercise of the options which may be granted under the Share Option Scheme and (ii) the passing at the PHL SGM of the necessary resolutions to approve the Distribution:

- (a) the Introduction and its implementation be approved;
- (b) subject to the passing of the relevant ordinary resolution in the PHL SGM, the Share Option Scheme be approved and adopted with effect from the date on which dealings in the Shares first commence on the Stock Exchange and the Directors be authorised, subject to the terms of the Share Option Scheme, to grant options to subscribe for Shares thereunder and to allot, issue and deal with Shares pursuant to the exercise of any options which may be granted under the Share Option Scheme and to take all such steps as they consider necessary or desirable to implement the Share Option Scheme;
- (c) a general unconditional mandate be given to the Directors to exercise all the powers of the Company to allot or issue and deal with securities, including Shares, of the Company and to make or grant offers, agreements, or options, including warrants to subscribe for Shares which might require securities to be allotted, issued or disposed of (otherwise than by way of rights or an issue of shares upon the exercise of any options which may be granted under the Share Option Scheme or any other option scheme or similar arrangement for the time being adopted for the grant or issue to officers and/or employees of the Company and/or any of its subsidiaries of shares or rights to acquire shares or any scrip dividend schemes or similar arrangements providing for the allotment and issue of Shares in lieu of the whole or part of a dividend on shares in accordance with the bye-laws of the Company or a specific authority granted by the shareholders of the Company in general meeting) with a total nominal value not exceeding 20% of the aggregate of the total nominal value of the share capital of the Company in issue, such mandate to remain in effect until whichever is the earliest of:
 - (i) the conclusion of the next annual general meeting of the Company;

- (ii) the date by which the next annual general meeting of the Company is required by the bye-laws of the Company or by any applicable law to be held; or
 - (iii) the passing of an ordinary resolution of the shareholders of the Company in general meeting revoking, varying or renewing such mandate;
- (d) a general unconditional mandate be given to the Directors to exercise all powers of the Company to repurchase on the Stock Exchange or on any other stock exchange on which securities of the Company may be listed and which is recognised by the Securities and Futures Commission in Hong Kong and the Stock Exchange for this purpose such number of shares with a total nominal value not exceeding 10% of the total nominal value of the share capital of the Company in issue, such mandate to remain in effect until whichever is the earliest of:
- (i) the conclusion of the next annual general meeting of the Company; or
 - (ii) the date by which the next annual general meeting of the Company is required by the bye-laws of the Company or by any applicable law to be held; or
 - (iii) the passing of an ordinary resolution of the Shareholders of the Company in general meeting revoking, varying or renewing such mandate;
- (e) the general unconditional mandate mentioned in paragraph (c) above be extended by the addition to the aggregate nominal value of the share capital of the Company which may be allotted or agreed conditionally or unconditionally to be allotted by the Directors pursuant to such general mandate of an amount representing the aggregate nominal value of the share capital of the Company repurchased shares referred to in paragraph (d) above provided that such extended amount shall not exceed 10% of the total nominal value of the share capital of the Company in issue; and
- (f) the new bye-laws of the Company be approved and adopted.

1.5 Reorganization

As part of the Reorganization, the following events took place:

- (a) pursuant to a securities purchase agreement dated 31 May 2007, Playmates Inc. transferred the entire issued share capital of PAS to PIL for a consideration of US\$1,720,000 (or approximately HK\$13,416,000);

- (b) pursuant to a securities purchase agreement dated 31 May 2007, Next Electronix, LLC transferred the entire issued share capital of PTIL to PIL for a consideration of US\$2,848,000 (or approximately HK\$22,214,400);
- (c) PIL incorporated PTE on 17 May 2007 in the British Virgin Islands to act as an immediate holding company for each of the Hong Kong, U.S. and PRC-based toy business;
- (d) PTE incorporated PTA on 25 May 2007 in Hong Kong;
- (e) pursuant to a contribution and assignment agreement dated 31 May 2007, PIL contributed the entire issued share capital of PAS to PTE, and because PTE is a wholly owned subsidiary of PIL before and after the contribution and assignment of the entire issued share capital of PAS, PTE and PIL agree that execution of such agreement would constitute adequate consideration;
- (f) pursuant to a contribution and assignment agreement dated 31 May 2007, PIL contributed the entire issued share capital of PTIL to PTE, and because PTE is a wholly owned subsidiary of PIL before and after the contribution and assignment of the entire issued share capital of PTIL, PTE and PIL agree that execution of such agreement would constitute adequate consideration;
- (g) pursuant to a contribution and assignment agreement dated 31 May 2007, PIL contributed the entire issued share capital of Playmates Inc. to PTE, and because PTE is a wholly owned subsidiary of PIL before and after the contribution and assignment of the entire issued share capital of Playmates Inc., PTE and PIL agree that execution of such agreement would constitute adequate consideration;
- (h) pursuant to a written resolution of the directors and written resolution of the sole member of PAS dated 31 May 2007, PAS transferred substantially all of its assets in Hong Kong (the “PAS Assets”) to PTE by way of distribution of dividend in specie;
- (i) pursuant to (h) above and a contribution and assignment agreement dated 31 May 2007, PTE transferred the PAS Assets to PTA, and because PTA is a wholly owned subsidiary of PTE before and after the assignment and contribution of the PAS Assets, PTA and PTE agree that execution of such agreement would constitute adequate consideration;
- (j) all PAS employees based in Hong Kong were transferred to PTA, effective from 1 June 2007;
- (k) PTE incorporated PCH on 25 May 2007 in Hong Kong;

- (l) pursuant to a contribution and assignment agreement dated 31 May 2007, PIL contributed the entire issued share capital of PTE to the Company, and because the Company is a wholly owned subsidiary of PIL before and after the contribution and assignment of the entire issued share capital of PTE, the Company and PIL agree that execution of such agreement would constitute adequate consideration;
- (m) PIL incorporated PIL Toys on 17 May 2007 in the British Virgin Islands to act as our holding company;
- (n) pursuant to a contribution and assignment agreement dated 31 May 2007, PIL contributed the entire issued share capital of the Company to PIL Toys, and because PIL Toys is a wholly owned subsidiary of PIL before and after the contribution and assignment of the entire issued share capital of the Company, PIL Toys and PIL agree that execution of such agreement would constitute adequate consideration;
- (o) pursuant to a contribution and assignment agreement dated 31 May 2007, PIL contributed the entire issued share capital of PIL Toys to PIL Investments Limited, and because PIL Investments Limited is a wholly owned subsidiary of PIL before and after the contribution and assignment of the entire issued share capital of the PIL Toys, PIL Investments Limited and PIL agree that execution of such agreement would constitute adequate consideration;
- (p) PCH incorporated Playmates Toys China Limited on 26 November 2007 in the PRC; and
- (q) pursuant to a sale and purchase agreement dated 27 December 2007, PIL Investments Limited transferred its 49% interest in the issued share capital of Unimax Holdings Limited to PTE for a consideration of HK\$1.00.

1.6 Changes in Share Capital of Subsidiaries

The Company's subsidiaries are referred to in the Accountants' Report, the text of which is set out in Appendix I to this document.

No alterations in the share capital of the Company's subsidiaries have taken place within the two years preceding the date of this document.

2. PURCHASE BY THE COMPANY OF ITS OWN SECURITIES

This section includes the information required by the Stock Exchange to be included in this document concerning the purchase by the Company of its own securities.

2.1 Provisions of the Listing Rules

The Listing Rules permit companies whose primary listing is on the Stock Exchange to purchase their securities on the Stock Exchange subject to certain restrictions, the most important of which are summarized below:

(1) *Shareholders' Approval*

The Listing Rules provide that all proposed purchases of securities on the Stock Exchange by a company with its primary listing on the Stock Exchange must be approved in advance by an ordinary resolution of shareholders, either by way of general mandate or by specific approval in relation to specific transactions.

