



LUNG CHEONG INTERNATIONAL HOLDINGS LIMITED

(Incorporated in the Cayman Islands with limited liability)

Stock Code : 348

INTERIM REPORT 2007/08

Quality



Customer
Oriented



Integrity



Diligence

Intellectual
Development





CORPORATE INFORMATION

Executive Directors

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

Independent Non-executive Directors

Mr. Wong Lam, O.B.E., J.P.
Mr. Ye Tian Liu
Mr. Lai Yun Hung

Non-executive Director

Mr. Ko, Peter Ping Wah

Company Secretary

Mr. Mak, Yee Chuen Vincent

Auditor

Shu Lun Pan Horwath Hong Kong CPA Limited

Audit Committee

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

Remuneration Committee

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

Nomination Committee

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

Registered Office

Ugland House
South Church Street
P. O. Box 309
George Town
Grand Cayman
Cayman Islands
British West Indies

Head Office and Principal Place of Business

Lung Cheong Building
1 Lok Yip Road
Fanling
Hong Kong
Tel: (852) 2677 6699
Fax: (852) 2677 6857

Legal Advisers on Hong Kong Law

D. S. Cheung & Co., Solicitors

Principal Share Registrar and Transfer Office

Bank of Bermuda (Cayman) Limited
P. O. Box 513 G.T.
3rd Floor, British American Tower
Dr. Roy's Drive
George Town
Grand Cayman
Cayman Islands
British West Indies

Branch Share Registrar and Transfer Office in Hong Kong

Tricor Abacus Limited
26th Floor, Tesbury Centre,
28 Queen's Road East
Hong Kong

Listing Information

The Stock Exchange of Hong Kong Limited
Stock Code: 348

Website

www.e-lci.com



The board of directors (the “Directors”) of Lung Cheong International Holdings Limited (the “Company”) is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (the “Group”) for the six months ended 30 September 2007 together with comparative figures for the corresponding period in 2006. These interim consolidated accounts have not been audited but have been reviewed by the Company’s Audit Committee.

CONDENSED CONSOLIDATED INCOME STATEMENT

For The Six Months Ended 30 September 2007

	Note	Unaudited Six months ended 30 September	
		2007 HK\$'000	2006 HK\$'000
Turnover	2	408,168	371,613
Cost of sales		(296,188)	(268,024)
Gross profit		111,980	103,589
Other revenues	2	3,209	2,065
Selling and distribution expenses		(20,704)	(17,420)
Administrative expenses		(74,095)	(66,100)
Finance costs	3	(12,973)	(13,367)
Other gains and losses		3,124	—
Profit before taxation	4	10,541	8,767
Taxation	5	(276)	(370)
Profit for the period		10,265	8,397
Attributable to:			
Equity holders of the Company		10,265	8,454
Minority interest		—	(57)
		10,265	8,397
Dividends	6	—	—
Earnings per share for the profit attributable to the equity holders of the Company during the period			
— Basic	7	0.43 cents	0.56 cents
— Diluted	7	N/A	N/A

**CONDENSED CONSOLIDATED BALANCE SHEET**

As at 30 September 2007

	Note	Unaudited 30 September 2007 HK\$'000	Audited 31 March 2007 HK\$'000
Non-current assets			
Intangible assets		21,714	21,714
Leasehold land and land use rights		47,629	47,415
Property, plant and equipment	8	424,608	437,042
Deferred income tax assets		2,412	3,239
		496,363	509,410
Current assets			
Inventories		251,315	241,608
Trade and other receivables	9	292,997	194,593
Derivative financial instruments		15	369
Current tax recoverable		424	416
Restricted cash		49,320	48,138
Cash and cash equivalents		18,629	42,585
		612,700	527,709
Current liabilities			
Trade payables	10	77,768	51,317
Other payables and accrued charges		44,566	60,783
Provision	12	47,644	47,644
Derivative financial instruments		183	672
Trust receipt bank loans		87,431	93,997
Loans from banks and financial institutions		111,237	209,300
Current income tax liabilities		6,682	6,957
		375,511	470,670
Net current assets		237,189	57,039
Total assets less current liabilities		733,552	566,449
Financed by:			
Share capital		246,480	72,560
Other reserves		38,993	153,913
Retained profits		245,050	234,785
Equity attributable to equity holders of the Company		530,523	461,258
Non-current liabilities	11	203,029	105,191
		733,552	566,449



CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the Six Months Ended 30 September 2007

	Unaudited	
	Six months ended	
	30 September	
	2007	2006
	HK\$'000	HK\$'000
Net cash inflow/(outflow) from operating activities	(60,879)	25,721
Net cash inflow/(outflow) from investment activities	(10,334)	(5,384)
Net cash inflow/(outflow) from financing activities	45,699	(54,366)
Decrease in cash and cash equivalents	(25,514)	(34,029)
Cash and cash equivalents at 1 April	42,585	89,752
Effect on foreign exchange rate changes	1,558	744
Cash and cash equivalents at 30 September	18,629	56,467
Bank balances and cash	18,629	56,467



CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the Six Months Ended 30 September 2007

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

	Unaudited									
	Share capital HK\$'000	Share premium HK\$'000	Exchange fluctuation reserve HK\$'000	Capital reserve HK\$'000	Equity-settled employee benefits reserve HK\$'000	Buildings revaluation reserve HK\$'000	Retained profits HK\$'000	Attributable to equity holders of the Company HK\$'000	Minority interests HK\$'000	Total equity HK\$'000
At 1 April 2006	48,373	110,548	(42,456)	28,524	–	21,140	272,320	438,449	57	438,506
Exchange difference arising from translation of accounts of overseas subsidiaries	–	–	744	–	–	–	–	744	–	744
Profit for the period	–	–	–	–	–	–	8,454	8,454	(57)	8,397
At 30 September 2006	48,373	110,548	(41,712)	28,524	–	21,140	280,774	447,647	–	447,647



NOTES TO THE CONDENSED INTERIM ACCOUNTS

1. Basis of presentation and principal accounting policies

The unaudited consolidated interim financial statements have been prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and with the applicable disclosure requirement of Appendix 16 of the Rules Governing the Listing of Securities (“Listing Rules”) on the Stock Exchange. The accounting policies and basis of preparation adopted in the preparation of the interim financial statements are consistent with those used in the annual financial statements for the year ended 31 March 2007.

In the current period, the Group has adopted all of the new and revised Hong Kong Financial Reporting Standards (“HKFRSs”) issued by the HKICPA that are relevant to its operations and effective for the current accounting period of the Group. The adoption of these new and revised HKFRSs did not result in substantial changes to the Group’s accounting policies nor have affected the amounts reported for the current or prior periods.

At the date of authorisation of these financial statements, the following HKFRSs were in issue but not yet effective:

		Effective for annual periods beginning on or after
HKAS 23 (Revised)	Borrowing Costs	1 January 2009
HKFRS 8	Operating Segment	1 January 2009
HK(IFRIC) – Int 12	Service Concession Arrangements	1 January 2008
HK(IFRIC) – Int 13	Customer Loyalty Programmes	1 July 2008
HK(IFRIC) – Int 14	HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	1 January 2008

The directors of the Company anticipate that the application of these HKFRSs will have no material impact on the financial statements of the Group.

2. Turnover, revenue and segmental information

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

Revenues recognised during the periods are as follows:

	Unaudited Six months ended 30 September	
	2007 HK\$’000	2006 HK\$’000
Turnover		
Sale of goods	400,425	354,558
Mould income	7,743	17,055
	408,168	371,613
Other revenues		
Interest income	1,299	293
Other	1,910	1,772
	3,209	2,065
Total revenues	411,377	373,678



2. Turnover, revenue and segmental information

Primary reporting format – business segments

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

Secondary reporting format – geographical segments

	Unaudited Six months ended 30 September	
	2007 HK\$'000	2006 HK\$'000
Turnover		
United States	172,284	167,397
Europe	89,694	68,052
Japan	45,653	46,638
Mainland China	18,777	38,723
Other	81,760	50,803
	408,168	371,613

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

The turnover derived from Europe represents sales of toys to multiple customers with goods shipped directly to Europe under the instruction of these customers.