On 17 December 2007, the Directors were granted a general unconditional mandate to purchase up to 10% of the aggregate nominal value of the share capital of the Company in issue immediately following the Introduction (excluding options to be granted under the Share Option Scheme) on the Stock Exchange or on any other stock exchange on which our securities may be listed and which is recognized by the SFC and the Stock Exchange for this purpose. This mandate will expire at the earliest of (i) the conclusion of our next annual general meeting, (ii) the date by which our next general meeting is required by applicable laws and our bye-laws to be held, or (iii) such mandate being revoked or varied by ordinary resolutions of our shareholders in a general meeting (the "Relevant Period").

(2) *Source of Funds*

Purchases must be funded out of funds legally available for the purpose in accordance with the Bye-laws and the applicable laws of Bermuda. A listed company may not purchase its own securities on the Stock Exchange for a consideration other than cash or for settlement otherwise than in accordance with the trading rules of the Stock Exchange from time to time. Any purchases by the Company may be made out of the capital paid up on the purchased Shares or out of the funds of the Company otherwise available for dividend or distribution or out of the proceeds of a fresh issue of Shares made for the purpose. Any premium payable on a purchase over the par value of the Shares to be purchased must be provided for out of funds of the Company otherwise available for dividend or distribution or out of the Company's share premium account.

The Directors do not propose to exercise the purchase mandate to such an extent as would, in the circumstances, have a material adverse effect on the working capital requirements of the Company or the gearing levels which, in the opinion of the Directors, are from time to time appropriate for the Company.

However, there might be a material adverse impact on the working capital requirements of the Company as set out in this document in the event that the purchase mandate is exercised in full.

(3) *Status of Purchased Securities*

The listing of all purchased securities (whether on the Stock Exchange or, otherwise) is automatically cancelled and the relative certificates must be cancelled and destroyed. Under Bermuda law, a company's purchased Shares shall be treated as cancelled and the amount of the company's issued share capital shall be reduced by the aggregate nominal value of the purchased Shares accordingly although the authorized share capital of the company will not be reduced.

(4) *Connected Parties*

The Listing Rules prohibit a company from knowingly purchasing securities on the Stock Exchange from a "connected person", that is, a director, chief executive or substantial shareholder of the company or any of its subsidiaries or their respective associates (as defined in the Listing Rules) and a connected person shall not knowingly sell his securities to the company.

(5) *Funding of Purchases*

In purchasing securities, the Company may only apply funds legally available for such purpose in accordance with our bye-laws, Bermuda company law and the Listing Rules.

On the basis of the current financial position of the Group as disclosed in this document and taking into account the current working capital position of the Group, the Directors believe that, if the purchase mandate were to be exercised in full, it might have a material adverse effect on the working capital and/or the gearing position as compared with the position disclosed in this document. However, the Directors do not propose to exercise the purchase mandate to such an extent as would, in the circumstances, have a material adverse effect on the working capital requirements of the Group or the gearing levels which in the opinion of our Directors are from time to time appropriate for the Group.

2.2 Reasons for Purchases

The Directors believe that it is in the best interests of the Company and its shareholders for the Directors to have a general authority from shareholders to enable the Company to purchase Shares on the market.

Such purchases may, depending on market conditions and funding arrangements at the time, lead to an enhancement of the net value of the Company and its assets and/or its earnings per Share and will only be made when the Directors believe that such purchases will benefit the Company and its shareholders.

2.3 Exercise of the Purchase Mandate

Exercise in full of the purchase mandate on the basis of 495,000,000 Shares in issue immediately after completion of the Introduction (assuming that no options are granted under the Share Option Scheme) could accordingly result in up to 49,500,000 Shares being purchased by the Company during the period prior to (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 Bermuda law or its Bye-laws to be held; or (3) the revocation or variation of the purchase mandate by ordinary resolution of shareholders in a general meeting, whichever occurs first.

2.4 General

None of the Directors or, to the best of their knowledge having made all reasonable enquiries, any of their respective associates (as defined in the Listing Rules) have any present intention to sell any Shares to the Company or its subsidiaries if the purchase mandate is exercised.

The Directors have undertaken to the Stock Exchange that, so far as the same may be applicable, they will exercise the purchase mandate in accordance with the Listing Rules, the Bye-laws and the applicable laws of Bermuda.

If as a result of a purchase of Shares, a shareholder's proportionate interest in the voting rights of the Company is increased, such increase will be treated as an acquisition for the purposes of the Code. Accordingly, a shareholder or a Group of shareholders acting in concert could obtain or consolidate control of the Company and become obliged to make a mandatory offer in accordance with Rule 26 of the Code as a result of any such increase. Our Directors are not aware of any consequences of purchases which would arise under the Code.

However, the Directors do not have an intention to exercise the purchase mandate to the extent that will trigger a mandatory offer obligation.

No connected person (as defined in the Listing Rules) of the Company has notified the Company that he has a present intention to sell Shares to the Company, nor has he undertaken not to do so if the purchase mandate is exercised.

3. FURTHER INFORMATION ABOUT THE BUSINESS

3.1 Summary of Material Contracts






The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by the Company or its subsidiaries within the two years preceding the date of this document and are or may be material:















- (a) a securities purchase agreement dated 31 May 2007 between Playmates Inc. and PIL, whereby Playmates Inc. transferred the entire issued share capital of PAS to PIL for a consideration of US\$1,720,000;
- (b) a securities purchase agreement dated 31 May 2007 between Next Electronix, LLC and PIL, whereby Next Electronix, LLC transferred the entire issued share capital of PTIL to PIL for a consideration of US\$2,848,000;
- (c) a contribution and assignment agreement dated 31 May 2007 between PIL and PTE, whereby PIL contributed the entire issued share capital of PAS to PTE;
- (d) a contribution and assignment agreement dated 31 May 2007 between PIL and PTE, whereby PIL contributed the entire issued share capital of PTIL to PTE;
- (e) a contribution and assignment agreement dated 31 May 2007 between PIL and PTE, whereby PIL contributed the entire issued share capital of Playmates Inc. to PTE;
- (f) a contribution and assignment agreement dated 31 May 2007 between PTE and Playmates Asia Trading Limited (now known as PTA), whereby PTE transferred the PAS Assets to Playmates Asia Trading Limited;
- (g) a contribution and assignment agreement dated 31 May 2007 between PIL and the Company, whereby PIL contributed the entire issued share capital of PTE to the Company;
- (h) a contribution and assignment agreement dated 31 May 2007 between PIL and PIL Toys, whereby PIL contributed the entire issued share capital of the Company to PIL Toys;

- (i) a contribution and assignment agreement dated 31 May 2007 between PIL and PIL Investments Limited, whereby PIL contributed the entire issued share capital of PIL Toys to PIL Investments Limited;
- (j) a termination agreement dated 31 May 2007 between PTI and PAS, whereby PTI and PAS agreed to terminate a sourcing and support agreement between PTI and PAS effective on 1 January 2005;
- (k) a termination agreement dated 31 May 2007 between PTI and PTIL, whereby PTI and PTIL agreed to terminate a non-exclusive license and distribution agreement between PTI and PTIL effective on 1 January 2005;
- (l) a sale and purchase agreement dated 27 December 2007 between PIL Investments Limited and PTE, whereby PIL Investments Limited transferred its 49% interest in the issued share capital of Unimax Holdings Limited to PTE for a consideration of HK\$1.00;
- (m) a trade mark assignment agreement dated 27 December 2007 between Playmates IP Limited and the Company to assign certain registered trade marks and trade mark applications in classes 16 and 28 to our Group for a consideration of HK\$10.00 for each of the registered trade marks and trade mark applications;
- (n) a compliance services agreement dated 27 December 2007 entered into between PIL Finance Limited and the Company to provide, or procure to be provided, certain compliance services to our Group; and
- (o) Deed of Tax Indemnity dated 27 December 2007 entered into among the Indemnifiers and the Company.