3. Finance costs

	Unaudited Six months ended 30 September	
	2007 HK\$'000	2006 HK\$'000
Interest on loans from banks and financial institutions	11,976	13,075
Arrangement fees on bank loans	997	292
	12,973	13,367

4. Operating profit

Operating profit is stated after charging the following:

	Unaudited Six months ended 30 September	
	2007 HK\$'000	2006 HK\$'000
Charging:		
Depreciation of owned fixed assets	19,490	24,021
Amortisation of leasehold land and land use rights	560	560

**5. Taxation**

	Unaudited Six months ended 30 September	
	2007 HK\$'000	2006 HK\$'000
Current taxation		
Hong Kong profits tax	—	226
Mainland China enterprise income tax	276	826
	276	1,052
Deferred taxation	—	(682)
	276	370

Hong Kong profits tax has been provided at the rate of 17.5% (2006: 17.5%) on the estimated assessable profit for the period. Taxation on profits of Mainland China subsidiaries has been calculated on the estimated assessable profit for the period at the rates of taxation as applicable to the local subsidiaries. No provision for taxation of the subsidiary in Indonesia has been made as it has tax losses as at 30 September 2007 and 30 September 2006.

6. Dividends

The Board of Directors does not recommend the payment of interim dividend for the six month ended 30 September 2007 (2006: Nil).

7. Earnings per share

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

	Unaudited Six months ended 30 September	
	2007 HK\$'000	2006 HK\$'000 (restated)
Profit attributable to equity holders of the Company	10,265	8,454
Weighted average number of ordinary shares in issue	2,370,373,767	1,517,157,039
Basic earnings per share (HK cents)	0.43	0.56

Basic earnings per share for the six months ended 30 September 2006 is restated to take into effect the rights issue during the year ended 31 March 2007 and the bonus issue during the six months ended 30 September 2007.

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

No diluted earnings per share was shown for the six months ended 30 September 2006 as the Company has no potential dilutive ordinary shares at 30 September 2006.

**8. Property, plant and equipment**

	<i>HK\$'000</i>
At 1 April 2007	437,042
Additions	10,434
Depreciation	(19,490)
Exchange adjustment	(3,378)
At 30 September 2007	<u>424,608</u>

9. Trade and other receivables

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

	Unaudited 30 September 2007 HK\$'000	Audited 31 March 2007 HK\$'000
Trade receivables	239,267	159,456
Other receivables, deposits and prepayments	53,730	35,137
	<u>292,997</u>	<u>194,593</u>

The ageing analysis of the trade receivables was as follows:

	Unaudited 30 September 2007 HK\$'000	Audited 31 March 2007 HK\$'000
0 – 30 days	53,146	52,217
31 – 60 days	64,265	14,801
61 – 90 days	71,060	37,716
91 – 180 days	37,162	39,562
181 – 365 days	9,435	4,106
Over 365 days	4,199	11,054
	<u>239,267</u>	<u>159,456</u>

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

10. Trade payables

The ageing analysis of the trade payables was as follows:

	Unaudited 30 September 2007 HK\$'000	Audited 31 March 2007 HK\$'000
0 – 30 days	23,139	17,075
31 – 60 days	18,715	4,963
61 – 90 days	10,320	12,788
91 – 180 days	16,637	10,616
181 – 365 days	8,767	5,807
Over 365 days	190	68
	<u>77,768</u>	<u>51,317</u>

**11. Non-current liabilities**

	Unaudited 30 September 2007 HK\$'000	Audited 31 March 2007 HK\$'000
Borrowings	191,652	93,600
Deferred income tax liabilities	9,843	10,037
Provision for long service payment	1,534	1,554
	203,029	105,191

12. Provision

	Unaudited 30 September 2007 HK\$'000	Audited 31 March 2007 HK\$'000
Provision	47,644	47,644

In February 2002, Action Products International Inc. ("APII") filed civil lawsuits (the "Lawsuit") at the Circuit Court of the Alachua County, State of Florida, USA (the "Circuit Court") against the Company, Kid Galaxy Inc. ("Kid Galaxy") and Mr Tim Young ("Mr Young") and claimed an unspecified amount of damages. On 9 October 2006, the jury arrived at the decision against the Company, Kid Galaxy and Mr Young and awarded APII the damages in the amount of US\$5.1 million (approximately HK\$40 million) (the "Damages"). On 16 October 2006, the Company filed a motion to set aside the jury's previous verdict of the Damages which was subsequently denied by the Circuit Court.

Details of the Lawsuit and the previous verdicts were set out in the announcements of the Company dated 16 October 2006 and 16 November 2006.

In December 2006, the Company filed an appeal against the Circuit Court's judgement with the District Court of Appeal, First District, State of Florida, USA (the "Appellate Court"). Pending the outcome of the appeal process, the Company placed appeal bond of approximately HK\$48 million with the Circuit Court for the unfavorable judgement against the Group.

The Company has received the decision of the Appeal Court filed on 30 November 2007, pursuant to which the decision of the Circuit Court against the Company was affirmed. Hence, the Company's appeal did not succeed.

Pending the outcome of the said appeal, the Company had made sufficient provision for the Damages together with the related interests and legal costs in relation to the Lawsuit in the financial statements of the Group as at 30 September 2007.

13. Contingent liabilities

At 30 September 2007, the Group did not have material contingent liabilities.

14. Commitments

(a) Capital commitment for fixed assets

As at 30 September 2007, the Group did not have material capital commitment.

(b) Commitments under operating leases

At 30 September 2007, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	Unaudited 30 September 2007 HK\$'000	Audited 31 March 2007 HK\$'000
Not later than one year	3,756	3,446
Later than one year but not later than five years	10,311	13,180
Over five years	—	2,207
	14,067	18,833

15. Banking and other facilities

As at 30 September 2007, the Group had a total banking and other facilities of approximately HK\$420,800,000 (31 March 2007: HK\$440,900,000), of which the following had been utilized:

- (a) a syndication loan of HK\$200,000,000 (31 March 2007: HK\$218,400,000), secured by legal charges over the properties located in Hong Kong, pledge agreements over the equity interests in two PRC subsidiaries and the second collateral insurance assignments. Details of this syndication loan were set out in the announcement of the Company dated 21 August 2007; and
- (b) general banking facilities of approximately HK\$190,320,000 (31 March 2007: HK\$178,497,000), certain general banking facilities are secured by trade accounts receivables and production equipments.

These general banking facilities are all supported by a corporate guarantee executed by the Company.

16. Share based payment

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

Under the Scheme, share options can be exercised at any time during the periods to be determined and notified by the Directors to the grantees at the time of making offers to grant share options to them, provided that such periods shall not exceed the period of ten years from the date of grant. The scheme mandate limit of the Scheme was refreshed pursuant to a shareholders' resolution passed in the annual general meeting ("AGM") of the Company held on 27 August 2007, details of which have been set out in the circular dated 3 August 2007. Accordingly, as at 30 September 2007, the maximum number of shares available for issued under the Scheme is 82,159,999, representing 10% of the issued ordinary share capital of the Company as at the date of the AGM and approximately 3.33% of the issued ordinary share capital of the Company as at 30 September 2007 (taking into effect the bonus issue during the current period after the refreshment of scheme mandate limit). The subscription price for the shares under the Scheme shall be a price determined by the Directors at its discretion, provided that it shall not be less than the highest of (i) the closing price of the shares stated in the daily quotation sheets of the Stock Exchange of Hong Kong Limited ("Stock Exchange") on the date of grant; (ii) the average closing price of the shares stated in the Stock Exchange's daily quotation sheets for the five business days immediately preceding the date of grant of share options and (iii) the nominal value of the shares.

During the period (but before the refreshment of scheme mandate limit as stated above), a total of 28,940,000 share options were granted to the Directors and eligible employees and consultants of the Group with a weighted average exercise price of approximately HK\$3.73 per share. The total number of share options was subsequently restated to 86,820,000 to take into effect the bonus issue during the current period.