4. INTELLECTUAL PROPERTY OF THE GROUP

As at the Latest Practicable Date, the following intellectual property rights were material to the Group's business:

| Trademark | Country of Registration | Class | Registration Number | Registration Date | Expiry Date |
|---|-------------------------|-------|---------------------|-------------------|-------------|
|  | Australia | 28 | 518573 | 6 Sep 1989 | 6 Sep 2016 |
|  | Benelux | 28 | 535265 | 28 May 1993 | 28 May 2013 |
|  | Canada | 28 | TMA369,368 | 8 Jun 1990 | 8 Jun 2020 |
|  | PRC | 28 | 545845 | 10 Mar 1991 | 9 Mar 2011 |
|  | PRC | 28 | 3089377 | 14 Feb 2004 | 13 Feb 2014 |

| Trademark | Country of Registration | Class | Registration Number | Registration Date | Expiry Date |
|---|-------------------------|-------|---------------------|-------------------|---------------------------------------|
|  | Denmark | 28 | VR200100356 | 19 Jan 2001 | 19 Jan 2011 |
|  | France | 28 | 93470107 | 28 May 1993 | 27 May 2013 |
|  | Germany | 28 | 2106239 | 4 Jun 1993 | 30 Jun 2013 |
|  | Hong Kong | 28 | 199501616 | 22 May 1993 | 22 May 2014 |
|  | Italy | 28 | 664514 | 31 May 1993 | In the process of renewal application |
|  | Macau | 28 | 9731-M | 20 Jan 1995 | 20 Jan 2012 |
|  | New Zealand | 28 | 227225 | 27 May 1993 | 27 May 2014 |
|  | Spain | 28 | 1771552 | 9 Jul 1993 | 9 Jul 2013 |
|  | Sweden | 28 | 315481 | 9 Aug 1996 | 9 Aug 2016 |
|  | United Kingdom | 28 | 1461468 | 17 Apr 1991 | 17 Apr 2018 |
|  | | | | | |
|  | U.S. | 28 | 1,576,558 | 9 Jan 1990 | 9 Jan 2010 |
| PLAYMATES | U.S. | 28 | 1,381,554 | 4 Feb 1986 | 4 Feb 2016 |
|  | U.S. | 28 | 1,575,272 | 2 Jan 1990 | 2 Jan 2010 |
| LI'L PLAYMATES | U.S. | 28 | 1,211,698 | 5 Oct 1982 | 5 Oct 2012 |
|  | U.S. | 28 | 1,521,967 | 24 Jan 1989 | 24 Jan 2009 |
| PRECIOUS PLAYMATES | U.S. | 28 | 1,511,902 | 8 Nov 1988 | 8 Nov 2008 |

As at the Latest Practicable Date, the Group has filed applications for the following trademarks:

| Trademark | Class | Country of Application | Application Date | Application Number |
|---|-----------|------------------------|------------------|--------------------|
|  | 16 and 28 | U.S. | 10 October 2006 | 76/667136 |
| PLAYMATES | 16 and 28 | U.S. | 10 October 2006 | 76/667137 |
|  | 16 and 28 | U.S. | 10 October 2006 | 76/667138 |

4.1 Domain name

| Domain names | Registrant/Owner | Territory | Expiry date |
|-------------------------|---------------------------------|-----------|-------------|
| action-figures.com | Playmates Toys Inc. | Worldwide | 17-Apr-08 |
| amazingallysen.com | Playmates Toys Inc. | Worldwide | 16-Jan-11 |
| amazingallyson.com | Playmates Toys Inc. | Worldwide | 10-Oct-10 |
| amazinglexie.com | Playmates Toys Inc. | Worldwide | 30-Oct-09 |
| amazingmckayla.com | Playmates Toys Inc. | Worldwide | 30-Oct-09 |
| amazingpetstoys.com | Playmates Toys Inc. | Worldwide | 10-Oct-10 |
| coldnosepuppy.com | Playmates Toys Inc. | Worldwide | 26-Sep-10 |
| dcbattledice.com | Playmates Toys Inc. | Worldwide | 3-Feb-11 |
| disneyfairiestoys.com | Playmates Toys Inc. | Worldwide | 6-Jan-11 |
| kindergarden-babies.com | Playmates Toys Inc. | Worldwide | 11-Mar-10 |
| ninja-turtles.com | Playmates Toys Inc. | Worldwide | 21-Apr-08 |
| playmatestoys.com | Playmates Toys Inc. | Worldwide | 16-Aug-08 |
| playmateselectronix.com | Playmates Toys Inc. | Worldwide | 2-Sep-09 |
| webattledice.com | Playmates Toys Inc. | Worldwide | 3-Feb-11 |
| occompany.com | Playmates Toys Inc. | Worldwide | 14-Jan-08 |
| strutsfashion.com | Playmates Toys Inc. | Worldwide | 16-Nov-10 |
| wowpals.com | Playmates Toys Inc. | Worldwide | 28-Jun-10 |
| atomicbettytoys.com | Playmates Toys Inc. | Worldwide | 28-Jan-08 |
| blinkiesworld.com | Playmates Toys Inc. | Worldwide | 18-Mar-09 |
| hairchicks.com | Playmates Toys Inc. | Worldwide | 11-Nov-08 |
| yosticks.com | Playmates Toys Inc. | Worldwide | 11-Feb-09 |
| playmatestoys.com.hk | Playmates Toys Asia Limited | Hong Kong | 17-Jul-10 |
| playmatestoys.hk | Playmates Asia Services Limited | Hong Kong | 7-Oct-11 |
| 彩星玩具.cn/中國 | Playmates Asia Services Limited | PRC | 31-May-16 |
| 彩星玩具.公司 | Playmates Asia Services Limited | PRC | 31-May-16 |
| 彩星玩具.公司.cn | Playmates Asia Services Limited | PRC | 31-May-16 |
| playmatestoys.cn | Playmates Asia Services Limited | PRC | 9-Feb-12 |
| playmatestoys.com.cn | Playmates Asia Services Limited | PRC | 9-Feb-12 |

5. FURTHER INFORMATION ABOUT DIRECTORS, MANAGEMENT, STAFF, SUBSTANTIAL SHAREHOLDERS AND EXPERTS

5.1 Interests and Short Positions of Directors in the Share Capital of the Company and Its Associated Corporations Following the Introduction

Immediately following completion of the Introduction, the interests and short positions of the Directors and the chief executive of the Company in the Shares, underlying Shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO) which will have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he is taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be recorded in the register referred to therein or which will be required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Listing Rules, will be as follows:

Long Positions in the share capital of the Company

| Name of Director | Nature of interest | Number and class of securities | Approximate percent of voting power immediately after the Introduction |
|---------------------------|---|--------------------------------|--|
| Mr. Chan Chun Hoo, Thomas | Beneficial owner | 860,200 Shares | 0.17% |
| | Interest of controlled companies ¹ | 360,184,744 Shares | 72.76% |
| Mr. Novak, Lou Robert | Beneficial owner | 137,088 Shares | 0.03% |
| Mr. Soong, Ronnie | Beneficial owner | 354,600 Shares | 0.07% |

Notes:

- (1) Mr. Chan Chun Hoo, Thomas is the beneficial owner of all of the issued share capital of Angers Investments Limited, and is therefore deemed to be interested in the 87,708,000 Shares in aggregate which Angers Investments Limited is interested in and the 272,476,744 Shares in aggregate which PHL is interested in.

Long Positions in the share capital of PHL

| Name of Director | Nature of Interest | Number and class of securities | Approximate percent of voting power immediately after the Introduction |
|---------------------------|---|---------------------------------------|---|
| Mr. Chan Chun Hoo, Thomas | Beneficial owner | 8,602,000 PHL shares | 0.39% |
| | Interest of a controlled company ² | 877,080,000 PHL shares | 39.42% |
| Mr. Novak, Lou Robert | Beneficial owner | 46,033,880 ³ | 2.07% |
| Mr. Soong, Ronnie | Beneficial owner | 5,745,000 ⁴ | 0.26% |

Notes:

- (2) Mr. Chan Chun Hoo, Thomas is the beneficial owner of all of the issued share capital of Angers Investments Limited, and is therefore deemed to be interested in the 877,080,000 shares in aggregate which Angers Investments Limited is interested in.
- (3) These securities represent: (i) 44,663,000 outstanding options to purchase PHL Shares directly issued to Mr. Novak, Lou Robert; and (ii) 1,370,880 PHL Shares directly owned by Mr. Novak, Lou Robert.
- (4) These securities represent: (i) 2,199,000 outstanding options to purchase PHL Shares directly issued to Mr. Soong, Ronnie; and (ii) 3,546,000 PHL Shares directly owned by Mr. Soong, Ronnie.