The terms and conditions of the grants that existed at 30 September 2007 are as follows, whereby all options are settled by physical delivery of shares:

	Balance as at 1 April 2007	Granted during the period	Balance as at 30 September 2007	Exercise price HK\$	Closing price of each share at date of grant HK\$	Exercise period
Executive Directors	Nil	15,000,000	15,000,000	1.33	0.99	24/07/2007 to 23/07/2008
Independent non-executive Directors	Nil	2,400,000	2,400,000	1.00	0.99	24/07/2007 to 23/01/2008
Other employees (a)	Nil	19,620,000	19,620,000	1.00	0.99	24/07/2007 to 23/01/2008
(b)	Nil	600,000	600,000	1.00	0.99	24/07/2007 to 23/07/2009
Consultants (a)	Nil	48,600,000	48,600,000	1.33	0.99	24/07/2007 to 23/01/2008
(b)	Nil	600,000	600,000	1.00	0.99	24/07/2007 to 23/07/2009
	Nil	86,820,000	86,820,000			

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

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

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

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



INTERIM DIVIDEND

The Directors do not recommend the payment of an interim dividend for the six months ended 30 September 2007 (2006: Nil)

RESULTS, BUSINESS REVIEW AND PROSPECTS

Results

For the six months ended 30 September 2007, the Group's turnover increased by approximately 9.8% to approximately HK\$408.2 million, compared with approximately HK\$371.6 million for the corresponding period of last year. Gross profit margin was maintained at approximately 27% while gross profit rose by approximately 8.1%. Profit attributable to equity holders of the Group was approximately HK\$10.3 million, representing a year-on-year rise of approximately 21.4% (2006: approximately HK\$8.5 million).

Business Review

To strengthen the Group's performance, the Group has dedicated greater efforts toward the radio control (R/C) toy business segment, an area that has seen steady advances as reflected by its move from producing ordinary planes to the world's smallest and lightest indoor helicopters. Accordingly, the Group's R/C toy business accounted for 68% of total sales during the review period, showing clear leadership and strength in this segment.

Complementing the success of the R/C toy business is greater diversification of the Group's customer base, drawing approximately 60% of the top 5 customers compared with approximately 65% for the financial year 2006/07.

Indeed, Kid Galaxy is expecting to double its previous year's sales owing to the success of utilizing specialty toy channels and home TV shopping network for generating revenue. In recognition of its innovative and creative designs, Kid Galaxy received accolades from the most prominent national toy awards, namely "Oppenheim Toy Portfolio Gold Award" by Oppenheim Toy Portfolio, "100 Best Children's Products 2007" by Dr. Toy Award, and "Toy of the Year Award", "Preferred Choice Award" and "Seal of Excellence Award" by 2007 Creative Child Award.

Geographically, the United States, Europe, and other regions (except Japan and Mainland China) respectively accounted for approximately 42%, 22% and 20% of the Group's overall turnover during the review period.

Research and development in the Group's robotic investment has also reaped benefits. Besides the above said world's smallest and lightest indoor helicopters, production and marketing of the world's smallest and most advanced humanoid robot — i-sobot — and a more sophisticated Robot X has commenced at the Group's Changping factory.

To ensure the Group can meet orders cost-effectively, it has utilized its Indonesian factory more extensively. With major customers willing to transfer orders to our South East Asian plant, the Group was able to benefit from relieving the Changping plant for higher value production and took advantage of Indonesia's more flexible costs and plentiful labor. Utilization rate of the Indonesian plant has increased by more than five folds over the previous year.



Selling expenses have increased mainly due to rising transportation costs in parallel with the rising fuel charges. Moreover, appreciation of the Renminbi (“RMB”), labor costs and costs of operating three production plants until the redeployment of facilities of Qian Tou factory in September 2007, all together burdened the administration expenses. It is worth noting that the new Changping factory has commenced production and it has increased the Group’s fixed assets since its completion.