5.2 Substantial Shareholders

So far as is known to any Director or chief executive of the Company, the following persons (other than a Director or chief executive of the Company), will, immediately following completion of the Introduction, have an interest or short position in the Shares or underlying Shares which would fall to be disclosed to us under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who will be, directly or indirectly to be interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of our Company or any of our subsidiaries:

| Name | Nature of interest | Number of Shares | Approximate percent of issued Shares immediately after the Introduction |
|---------------------------------|---|---------------------------|---|
| Angers Investments Limited | Beneficial owner Interest of a controlled company ¹ | 87,708,000 272,476,744 | 17.72% 55.05% |
| PHL | Interest of a controlled company ² | 272,476,744 | 55.05% |
| Playmates International Limited | Interest of a controlled company ² | 272,476,744 | 55.05% |
| PIL Investments Limited | Interest of a controlled company ² | 272,476,744 | 55.05% |
| PIL Toys Limited | Beneficial owner | 272,476,744 | 55.05% |

Notes:

- (1) Angers Investments Limited directly owns approximately 39.42% of the shareholding of PHL, and is therefore deemed to be interested in the 272,476,744 Shares in aggregate which PHL is interested in.
- (2) Playmates International Limited is a wholly owned subsidiary of PHL; PIL Investments Limited is a wholly owned subsidiary of Playmates International Limited; and PIL Toys Limited is a wholly owned subsidiary of PIL Investments Limited. PHL, Playmates International Limited, and PIL Investments Limited are therefore deemed to be interested in the 272,476,744 Shares in which PIL Toys Limited is beneficially interested in.

5.3 Directors' Service Contracts and Remuneration

Particulars of Service Contracts

Each of Mr. Chan Chun Hoo, Thomas, Mr. Novak, Lou Robert and Mr. Soong, Ronnie, being all of our executive directors, has entered into a service contract with our Company for an initial term of three years commencing from 17 December 2007.

The aggregate annual directors' fee for the three executive directors is HK\$30,000, such annual sum is subject to the annual review by our Board and the compensation committee. Such executive director shall abstain from voting, and not be counted in the quorum, in respect of any resolution or our Board approving the determination of the salary, bonus and other benefits payable to him.

Each of Mr. Chow Yu Chun, Alexander, Mr. Lee Ching Kwok, Rin and Mr. Yang Victor being our independent non-executive directors, has entered into a service contract with our Company on 17 December 2007. Each service contract is for an initial term of three years commencing from 17 December 2007.

The aggregate annual fees payable to our independent non-executive directors under the service contracts is HK\$525,000, such sum is subject to the annual review by our Board and the compensation committee. Such independent non-executive directors shall abstain from voting, and not be counted in the quorum in respect of any resolution or our Board approving the determination of the salary, bonus and other benefits payable to him.

Save as disclosed above, none of our Directors has or is proposed to have a service contract with any member of our Group (other than contracts expiring or determinable by the employer within one year without the payment of compensation other than the statutory compensation).

Directors' remuneration

Remuneration and benefits in kind of approximately HK\$11 million in aggregate were paid and granted by the Group to the Directors in respect of the financial year ended 31 December 2006.

Under the current arrangements presently in force, the Directors will be entitled to receive remuneration which, for the year ending 31 December 2007 and 2008, is expected to be approximately HK\$10 million and HK\$11 million respectively, excluding the discretionary bonuses payable to the executive Directors.

Save as disclosed in this document, no Director in the promotion of the Company has been paid in cash or shares or otherwise by any person either to induce him to become, or to qualify him as a Director, or otherwise for services rendered by him in connection with the promotion or formation of the Company.

5.4 Disclaimers

Save as disclosed in this document:

- (a) none of the Directors or the experts named in the section headed “8.6 Consents of Experts” in this Appendix has any direct or indirect interest in the promotion of, or in any assets which have been, within the two years immediately preceding the date of this document, acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group;
- (b) no commissions, discounts, brokerages or other special terms have been granted in connection with the issue or sale of any Shares in or debentures of the Company within the two years ended on the date of this document;
- (c) none of the Directors is materially interested in any contract or arrangement subsisting at the date of this document which is significant in relation to the business of the Group taken as a whole;
- (d) none of the Directors or their associates (as defined in the Listing Rules) or existing shareholders or the Company (who, to the knowledge of the Directors, owns more than 5% of our issued share capital) has any interest in any of the five largest customers of the Company; and
- (e) none of the Directors or their associates (as defined in the Listing Rules) or our existing shareholders of the Company (who, to the knowledge of the Directors, owns more than 5% of our issued share capital) has any interest in any or the five largest suppliers of the Company.

6. OUR SHARE OPTION SCHEME

For the purpose of this section 6.1 only, unless the context otherwise requires the following words shall have the following meanings:

| | |
|-------------------------|---|
| “Auditors” | the auditors for the time being of the Company; |
| “Board” | the board of Directors of the Company or a duly authorized committee thereof; |
| “Business Day” | any day which the Stock Exchange is open for the business of dealing in securities; |
| “Commencement Date” | in respect of any particular Option, the Business Day on which that Option is deemed to have been granted in accordance with the terms of this Scheme; |
| “Disability” | shall have the meaning as defined under the long-term disability policy, if any, of the Company or the relevant Subsidiary to which the Grantee provides services regardless of whether the Grantee is covered by such policy. In the event the Company or the relevant Subsidiary to which the Grantee provides service does not have a long-term disability plan in place, “Disability” shall mean that a Grantee is unable to carry out the responsibilities and functions of the position held by the Grantee by reason of any medically determinable physical or mental impairment for a period of not less than ninety (90) consecutive days. A Grantee will not be considered to have incurred a Disability unless he or she furnishes proof of such impairment sufficient to satisfy the Board in its discretion; |
| “Effective Date” | the first day of dealings of the Shares on the Stock Exchange; |
| “Eligible Participants” | (i) directors (including executive directors, non-executive directors and independent non-executive directors) and employees of the Group and any, advisors, consultants, professional, contractors, suppliers, agents, customers, business partners to the Group or a company in which the Group holds an interest or a subsidiary of such company; (ii) the trustee of any trust the beneficiary of which or any discretionary trust the discretionary objects of which include any of the persons in (i); or (iii) a company beneficially owned by any of the persons in (i); |
| “Exercise Period” | in respect of any particular Option, the period to be notified by the Board to each Grantee, which the Board may in its absolute discretion determine, save that such period shall not be more than 10 years from the Commencement Date; |

| | |
|------------------------|--|
| “Exercise Price” | the price per Share at which a Grantee may subscribe for Shares upon the exercise of an Option pursuant to the terms and conditions of this Scheme; |
| “Grantee” | any Eligible Participant who accepts an Offer in accordance with the terms of the Share Option Scheme, or (where the context so permits) a person entitled to any such Option in consequence of the death of the original Grantee; |
| “Offer” | the offer of the grant of an Option; |
| “Option” | right(s) subscribe for Shares pursuant to the Share Option Scheme; |
| “Scheme Mandate Limit” | 10% of the Shares in issue on the date of approval of this Share Option Scheme; |
| “Shares” | ordinary shares of HK\$0.01 each in the share capital of the Company; and |
| “Subsidiary” | a company which is for the time being and from time to time a subsidiary (within the meaning of the Companies Ordinance), of the Company, and “Subsidiaries” shall be construed accordingly. |

The following is a summary of principal terms of the Share Option Scheme conditionally approved by a resolution of the sole shareholder passed on 17 December 2007 and adopted by a resolution of the Board on 17 December 2007. The Share Option Scheme is conditional upon the conditions as set out in “6.17 Conditions of the Share Option Scheme” in this appendix. The terms of the Share Option Scheme are in accordance with the provisions of Chapter 17 of the Listing Rules.