Both the inventory and accounts receivable of the Group saw seasonable increases. Stocks of products held during the end of financial year 2006/07 have been partly shipped with further shipments scheduled. The Group’s cash was utilized to address the rise in inventory and accounts receivable.

During the review period, the Group was confronted with its sternest test. The numerous hurdles made the Group depend on internally generated cash flow and expansion of capital base and most importantly the loyalty and strong support of existing customers.

Investors and shareholders have made strong contribution to the Group. On 31 May 2007, the Company entered into a top-up placing arrangement with investors, pursuant to which 96,000,000 new shares were issued and approximately HK\$55 million were raised. The gross proceeds from the placement were used as to approximately HK\$30 million for repayment of loans owing by the Group to a syndicate of banks, and the balance of approximately HK\$25 million would be used for the general working capital of the Group.

On 21 August 2007, the bankers also participated in strengthening our financial position by making available to the Group a HK\$200 million term loan facility as means of support. Apart from repaying the outstanding balance of a previous term loan of HK\$300 million, the balance of the new term loan was used for the general working capital of the Group.

Plans and Prospects

The toy industry will continue to be confronted with numerous challenges in the foreseeable future. Though the Group has not been involved in the highly publicized toy recalls rocking the industry, there has been renewed focus on test and production practices, particularly in relation with toys for younger users.

Aside from the issue regarding hazardous toys, appreciation of the RMB and increase in labor and material costs as well as shortage of labor look set to linger for some time. To overcome such difficulties, the Group will divert production to Indonesia when appropriate while at the same time streamline production in Mainland China. Specifically, the Group will consolidate operations to modernize the Changping factory while redeploying Qian Tou factory to reduce overhead. For mitigating concerns of labor shortage, the new factory, by being located in Changping, a key railway terminus in Guangdong, should enable the Group to attract and retain workers. To promote efficiency, the Group aims to discard all non-core assets before the close of the financial year. It will seek to renegotiate prices with customers for forthcoming sales taking into consideration the aforementioned factors in relation to the RMB, wages and material costs.

Taking a proactive approach, the Group will take steps to increase sales through its Original Brand Manufacturing (“OBM”) business, namely, utilize Kid Galaxy to bolster margins. To ensure that such momentum will continue, the Group will develop more innovative products as they are particularly popular among consumers.



Production of robotic products commenced at the end of the interim period. Strong demand for such products indicates that the production is likely to continue for the remaining of the financial year. The Group's share of this emerging robotic market is likely to expand with the development of future generations with more advance functions and capabilities.

With lower interest rates forecasted, as evidenced by recent rate cuts, the Group should benefit from a lower overall borrowing.

Concerning the lawsuit filed by Action Products International Inc. against the Company, Kid Galaxy, and Mr. Tim Young in 2002, the District Court of Appeal, State of Florida, USA, has affirmed the decision of the Circuit Court of Alachua County against the Company. Hence the Group was unsuccessful in its appeal. The impact of the outcome has been entirely reflected in the Group's results for the year ended 31 March 2007, with sufficient provisions made in the financial statements of the Group during that financial period.

Despite the challenges mentioned, the Directors are confident that through implementation of the measures prescribed, the Group will enhance its performance ahead of the next fiscal period.

GROUP RESOURCES AND LIQUIDITY

As at 30 September 2007, the Group's cash and bank balances were approximately HK\$19 million (2006: approximately HK\$56 million). The Group's total borrowings were HK\$390 million (2006: HK\$449 million). The gearing ratio, calculated as the total borrowings less cash and bank balances and divided by shareholders' equity, was approximately 70% (2006: approximately 88%). As at 30 September 2007, the Group recorded total current assets of approximately HK\$613 million (2006: approximately HK\$572 million) and total current liabilities of approximately HK\$376 million (2006: approximately HK\$581 million). The current ratio of the Group, calculated by dividing the total current assets by total current liabilities, was approximately 1.63 (2006: approximately 0.98). The Group recorded an increase in shareholders' funds from approximately HK\$448 million as at 30 September 2006 to approximately HK\$531 million as at 30 September 2007. The increase was mainly derived from the profit after tax, the rights issue and the share placement exercises taken place during the year 2007. In the opinion of the Board, the Group has sufficient financial resources to meet the future operational needs.