6.1 Purpose

The purpose of the Share Option Scheme is to recognise and acknowledge Eligible Participants who have contributed to the Group and to motivate Eligible Participants to work towards the benefit of the Company and its Shareholders as a whole, and to attract and retain Eligible Participants whose contributions are or may be beneficial to our Group.

6.2 Who May Join

On and subject to the terms of the Share Option Scheme and the Listing Rules, the Board shall be entitled at any time within 10 years after the Effective Date to make an Offer to any Eligible Participants as the Board may in its absolute discretion select to take up an Option pursuant to which such Eligible Participant may, during the Exercise Period, subscribe for such number of Shares at a price calculated in accordance with paragraph 6.4 below. An Offer shall remain open for acceptance by the Eligible Participant concerned for a period of 21 business days from the date of Offer. An Offer cannot be accepted by an Eligible Participant who ceases to be qualified as an Eligible Participant after the Offer has been made. Notwithstanding any

provisions in the Share Option Scheme, no Offer shall be open for acceptance after the tenth anniversary of the Effective Date or after the Share Option Scheme has been terminated. An Offer shall be accepted when the Company receives from the Grantee the offer letter signed by the Grantee specifying the number of Shares in respect of which the Offer is accepted (this can be less than the number of Shares in respect of which it is offered provided that it is accepted in respect of a board lot for dealings in Shares on the Stock Exchange or an integral multiple thereof), and a remittance to the Company of HK\$10.00 (or such other nominal sum in any currency as the Board may determine) as consideration for the grant of Option. Such remittance is not refundable in any circumstances.

The Offer shall specify the terms on which the Option is to be granted. Such terms shall, include, among other things, (i) the last date by which the Offer must be accepted (ii) the manner of payment for the Shares and procedure for acceptance and (iii) any other terms, all of which may be imposed (or not imposed) either on a case-by-case basis or generally. There is no pre-determined minimum period for which the Option must be held before it can be exercised nor is there any pre-determined performance target which must be achieved before the Options can be exercised.

6.3 Grant of Options to Connected Persons or any of their Associates

Any grant of Options to any director, chief executive or substantial shareholder (as such term is defined in the Listing Rules) of the Company, or any of their respective associates under the Share Option Scheme shall be subject to the prior approval of the independent non-executive directors of the Company (excluding independent non-executive directors who are the proposed Grantees of the Options in question). Where any grant of Options to a substantial shareholder or an independent non-executive director of the Company, or any of their respective associates, would result in the Shares issued and to be issued upon exercise of all Options already granted and to be granted (including Options exercised, cancelled or outstanding) to such person in the 12 month period up to and including the date of such grant:

- (1) representing in aggregate over 0.1% of the Shares in issue; and
- (2) having an aggregate value, based on the closing price of the Shares as stated on the Commencement Date, in excess of HK\$5 million,

such further grant of Options shall be subject to prior approval by the Shareholders (voting by way of poll). The Company shall send a circular to the Shareholders in accordance with the Listing Rules and all connected persons of the Company shall abstain from voting in such general meeting, except that any connected person may vote against the relevant resolution at the general meeting provided that his intention to do so has been stated in the circular. The circular must contain (i) details of the number and terms (including the Exercise Price) of the Options to be granted to each Eligible Participant, which must be fixed before the shareholders' meeting and the date of Board meeting for proposing such further grant should be taken as the date of grant for the purpose of calculating the Exercise Price under paragraph 6.4; (ii) a recommendation from the independent non-executive Directors on whether or not to vote in favour of the proposed grant; and (iii) all the information as required under the Listing Rules from time to time.

6.4 Exercise Price

The exercise price for the Options shall be determined by the Board but in any event shall not be less than the highest of:

- (1) the closing price of the Shares as stated in the daily quotations sheet issued by the Stock Exchange on the date of grant which must be a Business Day;
- (2) the average closing price of the Shares as stated in the daily quotations sheets issued by the Stock Exchange for the five Business Days immediately preceding the date of grant; and
- (3) the nominal value of the Shares on the date of grant.

6.5 Maximum Number of Shares

- (1) The maximum number of Shares which may be issued upon exercise of all Options to be granted under the Share Option Scheme and any other share option schemes of the Company shall not, in the absence of Shareholders' approval, in aggregate exceed 10% of the Shares in issue as at the date of approval of this Scheme (the "Scheme Mandate Limit"), representing 49,500,000 Shares. Options lapsed in accordance with the terms of the Share Option Scheme and (as the case may be) such other share option schemes of the Company will not be counted for the purpose of calculating the Scheme Mandate Limit.

The Company may renew the Scheme Mandate Limit at any time subject to prior Shareholders' approval but in any event, the total number of Shares which may be issued upon exercise of all Options to be granted under the Share Option Scheme and any other share option schemes of the Company under the limit as refreshed must not exceed 10% of the Shares in issue as at the date of approval of the renewal of the Scheme Mandate Limit. Options previously granted under the Share Option Scheme or any other share option schemes of the Company (including those outstanding, cancelled, lapsed in accordance with the terms or exercised options) will not be counted for the purpose of calculating the refreshed Scheme Mandate Limit.

- (2) Notwithstanding the foregoing, the Company may grant Options beyond the Scheme Mandate Limit to Eligible Participants if:
 - (i) separate Shareholders' approval has been obtained for granting Options beyond the Scheme Mandate Limit to Eligible Participants specifically identified by the Company before such Shareholders' approval is sought; and
 - (ii) the Company, in connection with the seeking of such separate Shareholders' approval, has first sent a circular to Shareholders containing such information as may be required by the Listing Rules then prevailing to be included in such circular.

- (3) Subject to paragraph (4) below, the maximum number of Shares issued and to be issued upon exercise of the Options granted to each Grantee under the Share Option Scheme (including both exercised and outstanding Options) in any 12-month period shall not exceed 1% of the Shares in issue for the time being (the “Individual Limit”).
- (4) Where any further grant of Options to an Eligible Participant would result in the Shares issued and to be issued upon exercise of all Options granted and to be granted to such person (including exercised, cancelled and outstanding Options) in the 12-month period up to and including the date of such further grant representing in aggregate over 1% of the Shares in issue, such further grant must be separately approved by Shareholders in general meeting with such Eligible Participant and his associates abstaining from voting. The Company must send a circular to the Shareholders disclosing the identity of such Eligible Participant, number and terms of the Options to be granted (and Options previously granted to such Eligible Participant) and such other information required under the Listing Rules from time to time.

6.6 Maximum Number of Options

At any time, the maximum number of the Shares which may be issued upon exercise of all outstanding Share Options which then have been granted and have yet to be exercised under the Share Option Scheme and any other share option schemes of the Company shall not exceed 30% of the relevant class of securities of the Company (or the subsidiary) in issue from time to time. No options may be granted under any schemes of the Company (or the subsidiary) if this will result in the limit being exceeded.

6.7 Time of Exercise of Option

Subject to any restrictions applicable under the Listing Rules and notwithstanding the terms of grant thereof, an Option may be exercised by the Grantee in accordance with the terms of the Share Option Scheme at any time during the period to be determined and notified by the Board to each Grantee, at the time of making an offer of the grant of an Option which shall not expire later than ten years from the Commencement Date.

6.8 Rights Are Personal to Grantees

An Option shall be personal to the Grantee and shall not be assignable and no Grantee shall in any way sell, transfer, charge, mortgage, encumber or create any interest in favour of any other person over or in relation to any Option.

6.9 (1) Rights on Termination of Employment by Dismissal

- (i) If the Grantee who is an employee ceases to be an employee by reason of the termination of his employment on the grounds that he has been guilty of serious misconduct, or has been convicted of any criminal offence involving his integrity or honesty, his Option shall lapse automatically (to the extent not already exercised) and not be exercisable on or after the date of termination of his employment.

- (ii) If the Grantee who is an employee or another member of the Group ceases to be an employee for any reason other than his death, Disability or the termination of his employment on one or more of the grounds specified above, the Option shall lapse (to the extent exercisable as at the date of the relevant event and not exercised) within 30 days following such cessation or such longer period as the Board may determine.

(2) Rights on death

In the event of death of the Grantee before exercising his Option in full, his legal personal representative(s) may exercise the Option up to the Grantee's entitlement as at the date of death (to the extent exercisable as at the date of his death and not exercised) within a period of twelve months following the date of his death or such longer period as the Board may determine.

(3) Rights on Disability

If the Grantee who is an employee, director, consultant, professional, agent, partner, advisor of or contractor to the Group or its Affiliate at the time of the grant of the relevant Option(s) and his employment or service to the Group or its Affiliate is terminated on the ground of Disability, the Grantee may exercise the Option (to the extent exercisable as at the date on which such Grantee ceases to be an employee, director, consultant, professional, agent, partner, advisor of or contractor to the Group or its Affiliate and not exercised) within 6 months following such cessation or such longer period as the Board may determine.

(4) Rights on cessation

- (i) If the Grantee is an employee, director, consultant, professional, agent, partner, advisor of or contractor to the Group or its Affiliate at the time of the grant of the relevant Option(s), in the event that such Grantee shall cease to be an employee, director, consultant, professional, agent, partner, advisor of or contractor to the Group or its Affiliate (as the case may be) but otherwise still remains an Eligible Participant, then the Option(s) granted prior to the date of such cessation shall remain exercisable until its expiry in accordance with the provisions of this Scheme and the terms and conditions upon which such Option(s) is granted unless the Board shall determine to the contrary;
- (ii) If the Grantee, who is a director, consultant, professional, customer, supplier, agent, partner or adviser of or contractor to the Group or an Affiliate but not an employee, ceasing to be a director, consultant, customer, supplier, agent, partner or adviser of or contractor to the Group or an Affiliate (as the case may be) for any reason other than his death (in the case of a Grantee being an individual) or Disability (in the case of a Grantee being a director or

consultant of the Group or its Affiliate), the Option (to the extent exercisable as at the date of such cessation and not exercised) shall be exercised within 30 days following the date of such cessation or such longer period as the Board may determine.

6.10 Effect of Alterations to Share Capital

In the event of any alteration to the capital structure of the Company whilst any Option remains exercisable, arising from capitalization of profits or reserves, rights issue, consolidation, subdivision or reduction of the share capital of the Company in accordance with legal requirements and requirements of the Stock Exchange, adjustment (if any) shall be made to (a) the number of Shares and/or (b) the Exercise price for the Shares in accordance with Rule 17.03(13) of the Listing Rules as the Auditors or the independent financial adviser to the Company shall at the request of the Company certify in writing to the Board either generally or as regards any particular Grantee that the adjustments are in compliance with Rule 17.03(13) of the Listing Rules and the notes thereto.

Any adjustment to be made to the exercise price of, and/or the number of Shares subject to, any options to be granted under the Share Option Scheme will comply with Chapter 17 of the Listing Rules, the supplemental guidance issued by the Stock Exchange on 5 September 2005 in relation to Rule 17.03(13) of the Listing Rules and any applicable future guidance and interpretation of the Listing Rules issued by the Stock Exchange from time to time.

The costs of the Auditors or the independent financial adviser of the Company relating to the Share Option Scheme shall be borne by the Company.

The capacity of the Auditors or the independent financial adviser to the Company in this paragraph is that of experts and not of arbitrators and their certification shall, in the absence of manifest error, be final and binding on the Company and the Grantees.

6.11 Rights on a General Offer by Way of Takeover

In the event of a general offer by way of takeover or scheme of arrangement or otherwise being made to all the Shareholders (or all such Shareholders other than the offeror and/or any person controlled by the offeror and/or any person acting in association or concert with the offeror) and such offer becomes or is declared unconditional (within the meaning of the Code), or it has been approved by the necessary number of holders of Shares at the requisite meetings, the Company shall forthwith notify all the Grantees and any Grantee (or his legal personal representative) shall be entitled to exercise the Option in full (to the extent not already exercised) or to the extent as notified by the Board at any time within such period as shall be notified by the Board.

6.12 Rights on Winding Up

In the event a notice is given by the Company to the Shareholders to convene a Shareholders' meeting for the purpose of considering and, if thought fit, approving a resolution to voluntarily wind up the Company, the Company shall forthwith give notice thereof to all the Grantees and any Grantee may, by notice in writing to the Company accompanied by the remittance for the total Exercise Price payable in respect of the exercise of the relevant Option (such notice to be received by the Company not later than two Business Days (excluding any period(s) of closure of the Company's share registers) prior to the proposed meeting), exercise the Option either in full or in part, and the Company shall as soon as possible and in any event no later than the Business Day (excluding any period(s) of closure of the Company's share registers) prior to the date of the proposed Shareholders' meeting, allot and issue such number of fully paid Shares to the Grantee which fall to be issued on such exercise.

6.13 Rights on a Compromise or Arrangement

In the event a compromise or arrangement (other than a scheme of arrangement) between the Company and its members or creditors is proposed in connection with a scheme for the reconstruction of the Company or its amalgamation with any other company or companies, the Company shall give notice thereof to all the Grantees on the same day as it gives notice of the meeting to its members or creditors to consider such compromise or arrangement, and any Grantee (or his legal personal representative) may, by notice in writing to the Company accompanied by the remittance for the total exercise price payable in respect of the exercise of the relevant Option, exercise the Option either to its full extent or in part and the Company shall as soon as possible and in any event no later than the Business Day immediately prior to the date of the proposed meeting, allot, issue and register in the name of the Grantee such number of fully paid Shares which fall to be issued on exercise of such Option.

6.14 Ranking of Shares

The Shares to be allotted upon the exercise of an Option shall be subject to all the provisions of the Bye-laws of the Company for the time being in force and shall rank *pari passu* in all respects with the existing fully paid Shares in issue on the date on which those Shares are allotted on exercise of the Option and accordingly shall entitle the holders to participate in all dividends or other distributions paid or made after the date on which the Shares are allotted other than any dividend or other distribution previously declared or recommended or resolved to be paid or made if the record date thereof shall be on or before the date on which the Shares are allotted. Any Share allotted upon the exercise of an Option shall not carry voting rights until the name of the Grantee has been duly entered into the register of members of the Company as the holder thereof.

6.15 Period of the Share Option Scheme

The Share Option Scheme shall take effect for a period of ten years from the Effective Date.

6.16 Alterations to the Share Option Scheme

Those specific provisions of the Share Option Scheme which relate to the matters set out in Rule 17.03 of the Listing Rules cannot be altered to the advantage of the Eligible Participants, and changes to the authority of the Board in relation to any alteration of the terms of the Share Option Scheme shall not be made, in either case, without the prior approval of Shareholders in general meeting. Any alterations to the terms and conditions of the Share Option Scheme which are of a material nature, or any change to the terms of Options granted, must also, to be effective, be approved by the Shareholders in general meeting, except where the alterations take effect automatically under the existing terms of the Share Option Scheme. The Share Option Scheme so altered must comply with Chapter 17 of the Listing Rules, the supplemental guidance issued on 5 September 2005 and any future guidance/interpretation of the Listing Rules issued by the Stock Exchange from time to time.

6.17 Conditions of the Share Option Scheme

The Share Option Scheme shall take effect on the Effective Date subject to:

- (1) the passing of the necessary resolutions by PHL, the sole shareholder of the Company, to approve and adopt the Share Option Scheme and to authorise Directors to grant Options to subscribe for the Shares hereunder and to allot, issue and deal with the Shares pursuant to the exercise of any Options under the Share Option Scheme;
- (2) the passing of the resolution by the shareholders of PHL in a special general meeting to approve and adopt the Share Option Scheme;
- (3) the Stock Exchange granting approval of the listing of and permission to deal in the Shares which fall to be issued pursuant to the exercise of any Options;
- (4) if necessary, the Bermuda Monetary Authority granting permission for the issue and free transferability of any Shares to be issued by the Company pursuant to the exercise of Options in accordance with the terms and conditions of this Scheme; and
- (5) the commencement of dealings in the Shares on the Stock Exchange.