EMPLOYEES

As at 30 September 2007, the Group had approximately 7,300 employees. Approximately 72, 7,000, 219 and 9 employees were based in Hong Kong, Dongguan factories, Indonesia factory and the U.S. office respectively. The number of workers employed by the Group varies from time to time depending on production needs and the workers are remunerated based on industry practice.



SHARE OPTION SCHEME

On 3 September 2002, the shareholders of the Company approved the adoption of a new share option scheme (the "Scheme") as a result of the amendments of Chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

Details of the Scheme are as follows:

(1) Purpose

To recognise the contribution of employees, suppliers, consultants, agents and advisers of the Group.

(2) Eligible persons

Full-time employees of the Group (including Directors of the Company and its subsidiaries) suppliers, consultants, agents and advisers who have contributed or will contribute to the Group.

(3) Maximum number of shares

The scheme mandate limit of the Scheme was refreshed pursuant to a shareholders' resolution passed in the annual general meeting ("AGM") of the Company held on 27 August 2007, details of which have been set out in the circular dated 3 August 2007. Accordingly, as at 30 September 2007, the maximum number of shares available for issued under the Scheme is 82,159,999, representing 10% of the issued ordinary share capital of the Company as at the date of the AGM and approximately 3.33% of the issued ordinary share capital of the Company as at 30 September 2007 (taking into effect the bonus issue during the current period after the refreshment of scheme mandate limit).

The maximum number of shares to be issued upon the exercise of all outstanding options granted and yet to be exercised under the Scheme and any other share option scheme of the Group must not in aggregate exceed 30 per cent of the issued share capital of the Company from time to time. The total number of shares which may be issued upon exercise of all options (excluding, for this purpose, options which have lapsed in accordance with the terms of the Scheme and any other share option scheme of the Group) to be granted under the Scheme and any other share option scheme of the Group must not in aggregate exceed 10 per cent of the Shares in issue on the day of adoption of the Scheme (namely, 3 September 2002). Subject to specific approval of the shareholders of the Company, the 10 per cent. limit may be refreshed with reference to the date of such specific approval of the shareholders of the Company.

(4) Maximum entitlement of each eligible person

Unless approved by shareholders, the total number of shares issued and to be issued upon exercise of the share options granted to each eligible person in any 12-months period must not exceed 1% of the shares of the Company in issue.



(5) Time of exercise of option

An option may be exercised during the periods to be determined and notified by the Directors to the grantees at the time of making offers to grant share options to them provided that such periods shall not exceed the period of ten years from the date of grant.

(6) Acceptance of offers

Offers for the grant of share options must be accepted within twenty-eight days, inclusive of the dates on which the offers are made. Offers for grant of share options have to be accepted together with remittance in favour of the Company of HK\$1.00.

(7) Basis of determining the option exercise price

The subscription price for the shares under the Scheme shall be a price determined by the Directors at its discretion, provided that it shall not be less than the highest of (i) the closing price of the shares stated in the daily quotation sheets issued by The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on the date of grant; (ii) the average closing price of the shares stated in the Stock Exchange's daily quotation sheets for the five trading days immediately preceding the date of grant of share options; and (iii) the nominal value of the shares.

(8) The remaining life of the Scheme

The Scheme will remain in force until 3 September 2012, being the date which falls ten years after the date of adoption of the Scheme.

Details of the share options outstanding as at 30 September 2007 which have been granted under the Scheme have been disclosed in Note 16 to the accounts.