If any of the above conditions are not satisfied on or before the earlier of the Listing Date and 31 March 2008, the Share Option Scheme shall terminate and no person shall be entitled to any rights or benefits or be under any obligations under or in respect of the Share Option Scheme.

6.18 Lapse of Option

An Option shall lapse and shall not be exercisable on the earliest of:

- (1) the expiry of the Exercise Period;
- (2) the expiry of the periods referred to in paragraphs 6.9, 6.12 or 6.13 above respectively;
- (3) the expiry of the period referred to in paragraph 6.11;
- (4) the date when the proposed compromise or arrangement becomes effective in respect of the situation contemplated in paragraph 6.13;
- (5) the date of the commencement of the winding-up of the Company; or
- (6) the date on which the Grantee who is an Employee ceases to be an Employee by reason of the termination of his employment on the grounds that he has been guilty of serious misconduct or has been convicted of any criminal offence involving his integrity or honesty.

6.19 Termination of the Share Option Scheme

The Company by resolution in general meeting or the Board may at any time terminate the Share Option Scheme and in such event no further Options may be granted but in all other respects the Share Option Scheme shall remain in full force and effect in respect of Options which are granted during the life of the Share Option Scheme and which remain unexpired immediately prior to termination of the operation of the Share Option Scheme.

6.20 Restriction on Grant of Option

In addition, a grant of Options may not be made after a price sensitive event has occurred or a price sensitive matter has been the subject of a decision until such price sensitive information has been published in the newspapers pursuant to Rule 17.05 of the Listing Rules. In particular, during the period commencing one month immediately preceding the earlier of:

- (1) the date of the meeting of the Board (as such date is first notified to the Stock Exchange in accordance with the Listing Rules) for the approval of the Company's results for any year or any other interim period (whether or not required under the Listing Rules); and
- (2) the deadline for the Company to publish an announcement of its results for any year or interim under the Listing Rules; and ending on the date that such information has been announced pursuant to the relevant requirements of the Listing Rules no Option may be granted.

6.21 Cancellation

The Board shall have the absolute discretion to cancel any Options granted but not exercised if the Eligible Participant so agrees.

6.22 Present Status of the Share Option Scheme

As at the date of this document, no Option has been granted or agreed to be granted pursuant to the Share Option Scheme.

7. PHL SHARE OPTION SCHEME AND SHARE OPTION PLAN

The following is a summary of principal terms of the Share Option Plan (“**Plan**”) and the Share Option Scheme (“**Scheme**”) approved by shareholders of PHL at the special general meetings held on 4 May 1998 and 28 June 2002 respectively.

Share options in PHL were granted to our Directors and employees under the Plan and the Scheme prior to the Spin-off. After the listing of our Company, the share options in PHL granted to our Directors and employees will remain exercisable subject to the 10-year limitation as described below but no new share options in PHL will be granted under the Plan nor the Scheme. As of the Listing Date, our Directors will be entitled to participate in our Share Option Scheme as described in the section headed “6. OUR SHARE OPTION SCHEME” above and will not be entitled to participate in the Plan and the Scheme.

Plan

7.1 Purpose

The purpose of the Plan is to attract, retain and motivate high calibre employees.

7.2 Who May Join

Employees of PHL or any subsidiary (including any executive director of PHL or any subsidiary) may join the Plan.

7.3 Exercise Price

The exercise price for the options shall be determined by the directors of PHL at their discretion, but will not be less than the higher of:

- (i) the nominal value of an ordinary share of PHL;
- (ii) the average (or, in the case of any person who owns ordinary shares of PHL possessing more than 10% of the total combined voting power of the ordinary shares of PHL or the shares of its parent or subsidiary corporations, 110% of the average) of the closing prices of the ordinary shares of PHL on the Stock Exchange of Hong Kong Limited (“Stock Exchange”) as stated in the Stock Exchange’s daily quotation sheets for the 5 trading days immediately preceding the date of grant

7.4 Maximum Number of Shares

The maximum number of shares which may be issued upon exercise of all options to be granted under the Plan shall not exceed 13,574,700 ordinary shares, representing 0.7% of the issued capital of PHL as at 12 March 2007.

7.5 Maximum Number of Option

Each participant of the Plan shall not be entitled to more than 25% of the aggregate number of ordinary shares of PHL in respect of options that may be granted under the Plan.

7.6 Time of Exercise of Option

The options are exercisable in stages and no option will be exercisable later than 10 years after its date of grant.

7.7 Amount Payable on Acceptance of the Option

The amount payable is HK\$10.00.

7.8 Period

The Plan shall remain in force until 3 May 2008.

Scheme**7.9 Purposes**

The purposes of the Scheme are:

- (i) To motivate the eligible participants to optimise their performance and efficiency for the benefit of the Playmates Group
- (ii) To attract and retain or otherwise maintain ongoing business relationship with eligible participants whose contributions are or will be beneficial to the Playmates Group

7.10 Who May Join

The following may join the Scheme:

- (i) Directors, employees, consultants, professionals, customers, suppliers, agents, partners or advisers of or contractors to the Playmates Group or a company in which the Playmates Group holds an interest or a subsidiary of such company

- (ii) The trustees of any trust the beneficiary of which or any discretionary trust the discretionary objects of which include any person/party mentioned in (i) above
- (iii) A company beneficially owned by any person/party mentioned in (i) above

7.11 Exercise Price

The exercise price for the options shall be determined by the directors of PHL at their discretion, but will not be less than the highest of:

- (i) the closing price of an ordinary share of PHL as stated in the Stock Exchange's daily quotations sheet on the date of grant of the relevant option, which must be a business day
- (ii) an amount equivalent to the average closing price of an ordinary share of PHL as stated in the Stock Exchange's daily quotation sheets for the 5 business days immediately preceding the date of grant of the relevant option
- (iii) the nominal value of an ordinary share of PHL on the date of grant

7.12 Maximum Number of Shares

The maximum number of shares which may be issued upon exercise of all options to be granted under the Scheme shall not exceed 80,047,300 ordinary shares, representing 4.3% of the issued capital of PHL as at 12 March 2007.

7.13 Maximum Number of Option

Unless approved by shareholders of PHL, the total number of securities issued and to be issued upon exercise of the options granted to each participant (including both exercised and outstanding options) in any 12-month period must not exceed 1% of the issued ordinary shares of the PHL.

7.14 Time of Exercise of Option

The options are exercisable in stages and no option will be exercisable later than 10 years after its date of grant.

7.15 Amount Payable on Acceptance of the Option

The amount payable is HK\$10.00 or such other nominal sum in any currency as the board may determine.

7.16 Period

The Scheme shall remain in force until 27 June 2012.

8. OTHER INFORMATION

8.1 Estate Duty, Tax and Other Indemnity

The Directors have been advised that no material liability for estate duty is likely to fall on us or any of our subsidiaries in Bermuda and the PRC. The Revenue (Abolition of Estate Duty) Ordinance 2005 came into effect on 11 February 2006 in Hong Kong. No Hong Kong estate duty is payable and no estate duty clearance papers are needed for an application for a grant of representation in respect of holders of Shares, whose deaths occur on or after 11 February 2006.

Each of the Indemnifiers has jointly and severally entered into a deed of tax indemnity with and in favour of our Company to provide indemnities, and keep our Company indemnified, against any tax liabilities falling on any member of our Company which might be payable in respect of, among others, any income, profit or gain earned, accrued or received on or before the listing of our Shares on the Stock Exchange, save in the following circumstances:

- (a) to the extent that provision or reserve has been made for such taxation in the accountants' report set out in Appendix I;
- (b) for which we are or may become liable as a result of transactions in the ordinary course of business after 30 June 2007;
- (c) to the extent that such taxation arises or is incurred as a consequence of any retrospective change in the law or practice thereof by the taxation authorities of the PRC, Hong Kong or Bermuda coming into force after the date of the deed of tax indemnity or to the extent that such taxation arises or is increased by an increase in rates of taxation after the date on which the introduction becomes unconditional with retrospective effect; or
- (d) to the extent that any provision or reserve made for any taxation in our audited accounts as at 30 June 2007 is determined to contain an excessive reserve.

8.2 Litigation

We have recently been party to disputes and legal proceedings that arose in the ordinary course of our business. Playmates Toys, Inc. has recently been involved in two litigation claims. The first one is a dispute with J. Shackelford and Associates, the licensor of the toy concept we used in the *Amazing* brand of dolls concerning a variety of issues including royalty payments and terms of the license agreement. The second one is an alleged trademark infringement dispute with Illektron LLC concerning alleged similarity in trademark design. We do not believe that any of these disputes or legal proceedings will have a material effect on our business, financial

condition or results of operations. Both of these claims have now been settled. Please see the section headed “BUSINESS – LEGAL MATTERS” for further information relating to these two litigation claims.

Save for that disclosed in this document and in the preceding paragraph, as at the Latest Practicable Date, no member of the Group was engaged in any litigation or arbitration of material importance and no litigation or claim of material importance is known to the Directors to be pending or threatened against any member of the Group.

8.3 Sponsor

WAG Worldsec Corporate Finance Limited have, as sponsor, made an application on behalf of the Company to the Listing Committee of the Stock Exchange for listing of and permission to deal in the Shares in issue as mentioned herein and any Shares falling to be issued pursuant to the exercise of options granted under the Share Option Scheme.

8.4 Preliminary Expenses

The preliminary expenses of the Company are estimated to be approximately HK\$11,620,000 and are payable by the Company.

8.5 Qualifications of Experts

The following are the qualifications of the experts who have given opinion or advice which are contained in this document:

| Name | Qualification |
|---|---|
| WAG Worldsec Corporate Finance Limited | Licensed under the SFO to conduct type 4 (advising on securities) and type 6 (advising on corporate finance) regulated activities under the SFO |
| Moores Rowland | Chartered accountants Certified public accountants |
| Savills Valuation and Professional Services Limited | Independent property valuer |
| Conyers Dill & Pearman | Bermuda barristers and attorneys |

8.6 Consents of Experts

Each of the experts set out above has given and has not withdrawn its consent to the issue of this document with the inclusion of its report and/or letter and/or summary of valuations and/or opinion and/or data (as the case may be) and references to its name included in the form and context in which it respectively appears.

None of the experts named in this paragraph has any shareholding interests in the Group or the right (whether legally enforceable or not) to subscribe for, or to nominate persons to subscribe for, securities in any member of the Group.

8.7 Binding Effect

This document shall have the effect, if an application is made in pursuance hereof, of rendering all persons concerned bound by all of the provisions (other than the penal provisions) of sections 44A and 44E of the Companies Ordinance insofar as applicable.

8.8 Miscellaneous

- (a) Save as disclosed in this document:
 - (1) within the two years preceding the date of this document, no share or loan capital of the Company or any of its subsidiaries has been issued or agreed to be issued fully or partly paid either for cash or for a consideration other than cash; and
 - (2) no share or loan capital of the Company or any of its subsidiaries is under option or is agreed conditionally or unconditionally to be put under option.
- (b) Since 30 June 2007, being the date of our latest audited combined financial results as set out in “Appendix I – Accountants Report” to this document, there has been no material adverse change in the financial or trading position or prospects of the Group.
- (c) The Company has no founder shares, management shares or deferred shares in the capital of the Company.
- (d) All necessary arrangements have been made to enable the Shares to be admitted into CCASS for clearing and settlement.
- (e) None of the equity and debt securities of the Company is listed or dealt with in any other Stock Exchange nor is any listing or permission to deal being or proposed to be sought.

9. GENERAL

9.1 Share Registers

The register of members of the Company will be maintained in Bermuda by The Bank of Bermuda Limited and a branch register of members of the Company will be maintained in Hong Kong by Tricor Abacus Limited. Unless the Directors otherwise agree, all transfers and other documents of title to Shares must be lodged for registration with, and registered by, the Company’s branch share registrars in Hong Kong and may not be lodged in Bermuda.

9.2 Taxation of Holders of Shares

(1) *Bermuda*

Under the present Bermuda law, transfers and other disposals of Shares are not subject to Bermuda stamp duty unless the Company holds an interest in land in Bermuda.

(2) *Hong Kong*

Dividends

Under the current practice of the Inland Revenue Department, no tax is payable in Hong Kong in respect of dividends paid by us.

Capital Gains and Profit Tax

No tax is imposed in Hong Kong in respect of capital gains from the sale of the Shares. Trading gains from the sale of Shares by persons carrying on a trade, profession or business in Hong Kong, where such gains are arising in or derived from Hong Kong, will be chargeable to Hong Kong profits tax. Currently, profits tax is imposed on corporations at the rate of 17.5% and on individuals at a maximum rate of 16.0%. The profits tax rate is proposed to be reduced from 17.5% to 16.5% and the standard rate of salaries tax from 16% to 15% in the 2008/2009 year of assessment. Gains from sales of the Shares effected on the Hong Kong Stock Exchange will be considered to be sourced in Hong Kong. Liability for Hong Kong profits tax would thus arise in respect of trading gains from sales of Shares effected on the Hong Kong Stock Exchange realized by persons carrying on a business of trading or dealing in securities in Hong Kong.

Stamp Duty

Hong Kong stamp duty will be payable by the purchaser on every purchase, and by the seller on every sale, of Shares registered on the Hong Kong branch register. The duty is charged at the ad valorem rate of 0.1% of the consideration for, or (if greater) the value of, the Shares transferred on each of the seller and purchaser. In other words, a total of 0.2% is currently payable on a typical sale and purchase transaction of Shares. In addition, any instrument of transfer (if required) will be subject to a flat rate of stamp duty of HK\$5.00. Where a sale or purchase of Shares registered on the Hong Kong branch register is effected by a person who is not resident in Hong Kong and any stamp duty payable on the contract note is not paid, the relevant instrument of transfer (if any) shall be chargeable with such duty, together with the duty otherwise chargeable thereon and the transferee shall be liable to pay such duty.

Estate Duty

The Revenue (Abolition of Estate Duty) Ordinance 2005 came into effect on 11 February 2006 in Hong Kong, pursuant to which estate duty ceased to be chargeable in Hong Kong in respect of the estates of persons dying on or after that date. No Hong Kong estate duty is payable and no estate duty clearance papers are needed for an application for a grant of representation in respect of holders of Shares whose death occur on or after 11 February 2006.

(3) *Generally*

Potential investors in the Introduction should consult their professional advisors if they are in any doubt as to the taxation implications of subscribing for, purchasing, holding and disposing of, or dealing in Shares. It is emphasized that none of the Company, the Sponsor and their respective directors or any other parties involved in the Introduction accepts responsibility for any tax effects on, or liabilities of, persons resulting from the application for, or purchasing, holding and disposal of, or dealing in Shares.

9.3 Bilingual Document

The English language and the Chinese language versions of this document are being published separately, in reliance upon the exemption provided by section 4 of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Chapter 32L of the Laws of Hong Kong).

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at the office of Freshfields Bruckhaus Deringer, 11th Floor, Two Exchange Square, Hong Kong, during normal business hours up to and including 25 January 2008:

- the memorandum of association and bye-laws of the Company;
- the Accountants' Report prepared by Moores Rowland, the text of which is set out in Appendix I to this document;
- the audited consolidated financial statements of certain companies comprising the Group for the three financial years ended 31 December 2006 and the 6 months ended 30 June 2007;
- a statement of adjustments relating to the Accountants' Report prepared by Moores Rowland;
- the letter, summary of values and valuation certificate relating to the property interests of the Group prepared by Savills, the text of which is set out in Appendix II to this document;
- the letter of advice dated 31 December 2007 prepared by Conyers Dill & Pearman summarizing certain aspects of Bermuda company law referred to in Appendix III to this document;
- the Companies Act;
- the Share Option Scheme;
- the service contracts referred to in the section headed "5.3 Directors' Service Contracts and Remuneration – Particulars of Service Contracts" in Appendix IV to this document;
- the material contracts referred to in the section headed "3.1 Summary of Material Contracts" in Appendix IV to this document; and
- the written consents referred to in the section headed "8.6 Consents of Experts" in Appendix IV to this document.

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