DIRECTORS' INTERESTS IN EQUITY SECURITIES

At 30 September 2007, the interests and short positions of each Director and chief executive of the Company in the shares or underlying shares of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of Laws of Hong Kong) ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules were as follows:

Name	Name of company	Capacity	Number and class of securities (Note 1)	Percentage on the issued share capital of the same class of securities
Leung Lun	The Company	Interest of controlled corporation	1,499,082,240 ordinary shares (L) (Note 2)	60.82%
	The Company	Beneficial interest	3,000,000 ordinary shares (L) (Note 3)	0.12%
	Lung Cheong Investment Limited	Interest of controlled corporation	1,000 ordinary shares (L)	100%
	Rare Diamond Limited	Beneficial interest	70 ordinary shares (L)	70%
Leung Chung Ming	The Company	Interest of controlled corporation	1,499,082,240 ordinary shares (L) (Note 2)	60.82%
	The Company	Beneficial interest	3,000,000 ordinary shares (L) (Note 3)	0.12%
	Lung Cheong Investment Limited	Interest of controlled corporation	1,000 ordinary shares (L)	100%
	Rare Diamond Limited	Beneficial interest	30 ordinary shares (L)	30%
Zhong Bingquan	The Company	Beneficial interest	3,000,000 ordinary shares (L) (Note 3)	0.12%
Cheng Yun Tai	The Company	Beneficial interest	3,000,000 ordinary shares (L) (Note 3)	0.12%
Wong, Andy Tze On	The Company	Beneficial interest	3,000,000 ordinary shares (L) (Note 3)	0.12%
Wong Lam	The Company	Beneficial interest	600,000 ordinary shares (L) (Note 3)	0.02%
Ye Tian Liu	The Company	Beneficial interest	600,000 ordinary shares (L) (Note 3)	0.02%
Lai Yun Hung	The Company	Beneficial interest	600,000 ordinary shares (L) (Note 3)	0.02%
Ko, Peter Ping Wah	The Company	Beneficial interest	600,000 ordinary shares (L) (Note 3)	0.02%

Notes:

1. The letter “L” represents the Director’s interests in the shares and underlying shares of the relevant company.
2. These shares were held by Lung Cheong Investment Limited, a company wholly owned by Rare Diamond Limited. Rare Diamond Limited is beneficially owned as to 70% by Mr. Leung Lun and 30% by Mr. Leung Chung Ming respectively.
3. This interests represent interests of the respective Directors in the share options of the Company granted under the Scheme.

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

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

SUBSTANTIAL SHAREHOLDERS

At 30 September 2007, the following persons, other than a Director or chief executive of the Company, had an interest in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO:

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

Notes:

1. The letter “L” represents the entity’s interests in the shares of the relevant company.
2. These shares were registered in the name of Lung Cheong Investment Limited, the entire issued share capital of which was owned by Rare Diamond Limited. Rare Diamond Limited is beneficially owned as to 70% by Mr Leung Lun and 30% by Mr Leung Chung Ming.

CONNECTED TRANSACTIONS

At 30 September 2007, a wholly-owned subsidiary of the Company, Lung Cheong Toys Limited (“LC Toys”), had long-term loans and deferred trading balances amounted in aggregate to HK\$60,648,000, plus accrued interest, due by PT. Lung Cheong Brothers Industrial (“PTLC”), a 60% owned subsidiary of LC Toys. The balance of the 40% interest in PTLC is owned by independent third parties who are not connected with the Directors, chief executives or substantial shareholders of the Company and its subsidiaries, other than PTLC, or any of their respective associates. The long-term loans were advanced to finance the set up of the production facilities of PTLC. The amounts are unsecured, bearing interest at 3-month HIBOR per annum (2006: 3-month HIBOR per annum) and have no fixed repayment terms. LC Toys considers the uncertainties on the repayment of the advances and makes the full provision for the whole balance.



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

- (1) in the ordinary and usual course of business of the Group;
- (2) on normal commercial terms; and
- (3) in accordance with the relevant agreement governing the transaction on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the period.

CODE ON CORPORATE GOVERNANCE PRACTICES

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

MODEL CODE FOR SECURITIES TRANSACTIONS

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

AUDIT COMMITTEE

The Company has an audit committee in compliance with Rule 3.21 of the Listing Rules for the purpose of reviewing and providing supervision over the Group's financial reporting process including a review of the unaudited condensed interim financial statements for the six months ended 30 September 2007, this interim report and the Group's internal controls.

On behalf of the Board of
Lung Cheong International Holdings Limited

Leung Lun
Chairman

11 December 2007